

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**HARRIS COUNTY, TEXAS**  
**ANNUAL FINANCIAL REPORT**  
**DECEMBER 31, 2011**

**McCALL GIBSON SWEDLUND BARFOOT, PLLC**  
Certified Public Accountants

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**

**HARRIS COUNTY, TEXAS**

**ANNUAL FINANCIAL REPORT**

**DECEMBER 31, 2011**

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Board of Directors  
Houston Ship Channel Security District  
Harris County, Texas

## Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities and major fund of Houston Ship Channel Security District (the "District"), as of and for the year ended December 31, 2011, which collectively comprise the District's basic financial statements as listed in the preceding table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We have conducted our audit in accordance with auditing standards generally accepted within the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and major fund of the District as of December 31, 2011, and the respective changes in financial position for the inception period then ended in conformity with accounting principles generally accepted in the United States of America.

Board of Directors  
Houston Ship Channel Security District

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis on pages 3 through 6 and the Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual – General Fund on page 20 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.

Our audit was conducted for the purpose of forming opinions on the financial statements as a whole. The supplementary information required by the Texas Commission on Environmental Quality as published in the *Water District Financial Management Guide* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The supplementary information, excluding that portion marked "Unaudited" on which we express no opinion or provide any assurance, has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



McCall Gibson Swedlund Barfoot PLLC  
Certified Public Accountants

August 14, 2012

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

Our discussion and analysis of Houston Ship Channel Security District's (the "District") financial performance provides an overview of the District's financial activities for the year ended December 31, 2011. Please read it in conjunction with the District's financial statements, which begin on page 7.

**USING THIS ANNUAL REPORT**

This report consists of a series of financial statements. The basic financial statements include: (1) combined fund financial statements and government-wide financial statements and (2) notes to the financial statements. The combined fund financial statements and government-wide financial statements combine both: (1) the Statement of Net Assets and Governmental Funds Balance Sheet and (2) the Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balances. This report also includes other supplementary information in addition to the basic financial statements.

**GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The District's report includes two financial statements combining the government-wide financial statements and the fund financial statements. The government-wide portion of these statements provides both long-term and short-term information about the District's overall status. Financial reporting at this level uses a perspective similar to that found in the private sector with its basis in full accrual accounting and elimination or reclassification of internal activities.

The first of the government-wide statements is the Statement of Net Assets. This information is found in the Statement of Net Assets column on page 7. The Statement of Net Assets is the District-wide statement of its financial position presenting information that includes all of the District's assets and liabilities, with the difference reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District as a whole is improving or deteriorating. Evaluation of the overall health of the District would extend to other non-financial factors.

The government-wide portion of Statement of Activities on page 9 reports how the District's net assets changed during the fiscal year. All current year revenues and expenses are included regardless of when cash is received or paid.

**FUND FINANCIAL STATEMENTS**

The combined statements also include fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District has one governmental fund type. The General Fund accounts for resources not accounted for in another fund, assessment and contract revenues, costs and general expenditures.

See accompanying independent auditor's report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

**FUND FINANCIAL STATEMENTS (Continued)**

Governmental funds are reported in each of the financial statements. The focus in the fund statements provides a distinctive view of the District's governmental funds. These statements report short-term fiscal accountability focusing on the use of spendable resources and balances of spendable resources available at the end of the fiscal year. They are useful in evaluating annual financing requirements of the District and the commitment of spendable resources for the near-term.

Since the government-wide focus includes the long-term view, comparisons between these two perspectives may provide insight into the long-term impact of short-term financing decisions. The adjustments columns, the Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets and the Reconciliation of the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities on pages 8 and 10 explain the differences between the two presentations and assist in understanding the differences between these two perspectives.

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

The accompanying notes to the basic financial statements provide information essential to a full understanding of the government-wide and fund financial statements. The notes to the basic financial statements can be found on pages 11 through 18 in this report.

**OTHER INFORMATION**

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information ("RSI"). A budgetary comparison schedule is included as RSI for the General Fund.

**GOVERNMENT-WIDE FINANCIAL ANALYSIS**

Net assets may serve over time as a useful indicator of the District's financial position. In the case of the District, assets exceeded liabilities by \$4,453,518 as of December 31, 2011.

The following is a comparative analysis of the Statement of Net Assets as December 31, 2011 and December 31, 2010:

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

**GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)**

	Summary of the Statement of Net Assets		
	2011	2010	Change Positive (Negative)
Cash	\$ 4,016,206	\$ 3,995,143	\$ 21,063
Accounts Receivable	<u>726,284</u>	<u>590,363</u>	<u>135,921</u>
Total Assets	<u>\$ 4,742,490</u>	<u>\$ 4,585,506</u>	<u>\$ 156,984</u>
Accounts Payable and Accrued Expenses	\$ 198,972	\$ 50,522	\$ (148,450)
Deferred Contract Revenue	<u>90,000</u>	<u>75,000</u>	<u>(15,000)</u>
Total Liabilities	<u>\$ 288,972</u>	<u>\$ 125,522</u>	<u>\$ (163,450)</u>
Net Assets:			
Unrestricted	<u>\$ 4,453,518</u>	<u>\$ 4,459,984</u>	<u>\$ (6,466)</u>
Total Net Assets	<u>\$ 4,453,518</u>	<u>\$ 4,459,984</u>	<u>\$ (6,466)</u>

The following table provides a summary of the District's operations for the years ended December 31, 2011 and the inception period ended December 31, 2010. The District's net assets decreased by \$6,466 during the current fiscal year.

	Summary of the Statement of Activities		
	2011	2010	Change Positive (Negative)
Revenues:			
Assessment Revenues	\$ 4,445,000	\$ 4,445,000	\$
Other Revenues	<u>160,259</u>	<u>124,903</u>	<u>35,356</u>
Total Revenues	\$ 4,605,259	\$ 4,569,903	\$ 35,356
Expenses for Services	<u>4,611,725</u>	<u>109,919</u>	<u>(4,501,806)</u>
Change in Net Assets	\$ (6,466)	\$ 4,459,984	\$ (4,466,450)
Net Assets, Beginning of Year	<u>4,459,984</u>	<u>-0-</u>	<u>4,459,984</u>
Net Assets, End of Year	<u>\$ 4,453,518</u>	<u>\$ 4,459,984</u>	<u>\$ (6,466)</u>

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

**FINANCIAL ANALYSIS OF THE DISTRICT'S GOVERNMENTAL FUNDS**

The District's General Fund fund balance was \$4,453,518, as of December 31, 2011, an increase of \$58,097 from the previous period, which was primarily due to assessment and contract revenues exceeding operating expenditures.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The Board of Directors did not amend the budget during the current fiscal year. The budget for the fiscal year was approved on November 29, 2011. Actual revenue was \$73,972 more than budgeted revenue primarily due to higher assessment revenues than were budgeted. Total expenditures were \$359,407 less than budgeted expenditures primarily due to the refund of grant matching funds. See the budget to actual comparison on page 20.

**CAPITAL ASSETS**

The District has not acquired capital assets as of December 31, 2011.

**LONG-TERM DEBT ACTIVITY**

The District does not have long-term debt as of December 31, 2011.

**CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT**

This financial report is designed to provide a general overview of the Houston Ship Channel Security District's finances for anyone with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Houston Ship Channel Security District, 111 East Loop North, Houston, TX 77029.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
STATEMENT OF NET ASSETS AND  
GOVERNMENTAL FUNDS BALANCE SHEET  
DECEMBER 31, 2011**

	General Fund	Adjustments	Statement of Net Assets
<b>ASSETS</b>			
Cash, Note 3	\$ 4,016,206	\$	\$ 4,016,206
Accounts Receivable:			
Assessments Receivable, Net of Allowance for Doubtful Assessments of \$-0-	15,000		15,000
Penalty and Interest on Delinquent Assessments	2,140		2,140
Port of Houston Authority, Note 7	150,000		150,000
Harris County, Texas, Note 6	559,144		559,144
<b>TOTAL ASSETS</b>	<b>\$ 4,742,490</b>	<b>\$ -0-</b>	<b>\$ 4,742,490</b>
<b>LIABILITIES</b>			
Accounts Payable	\$ 198,972	\$	\$ 198,972
Deferred Revenues:			
Contract Revenue	90,000		90,000
<b>TOTAL LIABILITIES</b>	<b>\$ 288,972</b>	<b>\$ -0-</b>	<b>\$ 288,972</b>
<b>FUND BALANCE/NET ASSETS</b>			
<b>FUND BALANCE</b>			
Unassigned	\$ 4,453,518	\$ (4,453,518)	\$ -0-
<b>TOTAL FUND BALANCE</b>	<b>\$ 4,453,518</b>	<b>\$ (4,453,518)</b>	<b>\$ -0-</b>
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<b>\$ 4,742,490</b>		
<b>NET ASSETS</b>			
Unrestricted		\$ 4,453,518	\$ 4,453,518
<b>TOTAL NET ASSETS</b>		<b>\$ 4,453,518</b>	<b>\$ 4,453,518</b>

The accompanying notes to basic financial  
statements are an integral part of this report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF NET ASSETS  
DECEMBER 31, 2011**

Total Fund Balance – Governmental Fund \$ 4,453,518

Amounts reported for governmental activities in the Statement of Net Assets  
are different because:

No adjustments were required this year to reconcile governmental funds with  
net assets.

Total Net Assets – Governmental Activities \$ 4,453,518

The accompanying notes to basic financial  
statements are an integral part of this report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES,  
EXPENDITURES AND CHANGES IN FUND BALANCES  
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>General Fund</u>	<u>Adjustments</u>	<u>Statement of Activities</u>
<b>REVENUES</b>			
Assessment Revenue, Note 4	\$ 4,505,000	\$ (60,000)	\$ 4,445,000
Penalty and Interest	22,222	(4,563)	17,659
Contract Revenue	135,000		135,000
Investment Revenues	7,440		7,440
Miscellaneous Revenues	<u>160</u>		<u>160</u>
<b>TOTAL REVENUES</b>	<u>\$ 4,669,822</u>	<u>\$ (64,563)</u>	<u>\$ 4,605,259</u>
<b>EXPENDITURES/EXPENSES</b>			
Service Operations:			
Professional Fees	\$ 112,582	\$	\$ 112,582
Contracted Services, Note 5	106,556		106,556
Grant Matching Funds, Note 6	4,127,509		4,127,509
Grant Operations and Maintenance, Note 6	236,446		236,446
Administrative	<u>28,632</u>		<u>28,632</u>
<b>TOTAL EXPENDITURES/EXPENSES</b>	<u>\$ 4,611,725</u>	<u>\$ -0-</u>	<u>\$ 4,611,725</u>
<b>NET CHANGE IN FUND BALANCE</b>	\$ 58,097	\$ (58,097)	\$
<b>CHANGE IN NET ASSETS</b>		(6,466)	(6,466)
<b>FUND BALANCE/NET ASSETS – JANUARY 1, 2011</b>	<u>4,395,421</u>	<u>64,563</u>	<u>4,459,984</u>
<b>FUND BALANCE/NET ASSETS – DECEMBER 31, 2011</b>	<u>\$ 4,453,518</u>	<u>\$ -0-</u>	<u>\$ 4,453,518</u>

The accompanying notes to basic financial statements are an integral part of this report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF  
REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES  
TO THE STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED DECEMBER 31, 2011**

Change in Fund Balance - Governmental Fund	\$ 58,097
<p>Amounts reported for governmental activities in the Statement of Activities are different because:</p>	
<p>Governmental funds report assessment revenue when it is collected. However, in the Statement of Activities, revenue is recorded when the assessments are assessed.</p>	(60,000)
<p>Governmental funds report penalties and interest revenue on assessments when it is collected. However, in the Statement of Activities, revenue for the current year is recorded when the penalties are assessed.</p>	<u>(4,563)</u>
Change in Net Assets - Governmental Activities	<u>\$ (6,466)</u>

The accompanying notes to basic financial statements are an integral part of this report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 1. CREATION OF DISTRICT**

Houston Ship Channel Security District (the "District") was created by an order dated June 9, 2009, of the Commissioners Court of Harris County, Texas, in accordance with Chapter 68 of the Texas Water Code. This action was authorized by the Texas Legislature under provision of House Bill No. 3011, Chapter 913, of the 80<sup>th</sup> Legislature effective June 15, 2007. The District is empowered to provide security projects and security services which encompass an integrated security strategy and an increased level of security on both the waterside and landside exposures of sites within the District boundaries. The projects and services are intended to increase preparedness and responses needed to address potential threats. The District is located wholly within Harris County and includes more than 100 refinery, chemical and marine facilities. The Board of Directors held its first meeting on January 27, 2010.

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES**

The accompanying basic financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board ("GASB").

The GASB has established the criteria for determining whether or not a given entity is a component unit. The criteria are: (1) is the potential component unit a legally separate entity, (2) does the primary government appoint a voting majority of the potential component unit's board, (3) is the primary government able to impose its will on the potential component unit, (4) is there a financial benefit or burden relationship. The District was created as an independent municipality. The District does not meet the criteria for inclusion as a component unit of any entity.

Financial Statement Presentation

These financial statements have been prepared in accordance with GASB Codification of Governmental Accounting and Financial Reporting Standards Part II, Financial Reporting.

The GASB Codification sets forth standards for external financial reporting for all state and local government entities, which include a requirement for a Statement of Net Assets and a Statement of Activities. It requires the classification of net assets into three components: Invested in Capital Assets, Net of Related Debt; Restricted; and Unrestricted. These classifications are defined as follows:

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Financial Statement Presentation (Continued)

- Invested in Capital Assets, Net of Related Debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvements of those assets.
- Restricted Net Assets – This component of net assets consists of external constraints placed on the use of net assets imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted Net Assets – This component of net assets consists of net assets that do not meet the definition of “Restricted” or “Invested in Capital Assets, Net of Related Debt.”

When both restricted and unrestricted resources are available for use, generally it is the District’s policy to use restricted resources first.

Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities display information about the District as a whole. The District’s Statement of Net Assets and Statement of Activities are combined with the governmental fund financial statements. The District is viewed as a special-purpose government and has the option of combining these financial statements.

The Statement of Net Assets is reported by adjusting the governmental fund types to report on the full accrual basis, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. Any amounts recorded due to and due from other funds are eliminated in the Statement of Net Assets.

The Statement of Activities is reported by adjusting the governmental fund types to report only items related to current year revenues and expenditures. Items such as capital outlay are allocated over their estimated useful lives as depreciation expense. Internal activities between governmental funds, if any, are eliminated by adjustment to obtain net total revenue and expense of the governmental-wide Statement of Activities.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Fund Financial Statements

As discussed above, the District's fund financial statements are combined with the government-wide statements. The fund statements include a Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances.

Governmental Funds

The District has one major governmental fund.

General Fund - To account for resources not required to be accounted for in another fund, assessment and contract revenues, costs and general expenditures.

Basis of Accounting

The District uses the modified accrual basis of accounting for governmental fund types. The modified accrual basis of accounting recognizes revenues when both "measurable and available." Measurable means the amount can be determined. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The District considers revenue reported in governmental funds to be available if they are collectible within 60 days after year end. Also, under the modified accrual basis of accounting, expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, which are recognized as expenditures when payment is due.

Annual assessments considered available by the District and included in fund revenue include 2011 assessments collected during the period August 10, 2011 to December 31, 2011, and 2010 assessments collected from March 28, 2010, to December 31, 2011.

Budgeting

In compliance with governmental accounting principles, the Board of Directors annually adopts an unappropriated budget for the General Fund. The budget for the fiscal year was approved on November 29, 2011. The budget was not amended during the current fiscal year.

Pensions

A pension plan has not been established. The District does not have employees.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Measurement Focus

Measurement focus is a term used to describe which transactions are recognized within the various financial statements. In the government-wide Statement of Net Assets and Statement of Activities, the governmental activities are presented using the economic resources measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets, financial position, and cash flows. All assets and liabilities associated with the activities are reported. Fund equity is classified as net assets.

Governmental fund types are accounted for on a spending or financial flow measurement focus. Accordingly, only current assets and current liabilities are included on the Balance Sheet, and the reported fund balances provide an indication of available spendable or appropriable resources. Operating statements of governmental fund types report increases and decreases in available spendable resources.

Fund Balances

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund-type Definitions*, requires the classification of fund balances in governmental funds using the following hierarchy:

*Nonspendable*: amounts that cannot be spent either because they are in nonspendable form or because they are legally or contractually required to be maintained intact. The District does not have any nonspendable fund balances.

*Restricted*: amounts that can be spent only for specific purposes because of constitutional provisions, or enabling legislation, or because of constraints that are imposed externally. The District does not have any restricted fund balances.

*Committed*: amounts that can be spent only for purposes determined by a formal action of the Board of Directors. The Board is the highest level of decision-making authority for the District. This action must be made no later than the end of the fiscal year. Commitments may be established, modified, or rescinded only through ordinances or resolutions approved by the Board. The District does not have any committed fund balances.

*Assigned*: amounts that do not meet the criteria to be classified as restricted or committed, but that are intended to be used for specific purposes. The District has not adopted a formal policy regarding the assignment of fund balances and does not have any assigned fund balances.

*Unassigned*: all other spendable amounts in the General Fund.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Fund Balances (Continued)

When expenditures are incurred for which restricted, committed, assigned or unassigned fund balances are available, the District considers amounts to have been spent first out of restricted funds, then committed funds, then assigned funds, and finally unassigned funds.

Accounting 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 the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Subsequent Events

In preparing these financial statements, management has evaluated and disclosed all material subsequent events through August 14, 2012, which is the date these statements were available to be issued.

**NOTE 3. DEPOSITS AND INVESTMENTS**

Deposits

Custodial Credit Risk is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The District's deposit policy for custodial credit risk requires compliance with the provisions of Texas statutes.

Texas statutes require that any cash balance in any fund shall, to the extent not insured by the Federal Deposit Insurance Corporation or its successor, be continuously secured by a valid pledge to the District of securities eligible under the laws of Texas to secure the funds of the District, having an aggregate market value, including accrued interest, at all times equal to the uninsured cash balance in the fund to which such securities are pledged. At fiscal year end, the carrying amount of the District's deposits was \$4,016,206 and the bank balance was \$4,016,206. Of the bank balance, \$1,085,181 was covered by federal depository insurance and the balance was covered by the pledge of securities held in safekeeping by a third-party institution in the District's name.

The carrying values of the deposits are included in the Governmental Funds Balance Sheet and the Statement of Net Assets at December 31, 2011, as listed below:

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 3. DEPOSITS AND INVESTMENTS (Continued)**

Deposits (Continued)

	Cash
GENERAL FUND	\$ 4,016,206

Investments

Under Texas law, the District is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity and that address investment diversification, yield, maturity, and the quality and capability of investment management, and all District funds must be invested in accordance with the following investment objectives: understanding the suitability of the investment to the District's financial requirements, first; preservation and safety of principal, second; liquidity, third; marketability of the investments if the need arises to liquidate the investment before maturity, fourth; diversification of the investment portfolio, fifth; and yield, sixth. The District's investments must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." No person may invest District funds without express written authority from the Board of Directors.

Texas statutes include specifications for and limitations applicable to the District and its authority to purchase investments as defined in the Public Funds Investment Act. Authorized investments are summarized as follows: (1) obligations of the United States or its agencies and instrumentalities, (2) direct obligations of the State of Texas or its agencies and instrumentalities, (3) certain collateralized mortgage obligations, (4) other obligations, the principal of and interest on which are unconditionally guaranteed or insured by the State of Texas or the United States or its agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States, (5) certain A rated or higher obligations of states, agencies, counties, cities, and other political subdivisions of any state, (6) bonds issued, assumed or guaranteed by the State of Israel, (7) insured or collateralized certificates of deposit, (8) certain fully collateralized repurchase agreements secured by delivery, (9) certain bankers' acceptances with limitations, (10) commercial paper rated A-1 or P-1 or higher and a maturity of 270 days or less, (11) no-load money market mutual funds and no-load mutual funds with limitations, (12) certain guaranteed investment contracts, (13) certain qualified governmental investment pools and (14) a qualified securities lending program.

As of December 31, 2011, the District had no investments.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 4. ASSESSMENTS**

In accordance with Chapter 68, Texas Water Code, the District may impose an assessment against facilities within its boundaries for any District purpose. On July 8, 2010, the District held a public hearing on its proposed initial plan of assessment. On August 17, 2010, the District adopted a resolution, dated effective September 20, 2010, adopting such plan of assessment. The plan of assessment allows facilities to pay their respective assessments in equal installments over a three year period, and all assessments installment payments not paid before November 1 of the year in which the statement is received shall become delinquent on that date and there shall be added thereto such penalties, interest, expenses of collection, attorneys' fees and other costs and expenses as are permitted by law.

For the 2011 fiscal year, \$4,445,000 of assessment installment payments were due. At the fiscal year end, \$4,430,000 of the assessment was collected. Subsequent to year end, all delinquent assessments were collected.

**NOTE 5. AGREEMENT FOR ADMINISTRATIVE SERVICES**

On August 17, 2010, the District executed a contract with the Greater Houston Port Bureau, Inc. (the "Bureau"). The contract provides for administrative services to be performed by the Bureau on behalf of the District. The Bureau is also to provide office space and necessary amenities. Unless terminated by either party, the contract will remain in effect indefinitely.

The District will compensate the Bureau monthly at an hourly rate of \$125 for the first 48 hours and \$75 per hour for additional hours in any given month. Office costs will be reimbursed by the District to the Bureau with no single cost exceeding \$200 nor any aggregation of costs exceeding \$500 in one week. During the current fiscal year, the District paid the Bureau \$106,556 for administrative services and related costs.

**NOTE 6. AGREEMENT TO PROVIDE FINANCIAL ASSISTANCE**

On March 8, 2011, the District entered into an agreement with Harris County, Texas (the "County"). The District is to provide financial assistance through assessments received from facilities to defray local matching requirements for federal grants received by the County, and a portion of operations and maintenance costs related to the security projects.

Pursuant to the agreement, the County will own, staff, operate and maintain the security project. Payments will be made to the County by the District as requested by the County. During the current fiscal year, the District paid the County \$4,127,509 in grant matching funds and \$236,446 for grant operations and maintenance costs. The grant matching funds expenditures are net of \$552,764 returned to the District, which was previously paid to the County for items which were not purchased as planned. The total amount recorded in the current fiscal year was \$559,144 including interest of \$6,380.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011**

**NOTE 6.      AGREEMENT TO PROVIDE FINANCIAL ASSISTANCE (Continued)**

The contract term is from March 8, 2011 through December 31, 2012. The contract may be terminated by either party upon default by the other party or for convenience, and without cause or default by the other party.

**NOTE 7.      AGREEMENT WITH PORT OF HOUSTON AUTHORITY OF HARRIS COUNTY, TEXAS**

On July 1, 2010, the District executed an agreement with the Port of Houston Authority of Harris County, Texas (the "Authority"). The agreement was for a period of one year and included a payment to the District by the Authority of \$150,000. On November 9, 2011, the District executed a second agreement with the Authority. The agreement is for the period July 1, 2011 to September 30, 2012, and calls for a payment to the District by the Authority of \$150,000. This payment was received subsequent to year end, on January 10, 2012. As a governmental agency, the Authority is excluded from the District by the Texas Water Code and thus exempt from the assessment imposed by the District. In support of the District and in lieu of an assessment, the Port Authority voluntarily contributes funds for authorized and approved costs of the District. This agreement may be terminated upon default by either party.

**NOTE 8.      RISK MANAGEMENT**

The District's Board of Directors is exposed to risks of claims under its errors and omissions policy. The District carries commercial insurance to provide errors and omissions coverage.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**

**REQUIRED SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2011**

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF REVENUES, EXPENDITURES AND  
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL - GENERAL FUND  
FOR THE YEAR ENDED DECEMBER 31, 2011**

	Original and Final Budget	Actual	Variance Positive (Negative)
<b>REVENUES</b>			
Assessment Revenue	\$ 4,445,000	\$ 4,505,000	\$ 60,000
Penalty and Interest		22,222	22,222
Contract Revenue	150,000	135,000	(15,000)
Investment Revenues	850	7,440	6,590
Miscellaneous Revenues		<u>160</u>	<u>160</u>
<b>TOTAL REVENUES</b>	<u>\$ 4,595,850</u>	<u>\$ 4,669,822</u>	<u>\$ 73,972</u>
<b>EXPENDITURES</b>			
Service Operations:			
Professional Fees	\$ 107,000	\$ 112,582	\$ (5,582)
Contracted Services	110,300	106,556	3,744
Grant Matching Funds	4,680,272	4,127,509	552,763
Grant Operations and Maintenance	57,000	236,446	(179,446)
Administrative	<u>16,560</u>	<u>28,632</u>	<u>(12,072)</u>
<b>TOTAL EXPENDITURES</b>	<u>\$ 4,971,132</u>	<u>\$ 4,611,725</u>	<u>\$ 359,407</u>
<b>NET CHANGE IN FUND BALANCE</b>	\$ (375,282)	\$ 58,097	\$ 433,379
<b>FUND BALANCE – JANAUARY 1, 2011</b>	<u>4,395,421</u>	<u>4,395,421</u>	
<b>FUND BALANCE – DECEMBER 31, 2011</b>	<u>\$ 4,020,139</u>	<u>\$ 4,453,518</u>	<u>\$ 433,379</u>

See accompanying independent auditor's report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT**  
**OTHER SUPPLEMENTARY INFORMATION**  
**DECEMBER 31, 2011**

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
GENERAL FUND EXPENDITURES  
FOR THE YEAR ENDED DECEMBER 31, 2011**

PROFESSIONAL FEES:	
Auditing	\$ 8,500
Legal	<u>104,082</u>
TOTAL PROFESSIONAL FEES	<u>\$ 112,582</u>
CONTRACTED SERVICES	
Administrator	<u>\$ 106,556</u>
GRANT MATCHING FUNDS	<u>\$ 4,127,509</u>
GRANT OPERATIONS AND MAINTENANCE	<u>\$ 236,446</u>
ADMINISTRATIVE EXPENDITURES:	
Advertising	\$ 1,590
Telephone	801
Insurance	8,237
Board Meetings	4,626
Office Supplies	1,528
Postage	1,883
Travel and Entertainment	1,204
Other	<u>8,763</u>
TOTAL ADMINISTRATIVE EXPENDITURES	<u>\$ 28,632</u>
TOTAL EXPENDITURES	<u>\$ 4,611,725</u>

See accompanying independent auditor's report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
 CHANGES IN ASSESSMENTS RECEIVABLE  
 FOR THE YEAR ENDED DECEMBER 31, 2011**

	Assessments	
ASSESSMENTS RECEIVABLE –		
JANUARY 1, 2011	\$ 575,000	
Adjustments to Beginning Balance		\$ 575,000
Original 2011 Assessment Levy	\$ 4,445,000	
Adjustment to 2011 Assessment Levy		4,445,000
TOTAL TO BE ACCOUNTED FOR		\$ 5,020,000
ASSESSMENT COLLECTIONS:		
Prior Years	\$ 575,000	
Current Year	4,430,000	5,005,000
ASSESSMENTS RECEIVABLE –		
DECEMBER 31, 2011		\$ 15,000
ASSESSMENTS RECEIVABLE BY YEAR:		
2011		\$ 15,000
TOTAL		\$ 15,000

See accompanying independent auditor's report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
COMPARATIVE SCHEDULE OF REVENUES AND EXPENDITURES  
GENERAL FUND - FIVE YEARS**

	<u>Amounts</u>		
	<u>2011</u>	<u>2010*</u>	<u>2009</u>
<b>REVENUES</b>			
Assessment Revenue	\$ 4,505,000	\$ 4,385,000	\$
Penalty and Interest	22,222	44,500	
Contract Revenue	135,000	75,000	
Investment Revenues	7,440		
Miscellaneous Revenues	<u>160</u>	<u>840</u>	<u>          </u>
<b>TOTAL REVENUES</b>	<u>\$ 4,669,822</u>	<u>\$ 4,505,340</u>	<u>\$          </u>
<b>EXPENDITURES</b>			
Professional Fees	\$ 112,582	\$ 37,497	\$
Contracted Services	106,556	54,461	
Grant Matching Funds	4,127,509		
Grant Operations and Maintenance	236,446		
Administrative	<u>28,632</u>	<u>17,961</u>	<u>          </u>
<b>TOTAL EXPENDITURES</b>	<u>\$ 4,611,725</u>	<u>\$ 109,919</u>	<u>\$          </u>
<b>NET CHANGE IN FUND BALANCE</b>	\$ 58,097	\$ 4,395,421	\$
<b>BEGINNING FUND BALANCE</b>	<u>4,395,421</u>	<u>-0-</u>	<u>          </u>
<b>ENDING FUND BALANCE</b>	<u>\$ 4,453,518</u>	<u>\$ 4,395,421</u>	<u>\$ N/A</u>

\* First audit was for the inception period ended December 31, 2010.

See accompanying independent auditor's report.

		Percent of Total Revenues				
<u>2008</u>	<u>2007</u>	<u>2011</u>	<u>2010*</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
\$	\$	96.5%	97.3%			
		0.5	1.0			
		2.9	1.7			
		0.1				
\$	\$	<u>100.0%</u>	<u>100.0%</u>			
\$	\$	2.4%	0.8%			
		2.3	1.2			
		88.4				
		5.1				
		<u>0.6</u>	<u>0.4</u>			
\$	\$	<u>98.8%</u>	<u>2.4%</u>			
\$	\$	<u>1.2%</u>	<u>97.6%</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>
\$	\$	<u>N/A</u>	<u>N/A</u>			

See accompanying independent auditor's report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
BOARD MEMBERS, KEY PERSONNEL AND CONSULTANTS  
DECEMBER 31, 2011**

District Mailing Address - Houston Ship Channel Security District  
111 East Loop North  
Houston, TX 77029

District Telephone Number - (713) 671-0947

<b>Board Members</b>	<u>Term of Office (All are Appointed)</u>	<u>Fees of Office for the year ended December 31, 2011</u>	<u>Expense Reimbursements for the year ended December 31, 2011</u>	<u>Title</u>
Robin C. Riley	09/2009 – 01/2012	\$ -0-	\$ 465	Chairperson
Tom Schroeter	01/2011 – 01/2013	\$ -0-	\$ 399	Secretary
Clayton Curtis	01/2010 – 01/2012	\$ -0-	\$ -0-	Treasurer
Richard L. Henderson	01/2011 – 01/2013	\$ -0-	\$ 71	Director
Charles King, Jr.	10/2011 – 01/2013	\$ -0-	\$ -0-	Director
Lawrence Waldron	01/2010 – 01/2012	\$ -0-	\$ -0-	Director
Raymond V. Yellig	01/2011 – 01/2013	\$ -0-	\$ -0-	Director
Beth Bowles	01/2010 – 01/2012	\$ -0-	\$ -0-	Director
Steve Stewart	07/2009 – 01/2012	\$ -0-	\$ 50	Director
Gary Scheibe	01/2011 – 01/2013	\$ -0-	\$ -0-	Director

See accompanying independent auditor's report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT  
BOARD MEMBERS, KEY PERSONNEL AND CONSULTANTS  
DECEMBER 31, 2011**

<u>Consultants:</u>	<u>Date Hired</u>	<u>Fees for the year ended December 31, 2011</u>	<u>Title</u>
Schwartz, Page & Harding, L.L.P 1300 Post Oak, Blvd., Suite 1400 Houston, TX 77056-3078	06/25/10	\$ 104,082	Attorney
McCall Gibson Swedlund Barfoot PLLC 13100 Wortham Center Drive Suite 235 Houston, TX 77065	09/13/11	\$ 8,500	Auditor
Greater Houston Port Bureau, Inc. 111 East Loop North Houston, TX 77029	08/17/10	\$ 106,556	Administrator

See accompanying independent auditor's report.