

**CITY OF HARLINGEN
WATERWORKS SYSTEM
FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

**For the Fiscal Years Ended
September 30, 2018 and 2017**

Prepared by:

**Finance Department
Kathern Davidson, Finance Director**

**CITY OF HARLINGEN WATERWORKS SYSTEM
ANNUAL FINANCIAL REPORT**

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March 29, 2019

Utility Board of Trustees,
Members of the City Commission
Citizens of the City of Harlingen, Texas

Management is pleased to submit the annual financial report of the City of Harlingen, Texas Waterworks System (the "System") for the fiscal year ended September 30, 2018.

This report is published to provide the citizens, City Commission, Utility Board of Trustees, the System staff, bondholders, and other interested parties detailed information concerning the financial condition of the System. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the System.

To the best of our knowledge and belief the data is accurate in all material aspects, and is organized in a manner designed to fairly present the financial position and results of operations of the System as measured by its financial activity. We also believe that all disclosures necessary to enable the reader to gain the maximum understanding of the System's financial affairs have been included.

The City Charter requires an annual audit of the financial records and transactions of the System by an independent auditor.

This report is comprised of three sections: Introductory, Financial and Statistical. The Introductory Section includes this transmittal letter, a listing of the principal System officials, and an organizational chart of the System. The Financial Section contains the Independent Auditors' Report on the basic financial statements, Management's Discussion and Analysis ("MD&A"), the basic financial statements, with related notes and supplemental schedules. The MD&A is a narrative introduction, overview, and analysis to accompany the basic financial statements. This letter of transmittal is designed to complement the MD&A and should be read in conjunction therewith. The System's MD&A can be found immediately following the Independent Auditors' Report. The Statistical Section provides financial and demographic information, usually presented on a multi-year basis that is relevant to a financial statement reader.

The Financial Section described above is prepared in accordance with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board ("GASB") and other professional associations, as applicable.

The City of Harlingen (the "City") is located in Cameron County in the center of the Rio Grande Valley, at the southern tip of Texas. The City covers approximately 32 square miles, and has an estimated population of 65,467. The City is a political subdivision and municipal corporation of

the State, duly organized and existing under the laws of the State, including the City's Home Rule Charter. The City was incorporated in 1910, and first adopted its Home Rule Charter in 1927. The City operates under a Commission/Manager form of government. The System provides water treatment and distribution services, and wastewater collection, treatment and disposal services for the citizens of the City and, to areas beyond its corporate boundaries pursuant to a Certificate of Convenience and Necessity, issued by the Texas Commission on Environmental Quality. The System is owned by the City, but by Charter Amendment, is operated under a Utility Board of Trustees (the "Board"). The Board is responsible for the management and operation of the System. The City Commission appoints the members of the Board; approves the retail rates and wholesale contracts of the System; approves the System's annual budget; and authorizes the issuance of debt.

The System's accounting records are maintained on an accrual basis. In developing and maintaining the System's accounting system, consideration is given to the adequacy of the internal control structure. Internal accounting controls are designed to provide reasonable, but not absolute assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition; and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived; and the evaluation of costs and benefits requires estimates and judgments by management. All internal accounting control evaluations occur within the above framework. We believe that the System's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

The preparation of this report would not have been accomplished without the efforts and dedicated services of the staff of the Finance Department. We would like to express our appreciation to all members of the department who assisted in the preparation of this report. Credit also must be given to the Utility Board of Trustees for their interest and support in planning and conducting the financial affairs of the System in a responsible and professional manner.

Respectfully submitted,



Timothy E. Skoglund, P.E.
General Manager



Kathern Davidson
Finance Director

CITY OF HARLINGEN WATERWORKS SYSTEM

ANNUAL FINANCIAL REPORT

SEPTEMBER 30, 2018

UTILITY BOARD OF TRUSTEES

Officers

Joshua Fields, Chairman **May 2019**

Michael Garza, Vice-Chairman **May 2020**

Members

Kevin Campbell **May 2021**

Curtis Bonner **May 2022**

Michael Murphy **May 2019**

Ex-Officio Members

Chris Boswell, Mayor

Dan Serna, City Manager

General Manager

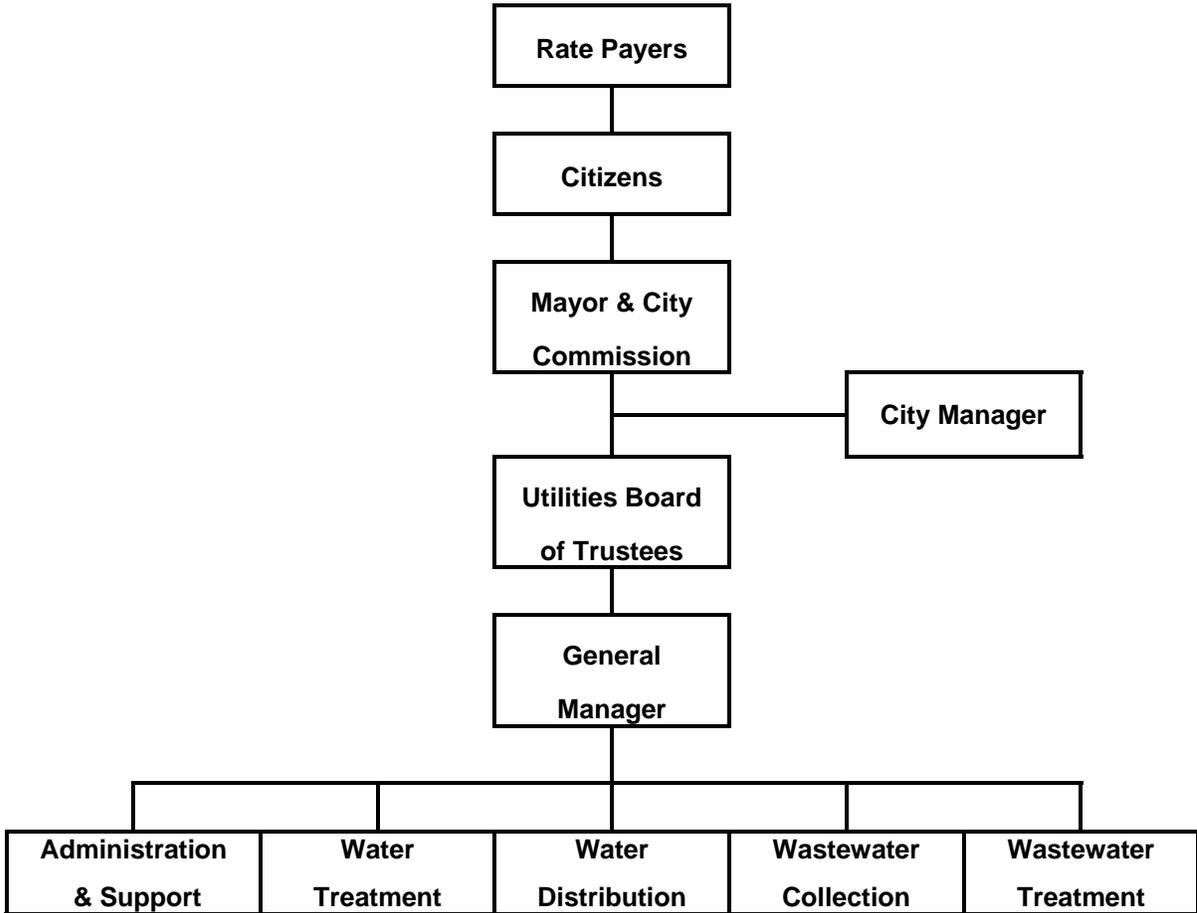
Timothy E. Skoglund, P.E.

CITY OF HARLINGEN WATERWORKS SYSTEM

ANNUAL FINANCIAL REPORT

SEPTEMBER 30, 2018

ORGANIZATIONAL CHART



INDEPENDENT AUDITORS' REPORT

To the City of Harlingen
Waterworks System Board of Trustees

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Harlingen Waterworks System, a component unit of the City of Harlingen, Texas, as of and for the years ended September 30, 2018 and 2017 and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the City of Harlingen Waterworks System, as of September 30, 2018 and 2017 and the respective changes in its financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Adoption of New Accounting Pronouncement

As described in Note 17 to the financial statements, the City of Harlingen Waterworks System adopted Government Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, which resulted in a cumulative effect of change in accounting principle of \$(6,072,122) to the September 30, 2017 net position of the System. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information on pages 13 through 21 and pages 57 through 62 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City of Harlingen Waterworks System's basic financial statements. The introductory section, other supplementary information section and statistical section, as listed in the accompanying table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The other supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other supplementary information is fairly stated, in all material respects in relation to the basic financial statements as a whole.

The introductory section and statistical section have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2019, on our consideration of the City of Harlingen Waterworks System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City of Harlingen Waterworks System's internal control over financial reporting and compliance.

Carly Riggs & Ingram, L.L.C.

Harlingen, Texas
March 29, 2019

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Management's Discussion and Analysis

As management of the City of Harlingen Waterworks System (the "System"), we offer readers of the System's financial statements this narrative overview and analysis of the financial performance of the System for the fiscal year ended September 30, 2018. We encourage readers to consider the information presented here in conjunction with the System's audited financial statements, which begin on page 22.

OVERVIEW OF THE FINANCIAL STATEMENTS

The System is a component unit of the City of Harlingen, Texas. These statements are included in the comprehensive annual financial report of the City. As a proprietary type component unit of the City, the System operates in a manner similar to a private business enterprise. The intent of the governing body of the City of Harlingen is for the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis, to be financed or recovered primarily through user charges. This report consists of the basic financial statements of the System: (a) the Statement of Net Position; (b) the Statement of Revenues, Expenses, and Changes in Net Position; (c) the Statement of Cash Flows; and (d) the Notes to the Financial Statements. These statements provide a broad overview of the results of the System's operations.

The Statement of Net Position presents information on all of the System's assets and deferred outflows of resources, liabilities and deferred inflows of resources, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the System is improving or deteriorating.

The Statement of Revenues, Expenses and Changes in Net Position presents information showing how the System's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The Statement of Cash Flows reports cash flows in three separate categories (operating, capital and related financing, and investing).

The basic financial statements can be found on pages 22-26 of this report.

Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the aforementioned statements. The notes to the financial statements can be found on pages 27-56 of this report.

In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information*, concerning the System's progress in funding its obligation to provide pension benefits and other post-employment benefits to employees who retire from the System, which can be found on page 57-62 of this report. Other supplementary information presented on pages 63-66 provides detailed revenues and expenses for the System's two operational departments, water and wastewater; for the current and previous fiscal years and a budgetary comparison schedule.

The Statistical Section includes financial and demographic information, usually presented on a multi-year basis that is relevant to a financial statement reader, is presented on pages 67-75.

Management's Discussion and Analysis

FINANCIAL HIGHLIGHTS

A summary of the System's net position is presented below together with relevant comments and information:

SUMMARY OF NET POSITION as of September 30,

<u>Assets</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
Current assets	\$ 27,243,789	\$ 23,327,564	\$ 18,417,798
Current restricted assets	6,856,566	9,752,429	11,880,802
Noncurrent assets:			
Net pension asset	1,148,146	-	-
Capital assets	73,628,521	70,661,842	69,811,864
Total assets	<u>108,877,022</u>	<u>103,741,835</u>	<u>100,110,464</u>
<u>Deferred Outflows of Resources</u>			
Deferred amount on debt refunding	215,886	269,324	337,810
Deferred pension related outflows	1,078,873	1,543,195	1,988,470
Deferred OPEB related outflows	764,111	189,177	-
Total deferred outflows of resources	<u>2,058,870</u>	<u>2,001,696</u>	<u>2,326,280</u>
<u>Liabilities</u>			
Current liabilities	3,164,096	2,974,370	3,376,973
Current liabilities payable from restricted assets	659,159	622,180	602,118
Long term debt	20,800,431	22,348,939	23,856,169
Net retiree health care plan liability	10,560,920	9,641,083	3,542,478
Net retiree death benefit plan liability	524,495	460,283	-
Net pension liability	-	323,981	193,753
Customer deposits	2,251,402	2,107,602	1,885,000
Other noncurrent liabilities	225,364	190,817	233,000
Total liabilities	<u>38,185,867</u>	<u>38,669,255</u>	<u>33,689,491</u>
<u>Deferred Inflows of Resources</u>			
Deferred pension related inflows	<u>1,285,678</u>	<u>56,456</u>	<u>93,042</u>
<u>Net Position</u>			
Net investment in capital assets	51,927,406	50,848,870	51,415,795
Restricted	4,887,346	8,185,405	11,095,359
Unrestricted	14,649,595	7,983,545	6,143,057
Total net position	<u>\$ 71,464,347</u>	<u>\$ 67,017,820</u>	<u>\$ 68,654,211</u>

Management's Discussion and Analysis

HWWS FINANCIAL ANALYSIS

The assets and deferred outflows of the System exceeded its liabilities and deferred inflows at the close of the most recent fiscal year by \$71,464,347, an increase of \$4,446,527 from the previous year's balance.

The largest portion of the System's net position, \$51,927,406 (72.7%) reflects its investment in capital assets (land, water rights, buildings, machinery, equipment, and water and wastewater system improvements) less any related debt used to acquire those assets that is still outstanding. The System uses these capital assets to provide services to its customers. Consequently, the assets are not available for future spending. Although the System's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate the liabilities. An additional portion of the System's net position \$4,887,346 (6.8%), represents resources subject to external restrictions on how they may be used. The remaining balance of unrestricted net position \$14,649,595 (20.5%) may be used to meet the System's ongoing obligations to customers and creditors.

For the fiscal year ended September 30, 2018, the System's total net position increased by \$4,446,527. The factors in this increase include an increase in the net investment in capital assets of \$1,078,536; a decrease in restricted net position of \$3,298,059; and an increase in unrestricted net position of \$6,666,050.

The System added \$6,537,001 in capital assets and accepted ownership of \$470,890 in infrastructure contributed by developers in fiscal year 2018. These additions were partially offset by asset retirements in the amount of \$283,783 and depreciation for the fiscal year. The net of those transactions resulted in the carrying value of the System's capital assets to increase by \$2,966,679. The System's investment in capital assets is reported net of related outstanding debt. Therefore, the use of bond proceeds to acquire assets, and the retirement of debt both affect the valuation. In fiscal year 2018, the System spent \$3,341,935 in debt proceeds on capital improvements; and, the net carrying value of outstanding debt was reduced by \$1,453,792.

The System's restricted net position decreased \$3,298,059 in fiscal year 2018, due primarily to the use of debt proceeds in the amount of \$3,341,935 to fund capital improvements. Funds restricted for the payment of principal and interest on debt increased by \$47,228. The net increase in impact fee, front-footage fee, and tie-in-charge revenues restricted for expansion and maintenance of infrastructure totaled \$218,065. Fiscal year 2018 revenues from these sources totaled \$926,526, and funds restricted for system expansion were used to purchase water rights in the amount of \$708,461. In accordance with GASB Statement No. 68, the System includes its net pension related deferred outflows, deferred inflows, and net pension asset or liability in the calculation of the System's net position. From 2017 to 2018, the decrease in restricted net position related to the System's pension obligation is \$221,417.

The System's unrestricted net position increase of \$6,666,050 is primarily due to the System's use of debt proceeds to fund capital improvements, in lieu of utilizing funds derived from operations.

Management's Discussion and Analysis

Revenues

In comparison to the previous fiscal year, customer fees and charges decreased a total of \$205,729 (1.0%) in fiscal year 2018.

Fiscal year 2018 retail water service sales revenue of \$6,212,055 reflects a decrease of \$199,822 (3.1%) from fiscal year 2017 levels. The decrease in sales/water consumption can be attributed to several significant rain events during the year. Rainfall of 33.7 inches for the fiscal year was 22.5% higher than the historical average of 27.5 inches per year. From October 2014 through March 2017, the number of gallons of water included in the customer "base" water charge was reduced by 100 gallons per month, eliminating all water included in the customers' base charge. Fiscal year 2017 retail sales revenue of \$6,411,877 reflected an increase of \$1,079,948 (20.25%) over fiscal year 2016 retail water service revenue of \$5,331,929. The fiscal year 2017 increase in revenue was due to the removal of water from the base charge. Wholesale water sales to local water providers increased by \$28,961 (4.8%) to \$634,903 in fiscal year 2018. Wholesale water sales revenue in fiscal year 2017 and 2016 were \$605,942 and \$483,457 respectively. Total water operating revenues decreased by \$110,054 (1.04%) in fiscal year 2018, while water operating revenue in fiscal year 2017 increased by \$1,276,549 (13.7%).

Wastewater "base" customer charges increased \$256,831 (15.3%) and \$307,622 (22.5%), to \$1,930,382 and \$1,673,551 in fiscal years 2018 and 2017, respectively. From November 2014 through February, 2018 the wastewater base customer charge was increased by \$0.10 per month, resulting in increased revenue annually; with revenue stabilizing in March 2018. Wastewater "service" revenue decreased by \$219,661 (2.7%) to \$7,982,057 in fiscal year 2018. The System uses winter-averaging to establish residential customer wastewater billing volumes. Theoretically, winter months are non-irrigation periods; consequently, residential customer water consumption in winter months is returned to the wastewater system for treatment. Residential customer wastewater billing volume is capped at the average of a customer's winter water usage. Fiscal year 2018 winter averages were slightly less than those in fiscal year 2017, resulting in reduced wastewater volume charges to residential customers. Fiscal year 2017 and 2016 increases in water sales volume resulted in increases in wastewater billing, although in lesser amounts. Wastewater service revenue increased by \$444,926 (5.74%) in 2017, and \$354,024 (4.78%) in 2016. Fiscal year 2018 total operating revenue decrease by \$95,675 (0.9%) to \$10,766,428.

As market interest rates increased, investment earnings increased by \$239,441 (116.1%) to \$445,721 in fiscal year 2018; and \$88,784 (75.6%) to \$206,280 in fiscal year 2017. The fiscal year 2018 average invested balance of \$30,692,000 earned a rate of return of 1.45%; the 2017 average invested balance of \$28,004,679 earned a rate of return of 0.73% while the fiscal year 2016 average invested balance of \$28,420,788 earned a rate of return of 0.41%.

Impact fee revenue of \$651,807 reflects a decrease of \$116,423 (15.2%) in comparison to impact fee revenue of \$768,230 collected in fiscal year 2017; fiscal year 2016 revenue was \$464,376. The average annual impact fee revenue for the four-year period (2017-2013) has been \$586,340. Fiscal year 2018 revenue is 11.2% above the four-year average, reflecting a slight increase in normal annual system growth.

Capital contributions of water and wastewater service lines for the 2018 fiscal year totaled \$470,890, an increase of \$38,008 (8.8%); fiscal year 2017 capital contributions of \$432,882, represented an increase of 97.2% over 2016 fiscal year contributions of \$219,410.

Management's Discussion and Analysis

Expenses

Fiscal year 2018 operating expenses of \$18,346,145 represent an increase of \$44,194 (0.24%) in relation to 2017 operating expenses of \$18,301,951.

Personnel services expenses totaled \$8,382,710 in fiscal year 2018, an increase of \$207,024, 2.5%. Similarly, fiscal year 2017 personnel services expenses had increased by \$124,396 (1.55%) in comparison to fiscal year 2016 expenses. As the construction of Wastewater Treatment Plant #2 drew to a close, the amount of wages capitalized in fiscal year 2018 was \$144,380 (32.8%) less than in fiscal year 2017, which represented a decrease of \$111,949 (20.3%) from fiscal year 2016 levels. Twenty-four hour-a-day manning in water distribution maintenance, which was implemented in fiscal year 2017, was discontinued in 2018, resulting in an increase in stand-by (on-call) pay in the amount of \$38,660 (77.6%).

Fiscal year 2018 contractual services expenses totaling \$2,909,671 represent a \$365,030 (11.1%) decrease in comparison to fiscal year 2017 expenses. The largest reduction in expenses was \$458,514 (32.1%) which was in the cost of electricity. Effective January 1, 2018, the City of Harlingen entered into a new contract for the supply of electricity, which included a reduction in the energy rate from \$0.07485 per kwh to \$0.03963 per kwh. A reduction in electric expense was also experienced in fiscal year 2017 as new equipment at the wastewater treatment plant was put into service mid-year, resulting in \$184,765 (5.3%) in savings in comparison to fiscal year 2016 electric power expense. Raw water diversion expense decreased from \$1,214,127 in fiscal year 2017 to \$1,165,862 in fiscal year 2018, a decrease of \$48,265 (4.0%) due to a slight reduction in customer consumption. Professional services expenses increased by \$144,334 (342.5%) in fiscal year 2018, as the System began the implementation of a Geographic Information System.

Supply and maintenance expenses totaled \$2,901,611, an increase of \$14,842 (1.7%) in fiscal year 2018. Maintenance expenses at the wastewater treatment plant increased \$99,057 (112.3%) in fiscal year 2018 when compared to fiscal year 2017. Both the headworks and sludge belt press required repairs. Limited use of the downtown water treatment plant in 2018 resulted in lower chemical costs in the amount of \$74,905 in fiscal year 2018. Changes in the types and amounts of chemicals used in the treatment processes in fiscal year 2017 created the savings of \$54,739 (6.3%) as well

Fiscal year 2018 "Other" expenses totaled \$150,646, an increase of \$9,103 (6.4%) in comparison to this category of expenses in 2017. Obsolete items with a historical cost of \$19,077 were removed from parts inventory in fiscal year 2018. Fiscal year 2017 expenses decreased \$98,922 (41.1%) in comparison to 2016 expenses due to outsourcing customer bank card payment processing.

Total depreciation expense in fiscal year 2018 of \$4,001,507 reflects an increase of \$178,255 (4.7%) over fiscal year 2017 depreciation expense. Assets added to Wastewater Treatment Plant #2 began being depreciated in 2018. Depreciation expense was \$3,823,252 and \$5,002,225 in fiscal years 2017 and 2016, respectively. A change in the estimated service life of water and wastewater mains in 2017 resulted in a significant reduction in depreciation expense in 2017 relative to depreciation expense in 2016.

In fiscal year 2018, net interest and amortization expense increased by \$124,068 (18.9%) to \$780,514. As construction of Wastewater Treatment Plant #2 neared completion, a decrease in the amount of interest capitalized during construction resulted in this expense increase. Similarly, net interest expense in fiscal 2017 increased by \$41,563 due to a decrease in interest capitalized. Fiscal year 2016 net interest expense was \$614,883.

Management's Discussion and Analysis

CHANGES IN NET POSITION

	2018	2017	2016
Operating revenues	\$ 21,271,728	\$ 21,477,457	\$ 19,423,277
Operating expenses	18,346,145	18,301,951	19,690,660
Operating income (loss)	2,925,583	3,175,506	(267,383)
Non-operating revenues:			
Impact fees	651,807	768,230	464,376
Investment earnings	445,721	206,280	117,496
Other	733,040	509,279	580,544
Total non-operating revenues	1,830,568	1,483,789	1,162,416
Non-operating expenses:			
Interest expense and amortization	780,514	656,446	614,883
Change in net position before contributions	3,975,637	4,002,849	280,150
Capital contributions	470,890	432,882	219,410
Change in net position	\$ 4,446,527	\$ 4,435,731	\$ 499,560

CAPITAL ASSETS

The value of the System's capital assets increased by \$2,966,679 to \$73,628,521 and \$849,978 to \$70,661,842 (net of accumulated depreciation) in fiscal years 2018 and 2017, respectively. This investment in capital assets includes land, water rights, buildings, machinery and equipment, and system improvements.

Fiscal year 2018 asset acquisitions totaled \$7,007,891, including \$470,890 in contributed assets. Asset retirements totaled \$283,783. The net accumulated depreciation on capital assets increased \$3,757,429. Total depreciation expense for the year 2018 of \$4,001,507 was offset by \$244,078 of accumulated depreciation on assets retired throughout the year.

Fiscal year 2017 asset acquisitions totaled \$4,950,582, including \$432,882 in contributed assets. Asset retirements totaled \$1,558,274. The net accumulated depreciation on capital assets increased \$2,542,330. Total depreciation expense for the year 2017 of \$3,823,252 was offset by \$1,280,922 of accumulated depreciation on assets retired throughout the year.

Management's Discussion and Analysis

Significant capital asset events during the current fiscal year included the following:

- Completed rehabilitation of clarifier rakes and skirts at M F Rynnion Water Treatment Plant – FY 2018 cost: \$1,783,829; Total project cost: \$1,914,432
- Substantially completed construction (96%) of 9,115 linear feet of 20 inch water transmission main from Roosevelt to Loop 499 - FY 2018 cost: \$1,817,340; Project to date cost: \$1,951,502
- Completed construction of aerobic digester structure, blowers and diffusers at Wastewater Treatment Plant #2 – FY 18 cost: \$12,400; Total cost: \$1,386,863
- Completed piping, valves, roads, ramps, stairs and grating at Wastewater Treatment Plant #2 – FY 18 cost: \$248,609; Total cost: \$1,675,085
- Replaced raw water and high service variable frequency drives at M F Rynnion Water Treatment – Total cost: \$299,547
- Completed rehabilitation of 44 wastewater manholes – Total cost: \$232,110
- Completed construction of 2,800 linear feet of 12 inch wastewater main on Brazil Road – Total cost: \$111,249
- Purchased 432 acre feet of municipal water rights – Total cost: \$708,461
- Purchased jet/vacuum truck at a cost of \$351,925
- Purchased a backhoe at a cost of \$85,890

Additional information on the City of Harlingen Waterworks System's capital assets can be found in note 5 on page 37 of this report.

SCHEDULE OF CAPITAL ASSETS

as of September 30

	2018	2017	2016
Water rights	\$ 6,131,830	\$ 5,423,369	\$ 5,423,369
Land	1,210,953	1,208,953	1,202,089
Construction in progress	2,010,777	3,209,690	10,692,042
Water infrastructure	85,864,026	83,125,321	82,796,853
Wastewater infrastructure	88,109,675	84,068,166	73,922,946
Other buildings and equipment	4,638,597	4,549,269	4,372,568
Vehicles	3,532,474	3,189,456	2,972,049
Total capital assets	191,498,332	184,774,224	181,381,916
Less accumulated depreciation	(117,869,811)	(114,112,382)	(111,570,052)
Capital assets net of depreciation	\$ 73,628,521	\$ 70,661,842	\$ 69,811,864

Management's Discussion and Analysis

DEBT ADMINISTRATION

At the end of the current fiscal year, the System had total bonded debt outstanding of \$22,205,000 with unamortized premiums and discounts of \$143,939 for net total debt of \$22,348,939. The debt is secured by a pledge of the revenues of the water and wastewater systems. The System retired \$1,480,000 in outstanding bonds in fiscal year 2018.

On August 27, 2015 in conjunction with the issuance of the Series 2015A and Series 2015B bonds, the System's outstanding bonds were rated Aa2 by Moody's Investors Service, with a negative outlook; and AA- by Standard & Poor's with a stable outlook.

On July 17, 2017, Moody's Investors Service affirmed the Aa2 rating of the System's outstanding bonds, and revised the outlook to stable.

Additional information on the System's long term debt can be found in notes 8 and 9 on pages 39-41 of this report.

As of September 30,

<u>Revenue Bonds</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
Current portion	\$ 1,548,508	\$ 1,507,230	\$ 1,484,834
Long-term portion	20,800,431	22,348,939	23,856,169

The System plans to issue additional debt within the next two years.

FISCAL YEAR 2019 BUDGET AND RATES

In October 2014, the System began eliminating the 3,000 gallons of water commodity from the water base service rate. Over the next 30 months, the amount of water included in the monthly base rate was been reduced by 100 gallons per month. This practice continued through March 2017, after which, no water commodity has been included in the monthly base service rate. Additionally, beginning in November 2014, the sewer base rate has been increased by \$0.10 per month. This continued through March, 2018. As of October 1, 2018, the sewer base rate was \$6.18 per customer, per month.

The fiscal year 2019 operating revenue budget was developed using the average consumption over the most recent five-year period, and reflects a 0.1% increase when compared to the fiscal year 2018 budgeted operating revenue. Fiscal year 2019 total operating revenues were budgeted at \$20,713,200.

An increase of \$690,355 in operating expenses was approved in the fiscal year 2019 budget. A 2% cost-of-living increase; 2% merit pay allocation; and elimination of 4 positions resulted in a net increase in the personnel services budget of \$125,945. The budget for contractual services was increased by \$552,175, reflecting \$450,000 budgeted for a water & wastewater conveyance master plan; and \$102,175 for numerous items including funding for an asset management system, computer security analysis, wastewater pretreatment study; and wastewater treatment plant permit renewal. The budget for the supplies and maintenance category of expenses reflects an increase of \$140,560 as additional funding was budgeted for water and wastewater chemical expenses due to market driven price increases; computer software subscriptions; and wastewater collection and treatment system maintenance. The budget for the "other" category of expenses increased \$24,675, reflecting an increase in the cost of banking services when the current contract expires; additional travel and training funding; and increases in memberships and subscriptions.

Management's Discussion and Analysis

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the City of Harlingen Waterworks System's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Director, 134 East Van Buren, Harlingen, Texas, 78550.

FINANCIAL STATEMENTS

CITY OF HARLINGEN WATERWORKS SYSTEM
Statements of Net Position
As of September 30,

	2018	2017
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 8,885,654	\$ 11,249,565
Investments	15,524,084	9,388,827
Accounts receivable, net of allowance for uncollectible	2,425,179	2,241,649
Interest receivable	27,125	39,239
Inventories	370,747	393,825
Prepaid items	11,000	14,459
Restricted assets		
Cash and cash equivalents	2,720,279	4,121,962
Investments	4,136,287	5,630,467
Total current assets	34,100,355	33,079,993
Noncurrent Assets		
Net pension asset	1,148,146	-
Capital assets:		
Capital assets, not being depreciated:		
Land	1,210,953	1,208,953
Construction in progress	2,010,777	3,209,690
Water rights	6,131,830	5,423,369
Other capital assets, net of accumulated depreciation	64,274,961	60,819,830
Total capital assets	73,628,521	70,661,842
Total noncurrent assets	74,776,667	70,661,842
Total assets	108,877,022	103,741,835
DEFERRED OUTFLOWS OF RESOURCES		
Deferred amount on debt refunding	215,886	269,324
Deferred pension outflows	1,078,873	1,543,195
Deferred OPEB outflows	764,111	189,177
Total deferred outflows of resources	2,058,870	2,001,696

The notes to the financial statements are an integral part of these statements.

CITY OF HARLINGEN WATERWORKS SYSTEM
Statements of Net Position - continued
As of September 30,

	2018	2017
LIABILITIES		
Current Liabilities		
Accounts payable	\$ 425,134	\$ 438,380
Due to primary government	131,996	111,801
Other liabilities	508,458	344,959
Compensated absences - current	550,000	572,000
Revenue bonds - current	1,548,508	1,507,230
Payable from restricted assets:		
Accrued interest	309,159	322,180
Customer deposits - current	350,000	300,000
Total current liabilities	3,823,255	3,596,550
Noncurrent Liabilities		
Revenue bonds payable (net of unamortized premiums and discounts)	20,800,431	22,348,939
Compensated absences	225,364	190,817
Net retiree health care plan liability	10,560,920	9,641,083
Net retiree death benefit plan liability	524,495	460,283
Net pension liability	-	323,981
Payable from restricted assets:		
Customer deposits	2,251,402	2,107,602
Total noncurrent liabilities	34,362,612	35,072,705
Total liabilities	38,185,867	38,669,255
DEFERRED INFLOWS OF RESOURCES		
Deferred pension inflows	1,285,678	56,456
Total deferred inflows of resources	1,285,678	56,456
NET POSITION		
Net investment in capital assets	51,927,406	50,848,870
Restricted	4,887,346	8,509,386
Unrestricted	14,649,595	7,659,564
Total net position	\$ 71,464,347	\$ 67,017,820

The notes to the financial statements are an integral part of these statements.

CITY OF HARLINGEN WATERWORKS SYSTEM
Statements of Revenues, Expenses and Changes in Net Position
For the Fiscal Years Ended of September 30,

	2018	2017
Operating Revenues		
Customer fees and charges	\$ 21,271,728	\$ 21,477,457
Operating Expenses		
Personnel services	8,382,710	8,175,686
Contractual services	2,909,671	3,274,701
Supplies and maintenance	2,901,611	2,886,769
Other	150,646	141,543
Depreciation	4,001,507	3,823,252
Total operating expenses	18,346,145	18,301,951
Operating Income	2,925,583	3,175,506
Non-Operating Revenues		
Impact fees	651,807	768,230
Investment earnings	445,721	206,280
Other	733,040	509,279
Total non-operating revenues	1,830,568	1,483,789
Non-Operating Expenses		
Interest and amortization expense	780,514	656,446
Change in Net Position before Contributions	3,975,637	4,002,849
Capital Contributions	470,890	432,882
Change in Net Position	4,446,527	4,435,731
Net Position - Beginning Year	67,017,820	68,654,211
Net Position - End of Year	\$ 71,464,347	\$ 73,089,942
Impact of change in accounting principle		(6,072,122)
Net Position - End of Year, as restated		\$ 67,017,820

The notes to the financial statements are an integral part of these statements.

CITY OF HARLINGEN WATERWORKS SYSTEM
Statements of Cash Flows
For the Fiscal Year Ended September 30,

	2018	2017
Cash Flows From Operating Activities		
Receipts from customers	\$ 22,018,388	\$ 22,319,814
Payments to suppliers	(5,895,049)	(6,466,765)
Payments to or on behalf of employees	(7,717,465)	(7,281,538)
	<u>8,405,874</u>	<u>8,571,511</u>
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of capital assets	(6,417,127)	(4,757,010)
Proceeds from sale of assets	18,150	-
Proceeds from impact fees	651,807	768,230
Principal paid on revenue bonds	(1,480,000)	(1,455,000)
Interest and fees paid on revenue bonds	(761,056)	(591,519)
	<u>(7,988,226)</u>	<u>(6,035,299)</u>
Cash Flow From Investing Activities		
Purchase of investments	(27,518,823)	(22,084,694)
Maturity of investments	22,877,746	20,606,535
Investment earnings	457,835	170,778
	<u>(4,183,242)</u>	<u>(1,307,381)</u>
Increase (decrease) in cash and cash equivalents	(3,765,594)	1,228,831
Cash and cash equivalents - beginning of year	<u>15,371,527</u>	<u>14,142,696</u>
Cash and cash equivalents - end of year	<u>\$ 11,605,933</u>	<u>\$ 15,371,527</u>

The notes to the financial statements are an integral part of these statements.

CITY OF HARLINGEN WATERWORKS SYSTEM
Statements of Cash Flows, Continued
For the Fiscal Years Ended September 30,

	2018	2017	
Reconciliation of operating income to net cash provided by operating activities			
Operating income	\$ 2,925,583	\$ 3,175,506	
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation expense	4,001,507	3,823,252	
Non-operating revenue	716,195	716,346	
Changes in assets and liabilities:			
Increase in receivables, net	(183,530)	(128,778)	
(Increase) decrease in inventory	23,078	(3,821)	
Decrease in prepaid expenses	3,459	93,698	
Increase in net pension assets	(1,148,146)	-	
Decrease in pension related deferred outflows	464,322	445,275	
(Increase) in OPEB related deferred outflows	(574,934)	-	
Decrease in accounts payable	(13,246)	(64,194)	
Increase (decrease) in due to primary government	20,195	(31,258)	
Increase (decrease) in other liabilities	75,754	(86,835)	
Increase (decrease) in liability for compensated absences	12,547	(13,700)	
Increase (decrease) in net pension liability	(323,981)	130,228	
Increase (decrease) in pension related deferred inflows	1,229,222	(36,586)	
Increase in OPEB (retiree health care plan) liability	919,837	297,589	
Increase in OPEB (retiree death benefit plan) liability	64,212	-	
Increase in customer deposits	193,800	254,789	
	\$ 8,405,874	\$ 8,571,511	
Net cash provided by operating activities	\$ 8,405,874	\$ 8,571,511	
	2018	2017	Increase (Decrease)
Reconciliation of total cash and cash equivalents:			
Unrestricted cash and cash equivalents	\$ 8,885,654	\$ 11,249,565	\$ (2,363,911)
Restricted cash and cash equivalents	2,720,279	4,121,962	(1,401,683)
Total cash and cash equivalents	\$ 11,605,933	\$ 15,371,527	\$ (3,765,594)
Supplemental disclosure of noncash financing activities:			
Water lines, sewer mains and related infrastructure contributed to the System by developers.	\$ 470,890	\$ 219,410	

The notes to the financial statements are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The City of Harlingen Waterworks System (the System) is a component unit of the City of Harlingen, Texas (the City). The System provides water and sewer services to the residents of the City. Activities of the System include administration, operations and maintenance of the water treatment and distribution system and the sewer collection and treatment system, billing and collection activities. The System also accounts for the accumulation of resources for, and the payment of long-term debt principal and interest for water and sewer debt. All costs are financed through charges to utility customers with rates reviewed regularly and adjusted, if necessary, to ensure integrity of the funds.

As provided by the Charter of the City of Harlingen, the City Commission appoints the Utility Board of Trustees. The Board of Trustees functions as the decision and policy making body for all activities related to the System. The City Commission approves rates for user charges, annual budgets, and bond issuance authorizations.

The accompanying financial statements present the financial position, results of operations, and cash flows of the System, and are not intended to present the financial position, results of operations, or cash flows of the City of Harlingen. The financial statements of the System are included in the comprehensive annual financial report of the City of Harlingen as a proprietary type (enterprise) fund.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The System's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. All assets and liabilities (whether current or non-current) and all deferred outflows and inflows of resources are included in the Statement of Net Position. The operating statements present increases (revenues) and decreases (expenses) in net position. Under the accrual basis of accounting, revenues are recognized when earned, including unbilled water and sewer services which are accrued. Expenses are recorded at the time the liability is incurred, regardless of the timing of related cash flows. The accounting objectives are determination of net income, financial position and cash flow.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the fund's principal ongoing operations. The principal operating revenues of the System are charges to customers for sales and services. Operating expenses include the cost of personal and contractual services, supplies and depreciation on capital assets. Revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

The accounting and reporting policies of the System relating to the accompanying financial statements conform to accounting principles generally accepted in the United States of America (GAAP) applicable to state and local governments. Generally accepted accounting principles for local governments include those principles prescribed by the Governmental Accounting Standards Board (GASB).

Cash and Investments

The System's cash and cash equivalents include cash on hand, demand deposits, certificates of deposit, and investments with original maturity dates of three months or less from the date of acquisition.

Investments in government pools and certificates of deposit are recorded at amortized cost. All other investments are recorded at fair value based upon current market conditions. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Receivables and Payables

Accounts receivable represent amounts due from customers for services and user charges, and are presented net of an allowance for uncollectible accounts. The allowance for uncollectible accounts is calculated as a percentage of operating revenue, using the two most recent fiscal years' data.

Outstanding balances between the System and the City of Harlingen are reported as "due to or due from" the primary government. The System performs customer billing and collection services for the City's garbage services. Customer payments collected on behalf of the City are remitted to the City monthly. Amounts collected from garbage customers within the month of September, as well as other reimbursable expenses incurred by the City on behalf of the System, are reflected as "due to the primary government" at fiscal year-end.

Inventories

Inventories are valued at cost using the first-in, first-out (FIFO) method. Inventories are recorded as expenses when used rather than when purchased.

Prepaid Assets

Certain payments made to vendors for goods and services that will benefit future accounting periods are recorded as prepaid items in the financial statements.

Restricted Assets

Certain funds of the System are classified as restricted assets on the statement of net position, because their use is restricted for specific purposes defined and adopted by legislative action. Funds restricted include amounts accumulated for debt service payments over the next twelve months (Debt Service); the proceeds of revenue bond issuances that are restricted for the acquisition or construction of capital assets (Revenue Bond Proceeds); amounts set aside to fund asset replacements (Replacement Reserve); accumulated customer deposits; as well as accumulated capital facilities user impact fees (Impact Fees).

When both restricted and unrestricted resources are available for use, it is the System's policy to use restricted resources first, then unrestricted resources as they are needed.

Capital Assets

Capital assets which include property, plant, equipment, and infrastructure assets are reported in the System's financial statements. All purchased capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Capital assets, other than infrastructure assets, are defined by the System as assets with an initial, individual cost of more than \$3,000 and an estimated useful life in excess of three years. Infrastructure assets are reported on a network basis.

Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. The amount of interest capitalized is determined by applying the System's weighted average interest rate to the average cumulative expenditures from inception to completion of the project.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital assets are depreciated using the straight-line method over the following useful lives:

Asset	Years
Buildings and improvements	10-40
Collection lines and lift stations	12-40
Production and treatment facilities	20-40
Furniture and fixtures	5-10
Equipment	3-10
Vehicles	3-7

Compensated Absences

The System's policy allows employees to accumulate earned but unused vacation and sick pay benefits. Upon termination, employees may be paid for accumulated vacation leave up to a maximum of 144 hours. It is the policy of the System to recognize an expense and a liability as the benefits accrue to employees. The accompanying financial statements reflect the vested or accumulated vacation leave accrued through the end of the fiscal year. In accordance with GASB No. 16 "Accounting for Compensated Absences", the System uses the vesting method of calculating the estimated liability for sick leave. The liability recorded by the System includes the maximum allowable benefit for employees who currently are eligible to receive the termination sick pay benefit, as well as an estimate for those employees who are expected to become eligible in the future. At termination of employment, depending upon length of service, employees are eligible to receive 50% of unused sick leave, up to a maximum of 360 hours.

Pensions

For purposes of measuring the net pension asset or liability, pension related deferred outflows and inflows of resources, and pension expense, System specific information about its Fiduciary Net Position in the Texas Municipal Retirement System (TMRS) and additions to/deductions from the System's Fiduciary Net Position have been determined on the same basis as they are reported by TMRS. For this purpose, plan contributions are recognized in the period that compensation is reported for the employee, which is when contributions are legally due. Benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. Information regarding the System's Total Pension Liability is obtained from TMRS through a report prepared for the System by TMRS' consulting actuary, Gabriel Roeder Smith & Company, in compliance with GASB Statements No. 68, *Accounting and Financial Reporting for Pensions*; and No. 71, *Pension Transition for Contributions made Subsequent to the Measurement Date*.

Other Post-Employment Benefits (OPEB)

OPEB cost for retiree healthcare and retiree supplemental death benefit is required to be measured and disclosed using the accrual basis of accounting. For both OPEB plans, net liability, related deferred outflow and inflows of resources, and expense is calculated by the actuary, Gabriel Roeder Smith & Company in accordance with GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position reports a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The System has the following items that qualify for reporting in this category.

- Deferred charges on refunding - A deferred charge on refunding results from the difference between the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.
- Pension and OPEB contributions after measurement date - These contributions are deferred and recognized in the following fiscal year.
- Difference in projected and actual earnings on pension assets - This difference is deferred and amortized over a closed five year period.
- Changes in actuarial assumptions used to determine pension or OPEB liability - This difference is deferred and amortized over the estimated average remaining lives of all members, determined as of the measurement date.

In addition to liabilities, the statement of financial position reports a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The System has two types of items that qualify for reporting in this category. The difference in expected and actual pension experience, and the difference in projected and actual investment earnings are deferred and recognized over the estimated average remaining lives of all members, determined as of the measurement date.

Net Position

Net position represents the difference between assets and deferred outflows of resources less liabilities and deferred inflows of resources. Net investment in capital assets consists of capital assets net of accumulated depreciation, reduced by the outstanding balances of borrowing spent for the acquisition, construction or improvement of those assets. Net position is reported as restricted when there are limitations imposed on use either through enabling legislation adopted by the System and or the City, or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

Budgetary Control

A formal budgetary process is employed by the System as a management control device.

The System's fiscal year is the twelve-month period beginning October 1. Department managers submit to the General Manager a budget of estimated expenses for the ensuing fiscal year. The General Manager subsequently submits a budget of estimated expenses and revenues to the Utility Board of Trustees. After approval by the Utility Board of Trustees, the budget is forwarded to the City Commission. The budget is legally enacted through passage of an ordinance.

The General Manager is authorized to transfer budgeted amounts between line items and departments. Any revisions that alter total expenses must be approved by the Utility Board of Trustees.

Budgeted amounts are as originally adopted, or as amended by the Utility Board of Trustees. Individual amendments were not material in relation to the original appropriations, which were adopted.

The Schedule of Revenues, Expenses and Changes in Net Position, Comparison of Actual to Budget, included as other supplementary information in this report, presents a comparison of budgetary data to actual results.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

Comparative Data/Reclassifications

Comparative data for the prior year have been presented in the financial statements in order to provide an understanding of the changes in the financial position and operations of the fund. Certain amounts presented in the prior year's financial statements have been reclassified to conform to the current year's presentation.

Adoption of New Accounting Standards

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* was adopted in the current year. This Statement replaces the requirements of Statement 45 and requires governments to report a liability on the face of the financial statements for the OPEB they provide. Statement 75 requires governments in all types to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities. Among the new note disclosures is a description of the effect on the reported OPEB liability of using a discount rate and a healthcare cost trend rate that are one percentage point higher and one percentage point lower than assumed by the government. The new RSI includes a schedule showing the causes of increases and decreases in the OPEB liability.

2. DEPOSITS AND INVESTMENTS

System Policies and Legal Contractual Provisions Governing Deposits

State statutes govern the deposit and investment of all funds of the System. Texas Local Government Code, Chapter 105. "Depositories for Municipal Funds" dictates the selection of and requirements for financial institutions to serve as depositories for public funds. Texas Government Code, Chapter 2257, "Collateral for Public Funds" governs security for a deposit of public funds.

The System's deposits, including certificates of deposit, at September 30, 2018 and during the year were fully insured by FDIC insurance under section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, were collateralized by securities pledged to the System and held by the System's agent bank in the System's name, or were secured by Irrevocable standby letters of credit.

At September 30, 2018, the carrying amount of the System's deposits was as follows:

	2018	
	BBVA Compass	Southside Bank
	Demand Deposit	Money Market
Book Value	\$ 6,023,812	\$ 2,207,632
Bank Balance	6,275,859	2,207,632
FDIC Coverage	250,000	250,000
Collateral	8,900,000	6,798,506

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

2. DEPOSITS AND INVESTMENTS (Continued)

At September 30, 2017, the carrying amount of the System's deposits was as follows:

	2017		
	BBVA Compass Demand Deposit	Southside Bank Money Market	Green Bank Money Market
Book Value	\$ 5,286,204	\$ 2,561,846	\$ 1,012,643
Bank Balance	5,702,283	2,561,846	1,012,643
FDIC Coverage	250,000	250,000	250,000
Collateral	13,250,000	2,492,530	2,822,000

In addition, the following is disclosed regarding coverage of combined balances on the date of highest deposit:

- a. Primary Depository: BBVA Compass Bank
- b. The highest combined balances of cash on deposit amounted to \$12,149,473 and occurred in the month of October, 2017.
- c. The amount of FDIC coverage as of the date of the highest combined balance on deposit was \$250,000.
- d. An Irrevocable Standby Letter Of Credit in the amount of \$13,750,000 was in force to secure the System's deposits as of the date of the highest combined balance.

Custodial Credit Risk for Deposits – State law requires governmental entities to contract with financial institutions in which funds will be deposited to secure funds on deposit at the end of each business day. The pledged securities must have a market value of not less than the amount of the deposits, be in the name of the governmental entity and be held by the entity or its agent. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance. Under section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, full deposit insurance coverage is provided for non-interest bearing deposit transaction accounts in FDIC-insured institutions, regardless of the dollar amount. At September 30, 2018, all System deposits were insured or adequately collateralized.

Foreign Currency Risk for Deposits – Transactions of the System are limited to those backed by domestic currency. The System is not directly exposed to foreign currency risk.

System Policies and Legal Contractual Provisions Governing Investments

The System's investment program is governed by the Public Funds Investment Act (Texas Government Code Chapter 2256), and by the System's investment policy which amplifies the State statutes and prescribes how the System will operate its investment program in accordance with applicable laws and regulations. The Public Funds Investment Act (the "PFIA") contains specific provisions governing investment practices, management responsibilities, the establishment of appropriate policies, and reporting requirements. The investment policy addresses the following areas: suitability; preservation and safety of principal; liquidity; marketability; diversification; allowable investments; acceptable risk levels; expected rates of return; maximum allowable stated maturity; maximum average dollar-weighted maturity allowed; investment staff quality, capabilities and responsibilities; and bid solicitation preferences. The System's investment policy authorizes the System to invest in the following:

1. Obligations of the United States of America, its agencies and instrumentalities;
2. Direct obligations of the State of Texas or its agencies and instrumentalities;
3. Other obligations, the principal of and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or United States of America or their respective agencies and instrumentalities;

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

2. DEPOSITS AND INVESTMENTS (Continued)

4. Obligations of states, agencies thereof, counties, cities, and other political subdivisions of any state having been rated as to investment quality by a nationally recognized investment rating firm, and having received a rating of not less than "A" or its equivalent;
5. Certificates of Deposit and other evidences of deposit at a financial institution that (a) has its main office or a branch office in Texas and is guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor; (b) secured by obligations described in 1 through 4 above, that have a market value of not less than the principal amount of the certificates, or (c) secured in any other manner and amount provided by law for deposits of the System, or (d) executed through a depository institution that has its main office or a branch office in Texas and meets the requirements of the Act;
6. Local government investment pools of political subdivisions in the State of Texas, which invest in instruments and follow practices allowed by current law; maintain as an investment objective a \$1.00 net asset value; provide offering circulars containing information required by the Act; provide investment transaction confirmations; provide a monthly report containing information required by the Act; have an advisory board as specified by the Act; are continuously rated no lower than AAA or AAA-m or an equivalent rating by at least one nationally recognized rating service; and have a weighted average maturity no greater than ninety (90) days. Participation in an investment pool must be authorized by Resolution of the Utility Board of Trustees;
7. No-load money market mutual funds organized and in compliance with current law; that maintain as an investment objective a \$1.00 net asset value for each share; are registered with and regulated by the Securities and Exchange Commission; have a dollar weighted average maturity of no more than 90 days; are continuously rated no lower than AAA or AAA-m or an equivalent rating by at least one nationally recognized rating service; and have provided to the System a prospectus and other information required by the Securities Exchange Act of 1937 or the Investment Company Act of 1940;
8. Repurchase agreements with a defined termination date, fully collateralized by securities described in 1 above, held in the name of the System by an independent third party custodian contracted by the System, placed through primary government securities dealers or financial institutions doing business in Texas; who have executed a Master Repurchase Agreement that has been approved by the Utility Board of Trustees of the System.

The PFIA also requires the System to have independent auditors perform test procedures related to investment practices. The System's management believes the System has complied with the requirements of the PFIA and the System's investment policies. At September 30, 2018, the fair value of the System's portfolio was as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Percentage of Total</u>	<u>Weighted Average Life</u>	<u>Credit Risk</u>
Certificates of Deposit				
BBVA Compass	\$ 2,004,600	8.70%	30	-
Legacy Bank	1,013,974	4.40%	4	-
Green Bank	3,540,128	15.37%	32	-
Southside Bank	4,042,463	17.55%	13	-
East West Bank	6,042,737	26.23%	64	-
BTH Bank	3,016,469	13.10%	27	-
Public Fund Pools				
TexSTAR	2,570,342	11.16%	1	AAAm
TexPool	804,147	3.49%	1	AAAm
Total	\$ 23,034,860	100.00%		

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

2. DEPOSITS AND INVESTMENTS (Continued)

At September 30, 2017, the carrying value of the System's portfolio was as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Percentage of Total</u>	<u>Weighted Average Life</u>	<u>Credit Risk</u>
Certificates of Deposit				
BBVA Compass	\$ 6,000,000	27.87%	23	-
Legacy Bank	7,019,293	32.60%	67	-
Green Bank	2,000,000	9.29%	50	-
Public Fund Pools				
TexSTAR	3,225,926	14.98%	1	AAAm
TexPool	3,284,908	15.26%	1	AAAm
Total	<u>\$ 21,530,127</u>	<u>100.00%</u>		

The System categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

As of September 30, 2018, the System has the fair value measurements for certificates of deposit totaling \$19,660,371 valued using cost-based measures. The system's investments in government pools at September 30, 2018 totaling \$3,374,489, are recorded at amortized cost.

Public funds investment pools in Texas ("Pools") are established under the authority of the Inter-local Cooperation Act Chapter 79 of the Texas Government Code and are subject to the provisions of the Public Funds Investment Act (the "PFIA"), Chapter 2256 of the Texas Government Code. In addition to other provisions of the PFIA designed to promote liquidity and safety of principal, the PFIA requires Pools to: have an advisory board composed of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool; maintain a continuous rating of no lower than AAA or AAAm or an equivalent rating by at least one nationally recognized rating service; and maintain the market value of its underlying investment portfolio within one half of one percent of the value of its shares.

Additional policies and contractual provisions governing deposits and investments for the System are specified below:

Credit Risk – In accordance with State law and the System's investment policy, investments in investment pools must be rated no lower than AAA or AAA-m or have an equivalent rating, obligations of states, agencies, counties, and cities must be rated at least A or its equivalent. As of September 30, 2018, the System's investments in TexPool and TexSTAR were rated AAAm by Standard and Poor's.

Custodial Risk for Investments – Is the risk that, in the event of the failure of the counter party, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The investment pools are not managed by the System and the System does not possess securities that exist in either physical or book entry form.

Concentration of Credit Risk – The underlying securities of the investment pools is diversified in terms of investment instruments and maturity scheduling to reduce the risk of loss resulting from over concentration of assets in specific class of investments, specific maturity or specific issuer.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

2. DEPOSITS AND INVESTMENTS (Continued)

Interest Rate Risk – The System’s objective is to obtain a reasonable rate of return throughout budgetary and economic cycles, taking into account the investment risk limitations and the cash flow characteristics of the portfolio. Investment maturities are structured to provide cash flow based on anticipated operating needs. At no time, are debt service fund investment maturities allowed to exceed the anticipated cash flow requirements. Market conditions influence the decision to fully extend maturities to the next “unfunded” payment date or to invest in shorter term instruments. Customer deposit funds require the liquidity adequate to cover the return of customer security deposits. Short term-investment pools and money market mutual funds may be utilized as a competitive yield alternative to fixed maturity investments.

Foreign Currency Risk for Investments – By virtue of the System’s investment policy and the PFIA, the System is not directly exposed to foreign currency risk. The System is not authorized to maintain deposits or investments denominated in a foreign currency.

3. ACCOUNTS RECEIVABLE

Accounts receivable as of September 30 are considered collectible within one year and consist of the following:

<u>Description</u>	<u>2018</u>	<u>2017</u>
Water Accounts	\$ 521,751	\$ 364,403
Wastewater Accounts	566,028	398,321
Customer invoices and charges	218,879	194,283
Other	35,521	31,642
Total invoiced accounts receivable	1,342,179	988,649
Unbilled customer charges:		
Water	600,000	705,000
Wastewater	693,000	752,000
Total unbilled customer charges	1,293,000	1,457,000
Total accounts receivable	2,635,179	2,445,649
Less allowance for uncollectible accounts	(210,000)	(204,000)
Total Accounts receivable (net)	\$ 2,425,179	\$ 2,241,649

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

4. RESTRICTED ASSETS

Restricted assets as of September 30 consist of the following:

<u>Cash and cash equivalents</u>	<u>2018</u>	<u>2017</u>
Customer deposits	\$ 376,402	\$ 282,602
Impact fees - replacement reserve	189,132	1,396,649
Front footage and tie in fees - replacement reserve	4,118	489,824
Debt service fund	1,718,689	1,684,481
Series 2015A bond proceeds	431,938	268,406
<u>Investments</u>		
Customer deposits	2,225,000	2,125,000
Series 2015A bond proceeds	-	3,505,467
Impact fees - replacement reserve	1,309,972	
Front footage and tie in fees - replacement reserve	601,315	-
	<u>\$ 6,856,566</u>	<u>\$ 9,752,429</u>

The ordinances authorizing the issuance of the Waterworks and Sewer System Revenue Bonds require the establishment of an interest and sinking fund. The interest and sinking fund is used to pay the principal of and interest on the bonds, as such comes due. Deposits are made into the interest and sinking fund in equal monthly installments sufficient to pay the next interest payment due and the next maturing principal of the bonds. Those same ordinances restrict the use of revenue bond proceeds for the purpose of improving, enlarging, or equipping the water and wastewater systems.

Capital facilities user impact fees and front footage and tie-in fees were established as restricted assets by ordinance of the City of Harlingen. Customer security deposits are held for the benefit of the System's customers to satisfy utility account balances upon termination of service.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

5. CAPITAL ASSETS

Interest incurred during the construction phase of capital assets and included as part of the capitalized value of the assets constructed in the fiscal years ended September 30 2018 and 2017, respectively was \$32,130 and \$199,712.

Capital asset activity for the System for the year ended September 30, 2018 was as follows:

	Balance <u>9/30/2017</u>	Reclass & <u>Additions</u>	Reclass & <u>Disposals</u>	Balance <u>9/30/2018</u>
Capital assets not being depreciated				
Water rights	\$ 5,423,369	\$ 708,461	\$ -	\$ 6,131,830
Land & land rights	1,208,953	2,000	-	1,210,953
Construction in progress	3,209,690	5,013,331	(6,212,244)	2,010,777
Total capital assets not being depreciated	<u>9,842,012</u>	<u>5,723,792</u>	<u>(6,212,244)</u>	<u>9,353,560</u>
Other capital assets				
Vehicles	3,189,456	415,737	(72,719)	3,532,474
Water production plant	27,652,943	2,550,734	(67,932)	30,135,745
Water transmission facilities and equipment	55,472,378	328,087	(72,184)	55,728,281
Wastewater treatment plant	31,386,507	3,089,527	(20,873)	34,455,161
Wastewater collection lines, lift stations and equipment	52,681,659	1,015,133	(42,278)	53,654,514
Laboratory building and equipment	415,964	-	-	415,964
Pretreatment buildings and equipment	76,801	-	(7,798)	69,003
Office buildings and equipment	4,056,504	97,126	-	4,153,630
Total capital assets being depreciated	<u>174,932,212</u>	<u>7,496,344</u>	<u>(283,784)</u>	<u>182,144,772</u>
Less accumulated depreciation				
Vehicles	(2,225,390)	(167,592)	72,718	(2,320,264)
Water production plant	(20,661,374)	(642,205)	67,933	(21,235,646)
Water transmission facilities and equipment	(35,417,606)	(824,616)	33,784	(36,208,438)
Wastewater treatment plant	(20,889,823)	(1,184,606)	20,873	(22,053,556)
Wastewater collection lines, lift stations and equipment	(31,459,360)	(1,013,945)	40,973	(32,432,332)
Laboratory building and equipment	(254,329)	(22,851)	-	(277,180)
Pretreatment buildings and equipment	(75,127)	(1,084)	7,797	(68,414)
Office buildings and equipment	(3,129,374)	(144,608)	-	(3,273,982)
Total accumulated depreciation	<u>(114,112,382)</u>	<u>(4,001,507)</u>	<u>244,078</u>	<u>(117,869,811)</u>
Capital assets, net of accumulated depreciation	<u>\$ 70,661,842</u>	<u>\$ 9,218,629</u>	<u>\$ (6,251,950)</u>	<u>\$ 73,628,521</u>

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

5. CAPITAL ASSETS (Continued)

Capital asset activity for the System for the year ended September 30, 2017 was as follows:

	Balance <u>9/30/2016</u>	Reclass & <u>Additions</u>	Reclass & <u>Disposals</u>	Balance <u>9/30/2017</u>
Capital assets not being depreciated				
Water rights	\$ 5,423,369	\$ -	\$ -	\$ 5,423,369
Land & land rights	1,202,089	6,864	-	1,208,953
Construction in progress	10,692,042	3,887,284	(11,369,636)	3,209,690
Total capital assets not being depreciated	<u>17,317,500</u>	<u>3,894,148</u>	<u>(11,369,636)</u>	<u>9,842,012</u>
Other capital assets				
Vehicles	2,972,049	217,407	-	3,189,456
Water production plant	27,630,188	22,755	-	27,652,943
Water transmission facilities and equipment	55,166,665	344,113	(38,400)	55,472,378
Wastewater treatment plant	23,325,702	9,513,147	(1,452,342)	31,386,507
Wastewater collection lines, lift stations and equipment	50,597,244	2,127,187	(42,772)	52,681,659
Laboratory building and equipment	315,638	100,326	-	415,964
Pretreatment buildings and equipment	76,801	-	-	76,801
Office buildings and equipment	3,980,129	101,135	(24,760)	4,056,504
Total capital assets being depreciated	<u>164,064,416</u>	<u>12,426,070</u>	<u>(1,558,274)</u>	<u>174,932,212</u>
Less accumulated depreciation				
Vehicles	(2,132,568)	(92,822)	-	(2,225,390)
Water production plant	(20,059,552)	(601,822)	-	(20,661,374)
Water transmission facilities and equipment	(34,572,037)	(845,569)	-	(35,417,606)
Wastewater treatment plant	(21,094,782)	(1,022,687)	1,227,646	(20,889,823)
Wastewater collection lines, lift stations and equipment	(30,420,046)	(1,067,830)	28,516	(31,459,360)
Laboratory building and equipment	(230,418)	(23,911)	-	(254,329)
Pretreatment buildings and equipment	(74,043)	(1,084)	-	(75,127)
Office buildings and equipment	(2,986,606)	(167,528)	24,760	(3,129,374)
Total accumulated depreciation	<u>(111,570,052)</u>	<u>(3,823,252)</u>	<u>1,280,922</u>	<u>(114,112,382)</u>
Capital assets, net of accumulated depreciation	<u>\$ 69,811,864</u>	<u>\$ 12,496,966</u>	<u>\$ (11,646,988)</u>	<u>\$ 70,661,842</u>

6. DUE TO PRIMARY GOVERNMENT

At September 30, 2018 and 2017 the System was liable to the City of Harlingen for amounts collected by the System from customers utilizing City garbage collection services; and amounts the City billed to the System for insurance premiums, and for other services provided by the City on behalf of the System in the amounts of \$131,996 and \$111,801 respectively.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

7. PAYABLE FROM RESTRICTED ASSETS

Payable from restricted assets as of September 30 consists of the following:

	<u>2018</u>	<u>2017</u>	
Current:			
Accrued interest	\$ 309,159	\$ 322,180	
Customer deposits	350,000	300,000	
Noncurrent:			
Customer deposits	2,251,402	2,107,602	
Total	\$ 2,910,561	\$ 2,729,782	

8. LONG-TERM DEBT

Revenue Bonds are used to finance the acquisition and construction of major capital improvements for the water and sewer system and related facilities. The revenue bonds are special obligations of the System solely secured by a first lien on and pledge of the net revenues of the combined waterworks and sewer system. Net revenues are defined in the respective covenants and are more fully explained therein as the gross revenues of the System less the expenses of operation and maintenance of the System. Depreciation and payments into and out of the required interest and sinking and the reserve funds are not considered expenses of operation and maintenance. Remaining revenues may then be used for any lawful purpose.

In October 2010, the System issued the Waterworks and Sewer System Revenue Bonds, Series 2010A in the principal amount of \$6,500,000 to provide funding for the System's ongoing capital improvement program and to cover the cost of issuance. Simultaneously, in order to achieve a debt service savings due to favorable interest rates. The Waterworks and Sewer System Revenue Refunding Bonds, Series 2010B were issued, in the principal amount of \$4,205,000. The proceeds from the sale of the Series 2010B Bonds were used for purpose of paying costs of issuance and refunding all of the then outstanding Waterworks and Sewer System Revenue Bonds, Series 2000 in the amount of \$1,220,000 and Series 2003 in the amount of \$4,410,000.

The Series 2010B Bond proceeds, along with other available funds of the System, were deposited with an escrow agent and irrevocably pledged to the payment of principal and interest on the refunded Bonds until the respective call dates. As a result, the refunded obligations are considered defeased, and the liability for those bonds has been removed from the System's financial statements. As of September 30, 2017, all Series 2000 and Series 2003 Bonds have been retired.

In September 2015, the System issued the Waterworks and Sewer System Revenue Bonds, Series 2015A in the principal amount of \$12,000,000 to provide funding for the System's ongoing capital improvement program and to cover the cost of issuance. Simultaneously, in order to achieve a debt service savings due to favorable interest rates, the Waterworks and Sewer System Revenue Refunding Bonds, Series 2015B were issued, in the principal amount of \$6,475,000. The proceeds from the sale of the Series 2015B Bonds were used for the purpose of refunding all of the then outstanding Waterworks and Sewer System Revenue Refunding Bonds, Series 2005 in the amount of \$2,620,000; and the Waterworks and Sewer System Revenue Bonds, Series 2005A in the amount of \$4,435,000 and to pay the costs of issuance.

The Series 2015B Bond proceeds, along with other available funds of the System, were deposited with an escrow agent for payment of principal and interest on the refunded debt until the respective call dates of November 1, 2015 through November 1, 2019. As a result, the refunded obligations are considered defeased, and the liability for those bonds has been removed from the System's financial statements. As of September 30, 2018, Series 2005A Bonds in the principal amounts of \$250,000 maturing November 1, 2018, and \$270,000 maturing November 1, 2019 have not been redeemed.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

8. LONG-TERM DEBT (Continued)

The bonds carry interest rates as set out below with the interest payment dates of May 1st and November 1st and principal payments due annually on November 1st. The bond ordinances authorizing these issues require establishing an interest and sinking fund; and, if certain financial ratios are not met, a reserve fund. A Credit Facility may be used as a substitute for or to replace cash or investments in the reserve fund. In addition, a provision in the ordinances requires that rates for service be adjusted if certain financial ratios are not met. Management of the System believes it is in compliance with all significant financial requirements of the bond ordinances as of September 30, 2018.

As of September 30, 2018, revenue bonds outstanding are as follows:

<u>Bond Issue</u>	<u>Original Amount</u>	<u>Interest Rates</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Principal Outstanding</u>
Waterworks and Sewer System Revenue, Series 2010A	\$ 6,500,000	2.0-4.00%	9/15/2010	11/1/2035	\$ 5,650,000
Waterworks and Sewer System Revenue Refunding, Series 2010B	\$ 4,205,000	2.0-3.00%	9/15/2010	11/1/2020	360,000
Waterworks and Sewer System Revenue, Series 2015A	\$ 12,000,000	2.0-3.75%	9/1/2015	11/1/2035	11,095,000
Waterworks and Sewer System Revenue Refunding, Series 2015B	\$ 6,475,000	2.0-3.25%	9/1/2015	11/1/2035	5,100,000
					<u>\$ 22,205,000</u>

Annual debt service requirements to maturity for revenue bonds are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 1,525,000	\$ 719,106	\$ 2,244,106
2020	1,565,000	672,756	2,237,756
2021	1,615,000	625,056	2,240,056
2022	1,015,000	585,444	1,600,444
2023	1,040,000	554,138	1,594,138
2024-2028	5,750,000	2,236,395	7,986,395
2029-2033	6,125,000	1,217,403	7,342,403
2034-2036	3,570,000	212,181	3,782,181
Total	<u>\$ 22,205,000</u>	<u>\$ 6,822,479</u>	<u>\$ 29,027,479</u>

9. CHANGES IN LONG TERM LIABILITIES

Long-term liability activity for the year ended September 30, 2018, was as follows:

	<u>Balance October 1</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30</u>	<u>Due within one year</u>
Bonds payable	\$ 23,685,000	\$ -	\$ (1,480,000)	\$ 22,205,000	\$ 1,525,000
Deferred amounts for discounts and premiums	171,169	-	(27,230)	143,939	23,508
Total bonds payable	23,856,169	-	(1,507,230)	22,348,939	1,548,508
Compensated absences	762,817	562,438	(548,891)	775,364	550,000
Retiree health care liability	9,641,083	1,259,267	(339,430)	10,560,920	-
Retiree death benefit liability	460,283	69,606	(5,394)	524,495	-
Net pension liability	323,981	703,557	(2,175,684)	(1,148,146)	-
Customer Deposits	2,407,602	549,311	(355,511)	2,601,402	350,000
Total	<u>\$ 37,451,935</u>	<u>\$ 3,144,179</u>	<u>\$ (4,932,140)</u>	<u>\$ 35,662,974</u>	<u>\$ 2,448,508</u>

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

9. CHANGES IN LONG TERM LIABILITIES (Continued)

Long-term liability activity for the year ended September 30, 2017, was as follows:

	Balance <u>October 1</u>	<u>Additions</u>	<u>Reductions</u>	Prior Period <u>Adjustment</u>	Balance <u>September 30</u>	Due within <u>one year</u>
Bonds payable	\$ 25,140,000	\$ -	\$ (1,455,000)	\$ -	\$ 23,685,000	\$ 1,480,000
Deferred amounts for discounts and premiums	201,003	-	(29,834)	-	171,169	27,230
Total bonds payable	<u>25,341,003</u>	<u>-</u>	<u>(1,484,834)</u>	<u>-</u>	<u>23,856,169</u>	<u>1,507,230</u>
Compensated absences	776,517	567,928	(581,628)	-	762,817	572,000
Retiree health care liability	3,542,478	631,733	(334,144)	5,801,016	9,641,083	-
Retiree death benefit liability	-	-	-	460,283	460,283	-
Net pension liability	193,753	680,909	(550,681)	-	323,981	-
Customer Deposits	2,152,813	545,704	(290,915)	-	2,407,602	300,000
Total	<u>\$ 32,006,564</u>	<u>\$ 2,426,274</u>	<u>\$ (3,242,202)</u>	<u>\$ 6,261,299</u>	<u>\$ 37,451,935</u>	<u>\$ 2,379,230</u>

10. COMMITMENTS AND CONTINGENT LIABILITIES

The System is currently under contract with five wholesale customers (users) to provide treated water. These agreements provide for the treatment of an aggregate minimum of at least 250,000,000 gallons annually. The contracts have various expiration dates ranging from year 2016 to 2054. The System has contracted to provide wastewater treatment services to two wholesale customers. The combined annual flow is estimated to be 250,000,000 gallons.

As of September 30, 2018, the System had open purchase orders for construction projects, operating supplies and equipment in the amount of \$376,573. The projects include water treatment, transmission and distribution system improvements and wastewater treatment and collection system improvements. These commitments will be funded with bond proceeds, and unrestricted cash.

Various claims are pending against the System. In the opinion of System management, after consultation with legal counsel, the potential loss on all claims will not materially affect the System's financial position, results of operations, or cash flows.

11. RISK MANAGEMENT

The System is exposed to various uncertainties for losses related to intentional and unintentional torts; theft of, damage to and destruction of real and personal property; errors and omissions; catastrophes, medical and dental claims by employees; employee illnesses and injuries and pollution claims for which the Waterworks carries commercial insurance coverage. There have been no significant reductions in insurance coverage from the previous year. No negotiated settlements or jury awards have exceeded policy limits in any of the past three years. The Waterworks is a member of an intergovernmental risk pool. The risk pool is an inter-local non-assessable agency with present unreserved resources in excess of \$342,852,000 (as of September 30, 2018, the most recently audited financial statements completed for the risk pool). Reinsurance is provided by several A and A++ rated companies in amounts ranging from \$10,000,000 to \$100,000,000 depending on the type of insurance coverage. The Waterworks must promptly pay contributions to the risk pool as outlined by the coverage contracts, comply with underwriting standards and implement loss control recommendations deemed necessary by a risk pool representative due to an eminent high risk of loss situation. City and System management are not aware of any pending or alleged claims that could exceed the policy limits of the present insurance coverage.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

12. NET POSITION

Net position is composed of three categories: Net investment in capital assets, restricted net position, and unrestricted net position. The following schedule provides detail of the categories of net position as of September 30:

	<u>2018</u>	<u>2017</u>
Net investment in capital assets		
Net capital assets	\$ 73,628,521	\$ 70,661,842
Revenue bonds payable (net of unspent Series 2015A bond proceeds)	<u>(21,701,115)</u>	<u>(19,812,972)</u>
Net investment in capital assets	<u>51,927,406</u>	<u>50,848,870</u>
 Net position restricted for:		
Debt service:		
Cash, cash equivalents and investments	1,718,688	1,684,481
Accrued interest payable	(309,159)	(322,180)
System expansion (impact fees):		
Cash, cash equivalents and investments	1,499,104	1,396,649
System expansion (front footage & tie-in fees)		
Cash, cash equivalents and investments	605,434	489,824
Capital improvements (bond proceeds):		
Cash, cash equivalents and investments	431,938	3,773,873
Customer deposits:		
Cash, cash equivalents and investments	2,601,402	2,407,602
Payable to utility customers	(2,601,402)	(2,407,602)
Employee pensions:		
Net Pension Asset	1,148,146	-
Deferred outflows related to pensions	1,078,873	1,543,195
Net Pension Liability	-	(323,981)
Deferred inflows related to pensions	<u>(1,285,678)</u>	<u>(56,456)</u>
Restricted net position	<u>4,887,346</u>	<u>8,185,405</u>
Unrestricted net position	<u>14,649,595</u>	<u>7,983,545</u>
Total net position	<u>\$ 71,464,347</u>	<u>\$ 67,017,820</u>

13. MAJOR CUSTOMERS

For the years ended September 30, 2018 and 2017, no single customer provided more than 10% of water revenues or wastewater revenues. For the year ended 2018, the top ten wastewater customers provided approximately \$1,013,341 or 9.4% of wastewater sales revenues. The top ten water customers generated approximately \$1,426,150 or 13.6% of the water sales revenues.

14. DEFINED BENEFIT PENSION PLAN

Plan Description

The System participates as one of 883 plans in the nontraditional, joint contributory, hybrid defined benefit pension plan administered by the Texas Municipal Retirement System (TMRS). TMRS is an agency created by the State of Texas and administered in accordance with the TMRS Act, Subtitle G, Title 8, Texas Government Code (the TMRS Act) as an agent multiple-employer retirement system for municipal employees in the State of Texas.

CITY OF HARLINGEN WATERWORKS SYSTEM
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14 DEFINED BENEFIT PENSION PLAN (Continued)

The TMRS Act places the general administration and management of the TMRS System with a six-member Board of Trustees. Although the Governor, with the advice and consent of the Senate, appoints the Board, TMRS is not fiscally dependent on the State of Texas. TMRS's defined benefit pension plan is a tax-qualified plan under Section 401(a) of the Internal Revenue Code. TMRS issues a publicly available comprehensive annual financial report (CAFR) that can be obtained at www.tmr.com.

All eligible employees of the System are required to participate in TMRS.

Benefits Provided

TMRS provides retirement, disability, and death benefits. Benefit provisions are adopted by the governing body of the Harlingen Waterworks System, within the options available in the state statutes governing TMRS.

At retirement, the benefit is calculated as if the sum of the employee's contributions, with interest, and the System-financed monetary credits, with interest, were used to purchase an annuity. Members may choose to receive their retirement benefit in one of seven actuarially equivalent payment options. Members may also choose to receive a portion of their benefit as a Partial Lump Sum Distribution in an amount equal to 12, 24, or 36 monthly payments, which cannot exceed 75% of the member's deposits and interest.

Plan provisions for the System were as follows:

Employee deposit rate	7%
Matching ration (System to employee)	1 to 1
Years required for vesting	5
Service retirement eligibility	20 yrs at any age; 5 yrs at age 60 and above
Updated service credit	0%
Annuity increase (to retirees)	0% of CPI
Supplemental death benefit	Active Employees & Retirees

At the December 31, 2017 valuation and measurement date, the following employees were covered by the benefit terms:

	2017	2016
Retirees or beneficiaries currently receiving benefits	116	111
Inactive employees entitled to but not yet receiving benefits	49	45
Active employees	135	141
Total	<u>300</u>	<u>297</u>

Contributions

Under the state law governing TMRS, the contribution rate for each participant is determined annually by the consulting actuary, using the Entry Age Normal (EAN) actuarial cost method. The actuarially determined rate is the estimated amount necessary to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability.

Employees for the Harlingen Waterworks System were required to contribute 7% of their annual gross earnings during the fiscal year. The contribution rates for the System were 0.59%, 1.75%, and 1.90% in calendar years 2016, 2017, and 2018 respectively. The System's contributions to TMRS for the fiscal years ended September 30, 2016, 2017, and 2018 were \$43,964, \$80,713 and \$89,251 respectively, and were equal to the required contributions.

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14. DEFINED BENEFIT PENSION PLAN (Continued)

Net Pension (Asset) Liability

The System's Net Pension (Asset) (NPA or NPL) Liability was measured as of December 31, 2017. The Total Pension Liability (TPL) used to calculate the Net Pension (Asset) Liability was determined by an actuarial valuation as of that date.

Actuarial Assumptions:

The Total Pension Liability in the December 31, 2017 actuarial valuation was determined using the following actuarial assumptions:

Inflation	2.5% per year
Overall payroll growth	3.0% per year
Investment Rate of Return	6.75%, net of pension plan investment expense, including inflation

Salary increases were based on a service-related table. Mortality rates for active members, retirees, and beneficiaries were based on the gender-distinct RP2000 Combined Healthy Mortality Table, with Blue Collar Adjustment, with male rates multiplied by 109% and female rates multiplied by 103%. The rates are projected on a fully generational basis by scale BB to account for future mortality improvements. For disabled annuitants, the gender-distinct RP2000 Combined Healthy Mortality Tables with Blue Collar Adjustment are used, with male rates multiplied by 109% and female rates multiplied by 103% with a 3-year set-forward for both males and females. In addition, a 3% minimum mortality rate is applied to reflect the impairment for younger members who become disabled. The rates are projected on a fully generational basis by scale BB to account for future mortality improvements subject to the 3% floor.

The actuarial assumptions were developed primarily from the actuarial investigation of the experience of TMRS over the four year period from December 31, 2010 to December 31, 2014. They were adopted in 2015 and first used in the December 31, 2015 actuarial valuation. The post-retirement mortality assumption for healthy annuitants and Annuity Purchase Rate (APRs) are based on the Mortality Experience Investigation Study covering 2009 through 2011 dated December 31, 2013. In conjunction with these changes first used in the December 31, 2013 valuation, TMRS adopted the Entry Age Normal actuarial cost method and a one-time change to the amortization policy. Plan assets are managed on a total return basis with an emphasis on both capital appreciation as well as the production of income, in order to satisfy the short-term and long-term funding needs of TMRS.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. In determining their best estimate of a recommended investment return assumption under the various alternative asset allocation portfolios, the actuary focused on the area between (1) arithmetic mean (aggressive) without an adjustment for time (conservative) and (2) the geometric mean (conservative) with an adjustment for time (aggressive).

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14. DEFINED BENEFIT PENSION PLAN (Continued)

The target allocation and best estimates of real rates of return for each major asset class in fiscal year 2018 are summarized in the following table:

	Target Allocation	Long-Term Expected Real Rate Of Return (Arithmetic)
Domestic Equity	17.5%	4.55%
International Equity	17.5%	6.35%
Core Fixed Income	10.0%	1.00%
Non-Core Fixed Income	20.0%	3.90%
Real Return	10.0%	3.80%
Real Estate	10.0%	4.50%
Absolute Return	10.0%	3.75%
Private Equity	5.0%	7.50%
Total	100.00%	

Discount Rate:

The discount rate used to measure the Total Pension Liability was 6.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current 7% and employer contributions will be made at the rates specified in statute. Based on that assumption, the pension plan's Fiduciary Net Position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability.

Sensitivity of the Net Pension (Asset) Liability to Changes in the Discount Rate:

The following presents the net pension (asset) liability of the System, calculated using the discount rate of 6.75%, as well as what the System's net pension (asset) liability would be if it were calculated using a discount rate that is 1 percentage point lower (5.75%) or 1 percentage point higher (7.75%) than the current rate:

	1% Decrease in Discount Rate -5.75%	Current Discount Rate -6.75%	1% Increase in Discount Rate -7.75%
Net pension liability (asset)	\$ 1,555,564	\$ (1,148,146)	\$ (3,421,216)

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14. DEFINED BENEFIT PENSION PLAN (Continued)

Changes in the Net Pension (Asset) Liability for the fiscal year ended September 30, 2018:

	Total Pension Liability (a)	<u>Increase/Decrease</u> Plan Fiduciary Net Pension (b)	Net Pension Liability (Asset) (a)-(b)
Balance at 12/31/2016	\$ 22,621,672	\$ 22,297,691	\$ 323,981
Changes for the year:			
Service cost	538,832		538,832
Interest (on Total Pension Liability)	1,497,198		1,497,198
Change of benefits terms	-		-
Difference between expected and actual experience	88,270	-	88,270
Changes of assumptions	-	-	-
Contributions - employer	-	104,889	(104,889)
Contributions - employee	-	419,558	(419,558)
Net investment income	-	3,088,807	(3,088,807)
Benefits payments, including refunds of employee contributions	(1,420,743)	(1,420,743)	-
Administrative expense	-	(16,016)	16,016
Other changes	-	(811)	811
Net changes	<u>703,557</u>	<u>2,175,684</u>	<u>(1,472,127)</u>
Balance at 12/31/2017	<u>\$ 23,325,229</u>	<u>\$ 24,473,375</u>	<u>\$ (1,148,146)</u>

Changes in the Net Pension Liability for the fiscal year ended September 30, 2017:

	Total Pension Liability (a)	<u>Increase/Decrease</u> Plan Fiduciary Net Pension (b)	Net Pension Liability (Asset) (a)-(b)
Balance at 12/31/2015	\$ 21,940,763	\$ 21,747,010	\$ 193,753
Changes for the year:			
Service cost	539,599		539,599
Interest (on Total Pension Liability)	1,453,483		1,453,483
Change of benefits terms	-		-
Difference between expected and actual experience	42,791		42,791
Changes of assumptions	-		-
Contributions - employer		35,295	(35,295)
Contributions - employee		418,757	(418,757)
Net investment income		1,469,085	(1,469,085)
Benefits payments, including refunds of employee contributions	(1,354,964)	(1,354,964)	-
Administrative expense		(16,598)	16,598
Other changes		(894)	894
Net changes	<u>\$ 680,909</u>	<u>\$ 550,681</u>	<u>\$ 130,228</u>
Balance at 12/31/2016	<u>\$ 22,621,672</u>	<u>\$ 22,297,691</u>	<u>\$ 323,981</u>

CITY OF HARLINGEN WATERWORKS SYSTEM
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14. DEFINED BENEFIT PENSION PLAN (Continued)

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions:

At September 30, 2018, the System reported deferred outflows and deferred inflows of resources related to pensions from the following sources:

	<u>2018</u>		<u>2017</u>	
	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Pension contribution after the measurement date	\$ 89,251	\$ -	\$ 80,713	\$ -
Difference in projected and actual investment earnings	679,601	(1,267,668)	1,047,861	(930)
Difference in expected and actual pension experience	133,092	(18,010)	103,655	(55,526)
Changes in actuarial assumptions used to determine pension liability	176,929	-	310,966	-
	<u>\$ 1,078,873</u>	<u>\$ (1,285,678)</u>	<u>\$ 1,543,195</u>	<u>\$ (56,456)</u>

Deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date of \$89,251 will be recognized as a reduction of the net pension asset or liability for the measurement year ending December 31, 2018 (i.e. recognized in the System's financial statements as of September 30, 2019). Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Measurement Year Ended <u>December 31</u>	
2018	\$ 226,145
2019	75,531
2020	(291,998)
2021	(305,734)
Total	<u>\$ (296,056)</u>

Deferred outflows and inflows of resources related to pensions from September 30, 2017 were to be amortized as follows:

Measurement Year Ended <u>December 31</u>	
2017	\$ 504,067
2018	523,572
2019	372,958
2020	5,429
Total	<u>\$ 1,406,026</u>

CITY OF HARLINGEN WATERWORKS SYSTEM
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15. OTHER POST EMPLOYMENT BENEFITS

Supplemental Death Benefits Fund

Plan Description

The System participates in the single-employer defined benefit plan operated by the Texas Municipal Retirement System known as the Supplemental Death Benefits Fund (SDBF). This is a voluntary program in which participating member cities may elect to provide group-term life insurance coverage (Supplemental Death Benefits) for their active members, including or not including retirees. The System elected, by resolution, to provide group-term life insurance coverage to both current and retired employees. The System may terminate coverage under and discontinue participation in the SDBF by adopting a resolution to do so before November 1 of any year to be effective the following January 1.

Benefits

Payments from this fund are similar to group-term life insurance benefits, and are paid to the designated beneficiaries upon the receipt of an approved application for payment. The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary (calculated based on the employee's actual earnings, for the 12-month period preceding the month of death). The death benefit for retirees is considered a postemployment benefit other than pension benefit (OPEB) and is a fixed amount of \$7,500. The obligations of this plan are payable only from the SDBF and are not an obligation of, or claim against, the pension trust fund.

Employees covered by benefit terms

At the December 31, 2017 valuation and measurement date, the following employees were covered by the benefit terms:

	2017
Inactive employees or beneficiaries currently receiving benefits	92
Inactive employees entitled to but not yet receiving benefits	7
Active employees	135
Total	234

CITY OF HARLINGEN WATERWORKS SYSTEM
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15. OTHER POST EMPLOYMENT BENEFITS (Continued)

Funding Policy and Annual Supplemental Death Benefit Fund Plan Cost

Contributions are made monthly based on the covered payroll of employee members of the plan participants. The contractually required contribution rate is determined annually for each participant. The rate is based on the mortality and service experience of all employees covered by the SDBF and the demographics specific to the workforce of the participant. There is a one-year delay between the actuarial valuation that serves as the basis for the employer contribution rate and the calendar year when the rate goes into effect. The contributions to the SDBF are pooled for investment purposes with those of the Pension Trust Fund. The TMRS Act requires the Pension Trust Fund to allocate investment income to the SDBF on an annual basis. The funding policy of this plan is to assure that adequate resources are available to meet all death benefit payments for the upcoming year. The intent is not to prefund retiree term life insurance during employees' entire careers. As such, contributions are utilized to fund active member deaths on a pay-as-you go basis; any excess contributions and investment income over payments then become net position available for benefits.

The System contributes to the SDBF at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. The required rate was 0.26% for 2018, 2017 and 2016, of which 0.09% represented the retiree-only portion for each year, as a percentage of annual covered payroll. The System's contributions to the TMRS SDBF for the fiscal years ended 2018, 2017, and 2016 were \$5,471, \$5,422, and \$5,372, respectively, which equaled the required contributions each year.

Year	Total SDBF Contribution	Retiree Portion of SDBF Contribution	Actual Contribution Made	Percentage of ARC Contributed
<u>Plan</u>	<u>Rate</u>	<u>(Rate)</u>	<u>(Rate)</u>	<u>(Rate)</u>
2016	0.26%	0.09%	0.09%	100.0%
2017	0.26%	0.09%	0.09%	100.0%
2018	0.26%	0.09%	0.09%	100.0%

The following presents the costs incurred by the retiree death benefit plan in fiscal year 2018:

Service Cost	\$ 14,385
Interest on total Death Benefit liability	17,569
Changes in benefit terms	-
Employer administrative costs	-
Recognition of deferred outflows/inflows of resources:	
Differences between expected and actual experience ¹	-
Changes in assumptions or other inputs ²	<u>6,883</u>
Total Supplemental Death Benefit Expense	<u>\$ 38,837</u>

1. In the year of implementation, the beginning of year liability is rolled back from the measurement date, so there will be no experience loss/gain.
2. Generally, this will only be the annual change in the municipal bond index rate.

CITY OF HARLINGEN WATERWORKS SYSTEM
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15. OTHER POST EMPLOYMENT BENEFITS (Continued)

Funded Status and Funding Progress:

The total Death Benefit OPEB Liability (TOL) shown in this report is based on an actuarial valuation performed as of December 31, 2017, the measurement date. The SDBF covers both inactive and retiree benefits with no segregation of assets, and therefore doesn't meet the definition of a trust under GASB No. 75; no assets are accumulated for OPEB. As such, the SDBF is considered to be an unfunded plan with benefit payments treated as being equal to the employer's annual contributions for retirees. Under the reporting parameters, the System's death benefit plan is 0.0% funded.

Actuarial Methods and Assumptions

The actuarial assumptions used in the December 31, 2017 valuation were based on the results of an actuarial experience study for the period December 31, 2010 to December 31, 2014. The actuarial assumptions include a 3.31% investment rate of return; a 2.5% inflation assumption; and salary increases of 3.5% to 10.5% including inflation. The valuation included the gender-distinct RP2000 Combined Healthy Mortality Tables with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% and projected on a fully generational basis with scale BB for service retirees. For disabled retirees, the valuation included the gender-distinct RP2000 Combined Healthy Mortality Tables with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% with a 3 year set-forward for both males and females. The rates are projected on a fully generational basis with scale BB to account for future mortality improvements subject to the 3% floor.

Sensitivity of the net OPEB liability to changes in the discount rate

The following presents the total OPEB liability of the System, calculated using the discount rate of 3.31% as well as what the System's total OPEB liability would be if it were calculated using a discount rate that is one percentage-point lower (2.31%) or one percentage-point higher (4.31%).

<u>1% Decrease</u>	<u>Current Discount Rate Assumption</u>	<u>1% Increase</u>
2.31%	3.31%	4.31%
\$ 619,579	\$ 524,495	\$ 448,887

Recognition of Deferred Outflows and Deferred Inflows of Resources

Differences between expected and actual experience and changes in assumptions are recognized in OPEB expense using a systematic and rational method over a closed period. At September 30, 2018, the System reported deferred outflows of resources related to OPEB from the following sources that are being amortized over a 5.470 year period:

Statement of Death Benefit Outflows and Inflows Arising from Current Reporting Period:

	<u>Recognition Period (amortization years)</u>	<u>Total (Inflow or Outflow of Resources</u>	<u>2018 Recognized in current OPEB expense</u>	<u>Deferred (Inflow) or Outflow in future expense</u>
Due to Liabilities:				
Contributions made after measurement date		\$ 4,228	\$ -	\$ -
Differences in expected and actual experience	5.470	-	-	-
Changes in actuarial assumptions used to determine death benefit liability	5.470	<u>37,652</u>	<u>6,883</u>	<u>30,769</u>
Total		<u>\$ 41,880</u>	<u>\$ 6,883</u>	<u>\$ 30,769</u>

CITY OF HARLINGEN WATERWORKS SYSTEM
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15. OTHER POST EMPLOYMENT BENEFITS (Continued)

Deferred outflows of resources resulting from contributions subsequent to the measurement date of \$4,228 will be recognized as a reduction of the total OPEB liability for the measurement year ending December 31, 2018 (i.e. recognized in the System's financial statements as of September 30, 2019). Other amounts reported as deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense as follows:

<u>December 31</u>	
2018	\$ 6,883
2019	6,883
2020	6,883
2021	6,883
2023	3,237
Total	<u>\$ 30,769</u>

Changes in the Supplemental Death Benefit Fund

Service Cost	\$ 14,385
Interest on liability	17,569
Changes of assumptions	37,652
Benefit payments	(5,394)
Net change in total liability	<u>\$ 64,212</u>
Liability as of FY 2017	\$ -
Net prior period adjustment for GASB 75	<u>460,283</u>
Total OPEB liability as of 12/31/2016	460,283
Net change in total OPEB liability	<u>64,212</u>
Total OPEB liability as of 12/31/2017	<u>\$ 524,495</u>
Covered employee payroll	\$ 5,993,680
Total OPEB liability as a percentage of covered-employee payroll	8.75%
Percentage of OPEB liability funded	0.00%

Retiree Health Care Plan

Plan Description

In addition to the pension benefits described in Note 14 and the supplemental death benefits described in Note 15, the System makes available health care and prescription-drug benefits to all employees who retire from the System and who are receiving benefits from the System sponsored retirement program, Texas Municipal Retirement System ("TMRS"). The System administers the single-employer Retiree Health Care Plan. All current full-time employees of the System hired prior to February 2010 are eligible for retirement and health-care and prescription-drug coverage at age 60 with five years of service or at any age with 20 years of service. Those approved for disability retirement through TMRS are also eligible for retiree health-care and prescription-drug coverage. The System provided group health care coverage is discontinued at the end of the month prior to the retiree's 65th birth month. Retirees are required to enroll in Medicare once eligible. A Medicare Supplement, Plan F is provided thereafter, until death. Retirees eligible for Medicare coverage are not provided prescription-drug coverage. As of December 31, 2017, there were 74 Retirees and 60 Active for a total of 134 participants in the plan.

CITY OF HARLINGEN WATERWORKS SYSTEM
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15. OTHER POST EMPLOYMENT BENEFITS (Continued)

Employees who are eligible for retirement, but instead choose to terminate employment, are not eligible for System sponsored health care and prescription drug coverage at a later date. The System does not provide subsidized retiree vision or dental care coverage. Nor does the System provide subsidized retiree life insurance coverage. Life insurance coverage carried at the time of retirement is portable. The System does not provide a death-in-service benefit to a surviving spouse; however, through TMRS, there is a \$7,500 death benefit. Retirees who elect to opt-out of the System sponsored health care plan do not receive any cash payment in lieu of electing the System sponsored health care plan. Benefit provisions are established by management.

No dependent coverage is available through the System but spouses and dependents are eligible for COBRA coverage for 18 months (or up to 36 months under certain circumstances) following members retirement date. Spouse and dependent(s) are responsible for payment of the full premium amount.

Funding Policy and Annual Retiree Health Care Plan Cost

The System provided health-care and prescription drug coverage premiums are paid 100% by the System. Medicare Supplement premiums are paid by retirees and reimbursed by the System. The System's contributions to the plan for the fiscal year 2018, were \$339,430, 46.41% of the annual OPEB cost of \$731,369.

The following presents the costs incurred by the retiree health care plan in fiscal year 2018:

OPEB cost:	<u>FY 2018</u>
Service Cost	\$ 188,372
Interest on total OPEB liability	364,448
Recognition of Current Year Outflow due to Liabilities	<u>178,549</u>
Total OPEB Expense	<u>\$ 731,369</u>

Funded Status and Funding Progress:

The total OPEB Liability (TOL) shown in this report is based on an actuarial valuation performed as of September 30, 2017. Update procedures were used to roll forward the total OPEB liability to the measurement date of December 31, 2017.

The System's annual retiree health care plan cost is based upon the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 75. The ARC represents a level of accrual that is projected to recognize the normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The System has not established a trust to fund the Retiree Health Care Plan liability and intends to continue the pay-as-you-go funding method. Under the reporting parameters, the System's retiree health care plan is 0.0% funded.

CITY OF HARLINGEN WATERWORKS SYSTEM
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15. OTHER POST EMPLOYMENT BENEFITS (Continued)

Changes in the Retiree Health Plan OPEB Liability

Actuarial values of the program involve estimates of the value of reported amounts and assumptions of the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and healthcare cost trends. Amounts determined regarding the funded status of the program and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The following table shows the components of the changes in the System's total OPEB Liability, the amount actually contributed to the plan, and changes in the System's total OPEB liability.

Total OPEB liability			
Service Cost		\$	188,372
Interest on total OPEB liability			364,448
Changes of assumptions			706,447
Benefit payments			(339,430)
Net change in total OPEB liability		\$	919,837
OPEB liability as of FY 2017		\$	3,840,067
Net prior period adjustment for GASB 75			5,801,016
Total OPEB liability as of 12/31/2016			9,641,083
Net change in total OPEB liability			919,837
Total OPEB liability as of 12/31/2017		\$	10,560,920
Covered employee payroll		\$	2,699,342
Total OPEB liability as a percentage of covered-employee payroll			391.2%
Percentage of OPEB liability funded			0.00%

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of benefit costs at the point.

For the September 30, 2017 actuarial valuation, the Individual Entry-Age cost method was used. The actuarial assumptions include a 3.31% investment rate of return (compounded annually net after investment expenses); and an initial annual healthcare cost trend rate of 7.50% for pre-65 retirees (6.5% for post-65), declining to an ultimate rate of 4.25% after 15 years. Both rates include a 2.5% inflation assumption. The valuation included the gender-distinct RP2000 Combined Healthy Mortality Tables with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103%. The rates are projected on a fully generational basis by scale BB to account for future mortality improvements.

CITY OF HARLINGEN WATERWORKS SYSTEM
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15. OTHER POST EMPLOYMENT BENEFITS (Continued)

Sensitivity of the net OPEB liability to changes in the discount rate

The following presents the total OPEB liability of the System, calculated using the discount rate of 3.31% as well as what the System's total OPEB liability would be if it were calculated using a discount rate that is one percentage-point lower (2.31%) or one percentage-point higher (4.31%).

1% Decrease 2.31%	Current Discount Rate Assumption 3.31%	1% Increase 4.31%
\$ 12,222,941	\$ 10,560,920	\$ 9,217,867

Sensitivity of the net OPEB liability to changes in the healthcare trend rate

The following presents the total OPEB liability of the System calculated using the assumed trend rates, as well as what the plan's total OPEB liability would be if it were calculated using the a trend rate that is one percentage-point lower or one percentage-point higher:

1% Decrease	Current Healthcare Cost Trend Rate Assumption	1% Increase
\$ 9,040,342	\$ 10,560,920	\$ 12,485,458

Recognition of Deferred Outflows and Deferred Inflows of Resources

Differences between expected and actual experience and changes in assumptions are recognized in OPEB expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with OPEB through the OPEB plan (active employees and inactive employees) determined as to the beginning of the measurement period. The average of the expected remaining service lives for purposes of recognizing the applicable deferred outflows (and inflows) of resources established in the current measurement period is 3.9566 years. At September 30, 2018, the System reported deferred outflows of resources related to OPEB from the following sources that are being amortized over a 3.9566 year period:

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

15. OTHER POST EMPLOYMENT BENEFITS (Continued)

	Recognition Period <u>(amortization</u> <u>years)</u>	Total (Inflow or Outflow <u>of Resources</u>	2018 Recognized in current OPEB <u>expense</u>	Deferred (Inflow) or Outflow <u>in future expense</u>
Due to Liabilities:				
OPEB contribution after the measurement date	1.0000	\$ 201,216		\$ -
Differences in expected and actual experience	3.9566	-	-	-
Changes in actuarial assumptions used to determine OPEB liability	3.9566	<u>706,447</u>	<u>178,549</u>	<u>527,898</u>
		<u>\$ 907,663</u>	<u>\$ 178,549</u>	<u>\$ 527,898</u>

Deferred outflows of resources related to OPEB resulting from contributions subsequent to the measurement date of \$201,216 will be recognized as a reduction of the net OPEB liability for the measurement year ending December 31, 2018 (i.e. recognized in the System's financial statements as of September 30, 2019). Other amounts reported as deferred outflows and inflows of resources related to the total OPEB liability will be recognized in OPEB expense as follows for the measurement years noted as follows:

<u>December 31</u>	
2019	\$ 178,549
2020	178,549
2021	<u>170,800</u>
Total	<u>\$ 527,898</u>

16. DEFERRED COMPENSATION PLAN

The System offers its employees a deferred compensation plan created in accordance with Internal Revenue Section 457. The plan, as amended, is available to all System employees, and permits them to defer a portion of their salary until future years. Participation in the plan is optional. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

A 1996 federal law requires all assets and income of Internal Revenue Code 457 deferred compensation plans to be held in trust, custodial accounts, or annuity contracts for the exclusive benefit of the participants and their beneficiaries. Assets of the System's plan are administered by private corporations under contract with the City. Consequently, the plan's assets and liabilities are not reported in the System's financial statements.

CITY OF HARLINGEN WATERWORKS SYSTEM
Notes to the Financial Statements
For the Fiscal Years Ended September 30, 2018 and 2017

17. IMPLEMENTATION OF ACCOUNTING PRONOUNCEMENT

In fiscal year 2018, the System implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*. The System provides two post-employment benefit plans, the Retiree Health Care Plan and the Supplemental Death Benefit Fund. In the year of implementation of GASB Statement No. 75,, a restatement to beginning net position was required for the recording of the beginning net OPEB liability, and for the recording of deferred outflows of resources for contributions made after the measurement date of the beginning net OPEB liability and the beginning of reporting entity's fiscal year. Beginning net position as of October 1, 2017 has been restated as follows for the implementation of GASB Statement No. 75:

Beginning net position, October 1, 2017	\$	73,089,942
Prior Period adjustment - Implementation of GASB No. 75		
Total Health Care OPEB liability (measurement date of December 31, 2016)		(5,801,016)
Total Death Benefit OPEB liability (measurement date of December 31, 2016)		(460,283)
Health Care OPEB Deferred Outflows - Contributions made after the measurement date (December 31, 2016)		185,026
Death Benefit OPEB Deferred Outflows - Contributions made after the measurement date (December 31, 2016)		4,151
Beginning net position, as restated	\$	67,017,820

18. FUTURE FINANCIAL REPORTING REQUIREMENTS

The System has reviewed GASB pronouncements which become effective in future years and notes the following statement are applicable to the System:

Statement No. 84, *Fiduciary Activities* – This statement establishes criteria for identifying fiduciary activities of governments and for identifying fiduciary component units and postemployment benefit arrangements that are fiduciary activities. This statement will become effective for the System in fiscal year 2020.

Statement No. 87, *Leases* – This statement changes the recognition requirements for certain lease assets and liabilities for leases that are currently classified as operating leases. This statement will become effective for the System in fiscal year 2021.

19. SUBSEQUENT EVENT

Pursuant to action by the City of Harlingen elected Commission, the election was made to discontinue participation in the TMRS System for all employees of all departments of the City employed or re-employed after September 30, 2007. Pursuant to action by the Harlingen Waterworks Utility Board of Trustees, the election has been made to discontinue participation in the TMRS System for all employees of the System employed or re-employed after October 1, 2018. All persons employed or re-employed by the System on or after October 1, 2018 will participate in the City of Harlingen 401(a) Retirement Plan and Trust, a defined contribution pension plan.

**REQUIRED SUPPLEMENTARY
INFORMATION**

CITY OF HARLINGEN WATERWORKS SYSTEM
Required Supplementary Information

Texas Municipal Retirement System
Schedule of Changes in Net Pension (Asset) Liability and Related Ratios
Last Four Fiscal Years
(Unaudited)

	Measurement Year Ended 12/31/2014	Measurement Year Ended 12/31/2015	Measurement Year Ended 12/31/2016	Measurement Year Ended 12/31/2017
Total pension liability:				
Service Cost	\$ 457,206	\$ 487,964	\$ 539,599	\$ 538,832
Interest (on total pension liability)	1,395,895	1,420,126	1,453,483	1,497,198
Changes of benefit terms	-	-	-	-
Difference between expected and actual experience	(168,074)	130,618	42,791	88,270
Changes of assumptions	-	579,040	-	-
Benefit payments, including refunds of employee contributions	(1,267,474)	(1,441,031)	(1,354,964)	(1,420,743)
Net change in total pension liability	417,553	1,176,717	680,909	703,557
Total pension liability - beginning	20,346,493	20,764,046	21,940,763	22,621,672
Total pension liability - ending	<u>20,764,046</u>	<u>21,940,763</u>	<u>22,621,672</u>	<u>23,325,229</u>
Plan fiduciary net position:				
Contributions - employer	114,431	61,279	35,295	104,889
Contributions - employee	381,436	397,180	418,757	419,558
Net investment income	1,271,634	33,518	1,469,085	3,088,807
Benefit payments, including refunds of employee contributions	(1,267,474)	(1,441,031)	(1,354,964)	(1,420,743)
Administrative expense	(13,278)	(20,418)	(16,598)	(16,016)
Other	(1,092)	(1,008)	(894)	(811)
Net change in plan fiduciary net position	485,657	(970,480)	550,681	2,175,684
Plan fiduciary net position - beginning	22,231,833	22,717,490	21,747,010	22,297,691
Plan fiduciary net position - ending	22,717,490	21,747,010	22,297,691	24,473,375
Net pension liability (asset)	<u>\$ (1,953,444)</u>	<u>\$ 193,753</u>	<u>\$ 323,981</u>	<u>\$ (1,148,146)</u>
Plan fiduciary net position as a percentage of total pension liability	109.41%	99.12%	98.57%	104.92%
Covered employee payroll	\$ 5,449,089	\$ 5,674,004	\$ 5,982,248	\$ 5,993,680
Net pension liability (asset) as a percentage of covered employee payroll	-35.85%	3.41%	5.42%	-19.16%

Note: This schedule is intended to present information for ten years. Previous years' information is not available.

**CITY OF HARLINGEN WATERWORKS SYSTEM
Required Supplementary Information**

**Texas Municipal Retirement System
Schedule of Contributions
Last Ten Fiscal Years
(Unaudited)**

Fiscal Year	(1) Actuarially determined contribution	(2) Contribution in relation to the actuarially determined contribution	(3) Contribution excess (deficiency) (2)-(1)	(4) Covered employee payroll	(5) Actuarially determined contributions as a percentage of covered employee payroll (1)/(4)	(6) Contributions as a percent of coverage employee payroll (2)/(4)
2009	405,957	405,957	-	5,178,302	7.84%	7.84%
2010	353,893	353,893	-	5,030,408	7.04%	7.04%
2011	346,863	346,863	-	4,805,717	7.22%	7.22%
2012	198,737	198,737	-	4,916,937	4.04%	4.04%
2013	127,903	127,903	-	5,021,386	2.55%	2.55%
2014	117,027	117,027	-	5,261,273	2.22%	2.22%
2015	74,455	74,455	-	5,584,459	1.33%	1.33%
2016	43,964	43,964	-	6,144,250	0.72%	0.72%
2017	89,045	89,045	-	6,024,295	1.48%	1.48%
2018	113,427	113,427	-	6,078,926	1.87%	1.87%

Notes to Schedule of Contributions:

Valuation Date:

Actuarially determined contribution rates are calculated as of December 31st and become effective in January, twelve months and a day later.

Methods and Assumptions Used to Determine Contribution Rate for 2017:

Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percentage of Payroll, Closed
Remaining Amortization Period	25 years
Asset Valuation Method	10 Year smoothed market; 15% soft corridor
Inflation	2.5%
Salary Increases	3.5% to 10.50% including inflation
Investment Rate of Return	6.75%
Retirement Age	Experience-based table of rates specific to the System's plan of benefits. Last updated for the 2015 valuation pursuant to an experience study of the period 2010-2014
Mortality	RP2000 Combined Mortality Table with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% and projected on a fully generational basis with scale BB.

Other Information:

Notes There were no benefit changes during the year.

**CITY OF HARLINGEN WATERWORKS SYSTEM
Required Supplementary Information**

**Texas Municipal Retirement System
Schedule of Contributions
Last Ten Fiscal years
(Unaudited)**

Assumption differences for the fiscal years prior to 2017:

Actuarial Cost Method	Projected Unit Credit for fiscal years 2008 to 2013
Inflation	3% for fiscal years prior to 2017
Investment Rate of Return	7% for fiscal years prior to 2017
Mortality	Prior to fiscal year 2014, Gender Distinct RP2000 Combined Healthy Mortality Table projected to the year 2003 by scale AA

Other Information:

Fiscal years 2012 and forward include the impact of Senate Bill 350 enacted by the Texas Legislature in June 2011. This legislation provided a restructuring of the Texas Municipal Retirement System funds effective December 31, 2010. Previously reported amounts include only Employee Savings Fund and Municipal Accumulation Fund, but excluded the System's portion of the Current Service Annuity Fund (CSARF) in which costs for all retirees were shared. The legislation eliminated the CSARF returning both liabilities and assets for retirees to the respective employer accounts.

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**CITY OF HARLINGEN WATERWORKS SYSTEM
Required Supplementary Information**

**Schedule of Changes in the System's Retiree Health Plan Total OPEB Liability and Related Ratios
(Unaudited)**

	Measurement Year Ended 12/31/2017
Total OPEB liability:	
Service Cost	\$ 188,372
Interest (on total OPEB liability)	364,448
Changes of benefit terms	-
Difference between expected and actual experience	-
Changes of assumptions	706,447
Benefit payments	(339,430)
Net change in total OPEB liability	919,837
Total OPEB liability - beginning	9,641,083
Total OPEB liability - ending	\$ 10,560,920
Covered employee payroll	\$ 2,699,342
Net OPEB liability as a percentage of covered employee payroll	391.24%

Notes to Schedule

No assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB Statement No. 75 to pay related benefits for this OPEB.

Change of Assumptions reflects the effects of changes in the discount rate each period. The following discount rates were used in each period.

2016	3.81%
2017	3.31%

**CITY OF HARLINGEN WATERWORKS SYSTEM
Required Supplementary Information**

**Schedule of Changes in the System's Supplemental Death Benefit OPEB Liability and
Related Ratios
(Unaudited)**

	Measurement Year Ended <u>12/31/2017</u>
Total Death Benefit OPEB liability:	
Service Cost	\$ 14,385
Interest (on total OPEB liability)	17,569
Changes of benefit terms	-
Difference between expected and actual experience	-
Changes of assumptions	37,652
Benefit payments	<u>(5,394)</u>
Net change in total Death Benefit OPEB liability	64,212
Total Health Care OPEB liability - beginning	460,283
Total Health Care OPEB liability - ending	<u>\$ 524,495</u>
Covered employee payroll	\$ 5,993,680
Net Death Benefit OPEB liability as a percentage of covered employee payroll	8.75%

Notes to Schedule

No assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB Statement No. 75 to pay related benefits for this OPEB.

Change of Assumptions reflects the effects of changes in the discount rate each period. The following discount rates were used in each period.

2016	3.81%
2017	3.31%

Note: This schedule is intended to present information for ten years.

**OTHER SUPPLEMENTARY
INFORMATION**

CITY OF HARLINGEN WATERWORKS SYSTEM

Schedule of Revenues, Expenses and Charges in Net Position

Comparison of Actual to Budget

For Fiscal Year Ended September 30, 2018

	Water		Percentage Variance	Wastewater		Percentage Variance
	Actual	Budget		Actual	Budget	
Operating Revenue						
Base charge	\$ 2,947,259	\$ 2,934,000	0.45%	\$ 1,930,382	\$ 1,926,000	0.23%
Service revenues	6,212,055	5,904,000	5.22%	7,982,057	7,830,000	1.94%
Sales to Combes	111,351	96,000	15.99%	184,538	177,000	4.26%
Sales to Primera	225,305	176,800	27.43%	138,716	123,000	12.78%
Sales to Palm Valley	217,829	165,000	32.02%	-	-	-
Sales to East Rio Hondo	79,218	59,000	34.27%	-	-	-
Sales to Military Highway	1,200	1,200	0.00%	-	-	-
Fuel adjustment	262,157	242,000	8.33%	239,403	234,000	2.31%
Customer penalties	163,049	146,000	11.68%	161,293	168,000	-3.99%
Disconnect fees	206,134	197,000	4.64%	-	-	-
Industrial surcharge fees	-	-	0.00%	117,387	222,000	-47.12%
Pretreatment testing fees	-	-	0.00%	12,652	15,000	-15.65%
Other revenues	79,743	80,000	-0.32%	-	-	-
Total operating revenues	<u>10,505,300</u>	<u>10,001,000</u>	5.04%	<u>10,766,428</u>	<u>10,695,000</u>	0.67%
Operating expenses						
Personnel services	4,519,258	4,717,590	4.20%	3,863,452	3,943,752	2.04%
Contracted services	2,120,684	2,318,750	8.54%	788,987	1,062,500	25.74%
Supplies and maintenance	1,808,759	2,176,650	16.90%	1,092,852	1,158,500	5.67%
Other expenses	78,834	88,300	10.72%	71,812	77,000	6.74%
Depreciation expense	1,592,591	1,636,000	2.65%	2,408,916	2,614,000	7.85%
Total operating expenses	<u>10,120,126</u>	<u>10,937,290</u>	7.47%	<u>8,226,019</u>	<u>8,855,752</u>	7.11%
Operating income (loss)	<u>385,174</u>	<u>(936,290)</u>	141.14%	<u>2,540,409</u>	<u>1,839,248</u>	38.12%
Non-operating revenues						
Impact fees	301,371	270,000	11.62%	350,436	330,000	6.19%
Investment earnings	224,079	132,000	69.76%	221,642	132,000	67.91%
Other revenues:						
Tap fees	70,800	60,000	18.00%	19,430	15,000	29.53%
Inspection fees	4,573	2,000	128.65%	6,606	5,000	32.12%
Backflow prevention	24,125	22,000	9.66%	-	-	0.00%
Tie in charges	23,462	14,000	67.59%	17,981	11,000	63.46%
Rental income	64,724	64,500	0.35%	64,724	64,500	0.35%
Lease of water rights	80,500	-	100.00%	-	-	100.00%
Garbage billing fees	37,500	37,500	0.00%	37,500	37,500	0.00%
Work done for others	28,034	25,000	12.14%	2,501	9,000	-72.21%
Gain(loss) on disposition of assets	26,700	10,000	167.00%	15,045	5,000	200.90%
Other revenue	62,787	36,000	74.41%	146,048	126,000	15.91%
Total non-operating revenue	<u>948,655</u>	<u>673,000</u>	40.96%	<u>881,913</u>	<u>735,000</u>	19.99%
Non-operating expenses						
Interest and amortization expense	389,106	405,141	3.96%	391,408	407,503	3.95%
Change in net position before contributions	944,723	(668,431)	241.33%	3,030,914	2,166,745	39.88%
Capital contributions	240,004	-	100.00%	230,886	-	100.00%
Change in net position	<u>\$ 1,184,727</u>	<u>\$ (668,431)</u>	277.24%	<u>\$ 3,261,800</u>	<u>\$ 2,166,745</u>	50.54%

CITY OF HARLINGEN WATERWORKS SYSTEM
Schedule of Revenues, Expenses and Changes in Net Position
Comparison of Actual to Budget
For the Fiscal Year Ended September 30, 2018

	Total		Percentage Variance
	Actual	Budget	
Operating Revenue			
Base charge	\$ 4,877,641	\$ 4,860,000	0.36%
Service revenues	14,194,112	13,734,000	3.35%
Sales to Combes	295,889	273,000	8.38%
Sales to Primera	364,021	299,800	21.42%
Sales to Palm Valley	217,829	165,000	32.02%
Sales to East Rio Hondo	79,218	59,000	34.27%
Sales to Military Highway	1,200	1,200	0.00%
Fuel adjustment	501,560	476,000	5.37%
Customer penalties	324,342	314,000	3.29%
Disconnect fees	206,134	197,000	4.64%
Industrial surcharge fees	117,387	222,000	-47.12%
Pretreatment testing fees	12,652	15,000	-15.65%
Other revenues	79,743	80,000	-0.32%
Total operating revenues	<u>21,271,728</u>	<u>20,696,000</u>	2.78%
Operating expenses			
Personnel services	8,382,710	8,661,342	3.22%
Contracted services	2,909,671	3,381,250	13.95%
Supplies and maintenance	2,901,611	3,335,150	13.00%
Other expenses	150,646	165,300	8.87%
Depreciation expense	4,001,507	4,250,000	5.85%
Total operating expenses	<u>18,346,145</u>	<u>19,793,042</u>	7.31%
Operating income (loss)	<u>2,925,583</u>	<u>902,958</u>	224.00%
Non-operating revenues			
Impact fees	651,807	600,000	8.63%
Investment earnings	445,721	264,000	68.83%
Other revenues:			
Tap fees	90,230	75,000	20.31%
Inspection fees	11,179	7,000	59.70%
Backflow prevention	24,125	22,000	9.66%
Tie in charges	41,443	25,000	65.77%
Rental income	129,448	129,000	0.35%
Lease of water rights	80,500	-	100.00%
Garbage billing fees	75,000	75,000	0.00%
Work done for others	30,535	34,000	-10.19%
Gain(loss) on disposition of assets	41,745	15,000	178.30%
Other revenue	208,835	162,000	28.91%
Total non-operating revenue	<u>1,830,568</u>	<u>1,408,000</u>	30.01%
Non-operating expenses			
Interest and amortization expense	<u>780,514</u>	<u>812,644</u>	3.95%
Change in net position before contributions			
Contributions	3,975,637	1,498,314	165.34%
Capital contributions	<u>470,890</u>	<u>-</u>	100.00%
	-		
Change in net position	<u>\$ 4,446,527</u>	<u>\$ 1,498,314</u>	196.77%

CITY OF HARLINGEN WATERWORKS SYSTEM

Schedule of Revenues, Expenses and Changes in Net Position Water, Wastewater and Total System For Fiscal Year Ended September 30

	Water		Percentage Variance	Wastewater		Percentage Variance
	2018	2017		2018	2017	
Operating Revenue						
Base charge	\$ 2,947,259	\$ 2,908,137	1.35%	\$ 1,930,382	\$ 1,673,551	15.35%
Service revenues	6,212,055	6,411,877	-3.12%	7,982,057	8,201,718	-2.68%
Sales to Combes	111,351	112,361	-0.90%	184,538	215,684	-14.44%
Sales to Primera	225,305	226,938	-0.72%	138,716	124,069	11.81%
Sales to Palm Valley	217,829	216,513	0.61%	-	-	-
Sales to East Rio Hondo	79,218	48,930	61.90%	-	-	-
Sales to Military Highway	1,200	1,200	0.00%	-	-	-
Fuel adjustment	262,157	250,820	4.52%	239,403	242,169	-1.14%
Customer penalties	163,049	161,866	0.73%	161,293	170,077	-5.16%
Disconnect fees	206,134	195,435	5.47%	-	-	-
Industrial surcharge fees	-	-	-	117,387	219,266	-46.46%
Pretreatment testing fees	-	-	-	12,652	15,444	-18.08%
Other revenues	79,743	81,277	-1.89%	-	125	-100.00%
Total operating revenues	<u>10,505,300</u>	<u>10,615,354</u>	-1.04%	<u>10,766,428</u>	<u>10,862,103</u>	-0.88%
Operating expenses						
Personnel services	4,519,258	4,511,248	0.18%	3,863,452	3,664,438	5.43%
Contracted services	2,120,684	2,251,319	-5.80%	788,987	1,023,382	-22.90%
Supplies and maintenance	1,808,759	1,976,991	-8.51%	1,092,852	909,778	20.12%
Other expenses	78,834	74,480	5.85%	71,812	67,063	7.08%
Depreciation expense	1,592,591	1,573,334	1.22%	2,408,916	2,249,918	7.07%
Total operating expenses	<u>10,120,126</u>	<u>10,387,372</u>	-2.57%	<u>8,226,019</u>	<u>7,914,579</u>	3.94%
Operating income (loss)	<u>385,174</u>	<u>227,982</u>	68.95%	<u>2,540,409</u>	<u>2,947,524</u>	-13.81%
Non-operating revenues						
Impact fees	301,371	334,970	-10.03%	350,436	433,260	-19.12%
Investment earnings	224,079	104,762	113.89%	221,642	101,518	118.33%
Other revenues:						
Tap fees	70,800	69,475	1.91%	19,430	16,500	17.76%
Inspection fees	4,573	4,251	7.57%	6,606	6,584	0.33%
Backflow prevention	24,125	27,025	-10.73%	-	-	0.00%
Tie in charges	23,462	16,648	40.93%	17,981	16,947	6.10%
Rental income	64,724	64,834	-0.17%	64,724	64,834	-0.17%
Lease of water rights	80,500	151,483	-46.86%	-	-	-
Garbage billing fees	37,500	34,375	9.09%	37,500	34,375	9.09%
Work done for others	28,034	41,364	-32.23%	2,501	6,655	-62.42%
Gain(loss) on disposition of assets	26,700	13,579	96.63%	15,045	(220,646)	106.82%
Other revenue	62,787	41,147	52.59%	146,048	119,849	21.86%
Total non-operating revenue	<u>948,655</u>	<u>903,913</u>	4.95%	<u>881,913</u>	<u>579,876</u>	52.09%
Non-operating expenses						
Interest and amortization expense	389,106	326,510	19.17%	391,408	329,936	18.63%
Change in net position before contributions	<u>944,723</u>	<u>805,385</u>	17.30%	<u>3,030,914</u>	<u>3,197,464</u>	-5.21%
Capital contributions	240,004	204,131	17.57%	230,886	228,751	0.93%
Change in net position	<u>\$ 1,184,727</u>	<u>\$ 1,009,516</u>	17.36%	<u>\$ 3,261,800</u>	<u>\$ 3,426,215</u>	-4.80%

CITY OF HARLINGEN WATERWORKS SYSTEM
Schedule of Revenues, Expenses and Changes in Net Position
Water, Wastewater and Total System
For Fiscal Year Ended September 30

	Total		Percentage Variance
	2018	2017	
Operating Revenue			
Base charge	\$ 4,877,641	\$ 4,581,688	6.46%
Service revenues	14,194,112	14,613,595	-2.87%
Sales to Combes	295,889	328,045	-9.80%
Sales to Primera	364,021	351,007	3.71%
Sales to Palm Valley	217,829	216,513	0.61%
Sales to East Rio Hondo	79,218	48,930	61.90%
Sales to Military Highway	1,200	1,200	0.00%
Fuel adjustment	501,560	492,989	1.74%
Customer penalties	324,342	331,943	-2.29%
Disconnect fees	206,134	195,435	5.47%
Industrial surcharge fees	117,387	219,266	-46.46%
Pretreatment testing fees	12,652	15,444	-18.08%
Other revenues	79,743	81,402	-2.04%
Total operating revenues	<u>21,271,728</u>	<u>21,477,457</u>	-0.96%
Operating expenses			
Personnel services	8,382,710	8,175,686	2.53%
Contracted services	2,909,671	3,274,701	-11.15%
Supplies and maintenance	2,901,611	2,886,769	0.51%
Other expenses	150,646	141,543	6.43%
Depreciation expense	4,001,507	3,823,252	4.66%
Total operating expenses	<u>18,346,145</u>	<u>18,301,951</u>	0.24%
Operating income (loss)	<u>2,925,583</u>	<u>3,175,506</u>	-7.87%
Non-operating revenues			
Impact fees	651,807	768,230	-15.15%
Investment earnings	445,721	206,280	116.08%
Other revenues:			
Tap fees	90,230	85,975	4.95%
Inspection fees	11,179	10,835	3.17%
Backflow prevention	24,125	27,025	-10.73%
Tie in charges	41,443	33,595	23.36%
Rental income	129,448	129,668	-0.17%
Lease of water rights	80,500	151,483	-46.86%
Garbage billing fees	75,000	68,750	9.09%
Work done for others	30,535	48,019	-36.41%
Gain(loss) on disposition of assets	41,745	(207,067)	120.16%
Other revenue	208,835	160,996	29.71%
Total non-operating revenue	<u>1,830,568</u>	<u>1,483,789</u>	23.37%
Non-operating expenses			
Interest and amortization expense	<u>780,514</u>	<u>656,446</u>	18.90%
Change in net position before contributions			
Contributions	3,975,637	4,002,849	-0.68%
Capital contributions	<u>470,890</u>	<u>432,882</u>	8.78%
Change in net position	<u>\$ 4,446,527</u>	<u>\$ 4,435,731</u>	0.24%

STATISTICAL SECTION

**CITY OF HARLINGEN WATERWORKS SYSTEM
SCHEDULE OF REVENUE BOND COVERAGE
Last Ten Fiscal Years**

Fiscal Year	Gross Revenue	(1) Operating Expenses	Net Revenue (2) Available for Debt Service	Annual Debt Service Requirement			(3) Coverage Ratio
				Principal	Interest	Total	
2009	\$ 20,014,422	\$ 14,662,383	\$ 5,352,039	\$ 1,695,000	\$ 692,686	\$ 2,387,686	2.24
2010	17,374,281	12,771,254	4,603,027	2,120,000	632,608	2,752,608	1.67
2011	20,185,415	12,785,464	7,399,951	1,850,000	738,190	2,588,190	2.86
2012	20,802,973	13,098,103	7,704,870	1,910,000	688,990	2,598,990	2.96
2013	20,337,489	13,504,156	6,833,333	1,980,000	629,890	2,609,890	2.62
2014	19,132,562	13,804,689	5,327,873	900,000	582,309	1,482,309	3.56
2015	18,770,642	13,801,280	4,969,362	320,000	576,203	896,203	5.54
2016	20,585,693	14,688,435	5,897,258	1,455,000	787,781	2,242,781	2.63
2017	22,961,246	14,478,699	8,482,547	1,480,000	757,606	2,237,606	3.79
2018	23,102,296	14,344,638	8,757,658	1,525,000	719,106	2,244,106	3.90

(1) All gross revenues of the System

(2) Expenses of operation and maintenance of the System, including salaries, labor, materials, repairs and extensions necessary to render efficient service. Depreciation and payments into and out of the interest and sinking fund and the reserve fund are excluded.

(3) The debt service due within one year of the fiscal year end.

**CITY OF HARLINGEN WATERWORKS SYSTEM
NUMBER OF CONNECTIONS
Last Ten Fiscal Years**

WATER SYSTEM			
Fiscal Year	Active Connections	Inactive Connections	Total Connections
2009	23,446	3,774	27,220
2010	23,824	3,668	27,492
2011	24,144	3,611	27,755
2012	24,445	3,523	27,968
2013	24,592	2,766	27,358
2014	24,842	2,754	27,596
2015	25,087	2,728	27,815
2016	25,248	2,835	28,083
2017	25,624	2,789	28,413
2018	25,895	2,701	28,596

WASTEWATER SYSTEM			
Fiscal Year	Active Connections	Inactive Connections	Total Connections
2009	18,978	3,419	22,397
2010	19,226	3,187	22,413
2011	19,457	3,083	22,540
2012	19,633	3,012	22,645
2013	19,762	2,976	22,738
2014	19,687	2,900	22,587
2015	19,892	1,582	21,474
2016	20,013	1,622	21,635
2017	20,164	928	21,092
2018	20,369	918	21,287

**CITY OF HARLINGEN WATERWORKS SYSTEM
MONTHLY WATER RATES (Effective October 1, 2018)**

Base Rate: Residential and Commercial

<u>Meter Size</u>	<u>Inside City Limits</u>	<u>Outside City Limits</u>
3/4"	\$ 7.93	\$ 12.49
1"	10.07	15.09
1 1/2"	14.56	21.86
2"	33.02	49.55
3"	49.17	73.77
4"	112.87	169.32
6"	231.80	346.97
8"	426.15	639.24

Commodity Charge

(per each 1,000 gallons of water usage)

All meters	\$ 1.65	\$ 2.48
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Fuel Cost Adjustment

(per each 1,000 gallons of water usage)

All meters	\$ 0.06	\$ 0.06
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Monthly Fire Suppression Charge

<u>Meter Size</u>	
4"	\$ 5.00
6"	7.00
8"	9.00
10"	11.00
12"	13.00

**CITY OF HARLINGEN WATERWORKS SYSTEM
MONTHLY SEWER RATES (Effective October 1, 2018)**

Base Rate: Residential and Commercial

Meter Size	Inside City Limits	Outside City Limits
3/4"	\$ 6.18	\$ 20.50
1"	9.44	20.50
1 1/2"	21.41	21.41
2"	25.77	25.77
3"	52.97	52.97
4"	134.60	134.60
6"	276.08	276.08
8"	439.33	439.33

Commodity Charge

All meters	\$ 3.66	\$ 3.66
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Fuel Cost Adjustment

All meters	\$ 0.11	\$ 0.11
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**CITY OF HARLINGEN WATERWORKS SYSTEM
TOP TEN WATER CUSTOMERS**

<u>Customer</u>	<u>Type of Industry</u>	<u>Water Revenues</u>	<u>% of Total</u>	<u>Water Used (in thousands)</u>	<u>% of Total</u>
Harlingen C.I.S.D.	Education	\$ 328,905	3.13%	168,802	4.17%
City of Primera	Municipality	233,187	2.22%	136,363	3.37%
City of Palm Valley	Municipality	225,440	2.15%	131,836	3.26%
Valley Baptist Medical Center	Health Care	152,057	1.45%	80,768	2.00%
City of Combes	Municipality	131,708	1.25%	80,589	1.99%
Paradise Park	Mobile Home Park/Housing	123,486	1.18%	70,630	1.74%
East Rio Hondo Water Supply	Rural Water Supplier	82,043	0.78%	46,235	1.14%
Harlingen Medical Center	Health Care	51,498	0.49%	28,381	0.70%
Texas State Technical College	Higher Education	50,576	0.48%	22,228	0.55%
Texas Industrial Service	Laundry/Uniform Service	47,250	0.45%	26,769	0.66%
		\$ 1,426,150	13.58%	792,601	19.58%
	Total Revenues/Gallons	\$ 10,505,300		4,048,500	

**CITY OF HARLINGEN WATERWORKS SYSTEM
TOP TEN SEWER CUSTOMERS**

<u>Customer</u>	<u>Type of Industry</u>	<u>Sewer Revenues</u>	<u>% of Total</u>
Paradise Park	Mobile Home Park/Housing	\$ 269,503	2.50%
Harlingen C.I.S.D	Education	255,295	2.37%
Valley Baptist Medical Center	Health Care	253,653	2.36%
City of Combes	Municipality	201,859	1.87%
City of Primera	Municipality	148,375	1.38%
Texas Industrial Service	Laundry/Uniform Service	101,245	0.94%
Harlingen Medical Center	Health Care	88,310	0.82%
Valco Chemical Co.	Industrial	86,023	0.80%
East Rio Hondo Water Supply	Rural Water Supply	70,954	0.66%
Rosemont of Highland Gardens	Housing	62,922	0.58%
		\$ 1,538,139	14.29%
	Total Wastewater Revenue	\$ 10,766,428	

**CITY OF HARLINEN WATERWORKS SYSTEM
HISTORICAL WATER PUMPAGE VOLUME - RAW WATER**

Fiscal Year Ended 9/30	Daily Average (millions)	Peak Day (millions)	Peak Month (millions)	Total Annual Usage (millions)	Paid To Irrigation District
2009	14.0	24.1	600.3	5,139.2	\$ 813,168
2010	11.6	20.3	429.7	4,643.2	673,276
2011	13.6	20.5	530.7	4,961.4	839,973
2012	14.1	23.6	543.7	5,156.6	956,142
2013	13.9	20.5	484.4	5,079.7	1,052,773
2014	12.9	21.1	561.6	4,709.0	991,612
2015	12.0	22.0	520.1	4,376.5	1,010,833
2016	13.2	22.2	561.4	4,838.9	1,154,384
2017	14.1	20.6	517.0	5,143.0	1,214,127
2018	13.6	23.1	529.0	4,968.0	1,165,861

**CITY OF HARLINGEN WATERWORKS SYSTEM
HISTORICAL WATER PUMPAGE VOLUME - HIGH SERVICE**

Fiscal Year Ended 9/30	Daily Average (millions)	Peak Day (millions)	Peak Month (millions)	Total Annual Usage (millions)	Water Revenue
2009	13.1	20.3	545.5	4,788.3	\$ 8,775,579
2010	10.3	14.8	379.2	3,761.2	7,465,844
2011	13.0	17.1	503.1	4,733.9	9,026,782
2012	13.3	23.6	503.5	4,878.5	9,274,968
2013	13.1	19.7	453.7	4,786.9	8,873,457
2014	12.0	20.4	541.7	4,393.4	8,288,521
2015	11.6	20.7	513.2	4,230.5	8,255,106
2016	12.9	22.5	549.2	4,724.5	9,338,805
2017	13.9	19.9	499.0	5,058.0	10,615,354
2018	13.3	21.2	518.0	4,865.0	10,505,300

**CITY OF HARLIEN WATERWORKS SYSTEM
HISTORICAL WASTEWATER TREATMENT VOLUME**

Fiscal Year Ended 9/30	Daily Average (millions)	Monthly Average (millions)	Total Annual Usage (millions)	Sewer Revenue
2009	6.4	193.5	2,321.7	\$ 9,304,795
2010	6.2	189.5	2,274.6	8,835,245
2011	6.2	189.7	2,276.4	10,109,783
2012	5.8	175.6	2,107.0	10,332,777
2013	5.7	171.8	2,061.4	10,009,046
2014	5.8	174.9	2,099.0	9,431,250
2015	6.1	186.7	2,240.1	9,329,251
2016	6.0	182.9	2,378.3	10,084,472
2017	5.6	168.8	2,357.5	10,862,103
2018	5.4	163.6	2,347.1	10,766,428

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COMPLIANCE SECTION

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the City of Harlingen
Waterworks System Board of Trustees

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the City of Harlingen Waterworks System, as of and for the year ended September 30, 2018, and the related notes to the financial statements, which collectively comprise the City of Harlingen Waterworks System's basic financial statements, and have issued our report thereon dated March 29, 2019

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Harlingen Waterworks System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Harlingen Waterworks System's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Harlingen Waterworks System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Harlingen Waterworks System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Carr, Riggs & Ingram, L.L.C.

Harlingen, Texas
March 29, 2019