

HOUSTON SHIP CHANNEL SECURITY DISTRICT

HARRIS COUNTY, TEXAS

ANNUAL FINANCIAL REPORT

DECEMBER 31, 2012

DRAFT SUBJECT TO CHANGE

HOUSTON SHIP CHANNEL SECURITY DISTRICT
HARRIS COUNTY, TEXAS
ANNUAL FINANCIAL REPORT
DECEMBER 31, 2012

TABLE OF CONTENTS

	<u>PAGE</u>
INDEPENDENT AUDITOR'S REPORT	1-2
MANAGEMENT'S DISCUSSION AND ANALYSIS	3-6
STATEMENT OF NET POSITION AND GOVERNMENTAL FUNDS BALANCE SHEET	7
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET POSITION	8
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES	9
RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES	10
NOTES TO THE FINANCIAL STATEMENTS	11-19
REQUIRED SUPPLEMENTARY INFORMATION	
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE-BUDGET AND ACTUAL-GENERAL FUND	21
OTHER SUPPLEMENTARY INFORMATION	
GENERAL FUND EXPENDITURES	23
CHANGES IN ASSESSMENTS RECEIVABLE	24
COMPARATIVE SCHEDULE OF REVENUES AND EXPENDITURES GENERAL FUND - FIVE YEARS	25-26
BOARD MEMBERS, KEY PERSONNEL AND CONSULTANTS	27-28

McCALL GIBSON SWEDLUND BARFOOT PLLC

Certified Public Accountants

13100 Wortham Center Drive
Suite 235
Houston, Texas 77065-5610
(713) 462-0341
Fax (713) 462-2708
E-Mail: mgsb@mgsbpllc.com

111 Congress Avenue
Suite 400
Austin, Texas 78701
(512) 610-2209
www.mgsbpllc.com

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the governmental activities and each major fund of the Houston Ship Channel Security District (the "District"), as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic 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.

Auditor's Responsibility

Our responsibility is to express opinions 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. 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 auditor's 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 District'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 opinions.

Board of Directors
Houston Ship Channel Security District

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 each major fund of the District as of December 31, 2012, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

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 21 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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The other supplementary information 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 other 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

May 14, 2013

**HOUSTON SHIP CHANNEL SECURITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2012**

Management's 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, 2012. 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 Position 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 Position. This information is found in the Statement of Net Position column on page 7. The Statement of Net Position 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 position. 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 position 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, 2012**

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 Position on page 8 and the Reconciliation of the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities on page 10 explain the differences between the two presentations and assist in understanding the differences between these two perspectives.

NOTES TO FINANCIAL STATEMENTS

The accompanying notes to the financial statements provide information essential to a full understanding of the government-wide and fund financial statements. The notes to the financial statements can be found on pages 11 through 19 in this report.

OTHER INFORMATION

In addition to the 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 position may serve over time as a useful indicator of the District's financial position. In the case of the District, assets exceeded liabilities by \$7,358,161 as of December 31, 2012.

The following is a comparative analysis of the Statement of Net Position as December 31, 2012 and December 31, 2011:

**HOUSTON SHIP CHANNEL SECURITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2012**

GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)

	Summary of the Statement of Net Position		
	2012	2011	Change Positive (Negative)
Cash	\$ 8,002,320	\$ 4,016,206	\$ 3,986,114
Accounts Receivable	16,350	726,284	(709,934)
Other Assets	<u>7,112</u>	<u> </u>	<u>7,112</u>
Total Assets	<u>\$ 8,025,782</u>	<u>\$ 4,742,490</u>	<u>\$ 3,283,292</u>
Accounts Payable	\$ 150,121	\$ 198,972	\$ 48,851
Due to Others	<u>405,000</u>	<u>270,000</u>	<u>(135,000)</u>
Total Liabilities	<u>\$ 555,121</u>	<u>\$ 468,972</u>	<u>\$ (86,149)</u>
Deferred Inflows of Resources	<u>\$ 112,500</u>	<u>\$ 90,000</u>	<u>\$ (22,500)</u>
Net Position:			
Unrestricted	<u>\$ 7,358,161</u>	<u>\$ 4,183,518</u>	<u>\$ 3,174,643</u>
Total Net Position	<u>\$ 7,358,161</u>	<u>\$ 4,183,518</u>	<u>\$ 3,174,643</u>

(1)

The following table provides a summary of the District's operations for the years ended December 31, 2012, and December 31, 2011. The District's net position increased by \$3,174,643 during the current fiscal year.

	Summary of the Statement of Activities		
	2012	2011	Change Positive (Negative)
Revenues:			
Assessment Revenues	\$ 4,310,000	\$ 4,175,000	\$ 135,000
Other Revenues	<u>247,353</u>	<u>160,259</u>	<u>87,094</u>
Total Revenues	\$ 4,557,353	\$ 4,335,259	\$ 222,094
Expenses for Services	<u>1,382,710</u>	<u>4,611,725</u>	<u>3,229,015</u>
Change in Net Position	\$ 3,174,643	\$ (276,466)	\$ 3,451,109
Net Position, Beginning of Year	<u>4,183,518</u>	<u>4,459,984</u>	<u>(276,466)</u>
Net Position, End of Year	<u>\$ 7,358,161</u>	<u>\$ 4,183,518</u>	<u>\$ 3,174,643</u>

(1)

(1) As Adjusted-See Note 11

**HOUSTON SHIP CHANNEL SECURITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2012**

FINANCIAL ANALYSIS OF THE DISTRICT'S GOVERNMENTAL FUNDS

The District's General Fund fund balance was \$7,358,161, as of December 31, 2012, an increase of \$3,174,643 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 February 14, 2012. Actual revenue was \$39,997 less than budgeted revenue primarily due to lower assessment revenues than were budgeted. Total expenditures were \$2,873,080 less than budgeted expenditures primarily due to lower than anticipated expenditures and billings from Harris County, Texas. See the budget to actual comparison on page 21.

CAPITAL ASSETS

The District has not acquired capital assets as of December 31, 2012.

LONG-TERM DEBT ACTIVITY

The District does not have long-term debt as of December 31, 2012.

CONTACTING THE DISTRICT'S MANAGEMENT

This financial report is designed to provide a general overview of the 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 POSITION AND
GOVERNMENTAL FUNDS BALANCE SHEET
DECEMBER 31, 2012**

	General Fund	Adjustments	Statement of Net Position
ASSETS			
Cash, Note 3	\$ 8,002,320	\$	\$ 8,002,320
Accounts Receivable:			
Assessments Receivable, Net of Allowance for Doubtful Assessments of \$-0-	15,000		15,000
Penalty and Interest on Delinquent Assessments	1,350		1,350
Prepaid Costs	7,112	_____	7,112
TOTAL ASSETS	\$ 8,025,782	\$ -0-	\$ 8,025,782
LIABILITIES			
Accounts Payable	\$ 150,121	\$	\$ 150,121
Due to Others	405,000	_____	405,000
TOTAL LIABILITIES	\$ 555,121	\$ -0-	\$ 555,121
DEFERRED INFLOWS OF RESOURCES			
Contract Revenue	\$ 112,500	\$ -0-	\$ 112,500
FUND BALANCE			
Nonspendable:			
Prepaid Costs	\$ 7,112	\$ (7,112)	\$
Unassigned	7,351,049	(7,351,049)	_____
TOTAL FUND BALANCE	\$ 7,358,161	\$ (7,358,161)	\$ -0-
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND FUND BALANCE	\$ 8,025,782		
NET POSITION			
Unrestricted		\$ 7,358,161	\$ 7,358,161
TOTAL NET POSITION		\$ 7,358,161	\$ 7,358,161

The accompanying notes to 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 POSITION
DECEMBER 31, 2012**

Total Fund Balance – Governmental Fund \$ 7,358,161

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

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

Total Net Position – Governmental Activities \$ 7,358,161

The accompanying notes to 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, 2012**

	<u>General Fund</u>	<u>Adjustments</u>	<u>Statement of Activities</u>
REVENUES			
Assessment Revenue, Note 4	\$ 4,310,000	\$	\$ 4,310,000
Penalty and Interest	1,350		1,350
Contract Revenue	127,500		127,500
Grant Refunds, Note 6	110,333		110,333
Investment Revenues	<u>8,170</u>		<u>8,170</u>
TOTAL REVENUES	<u>\$ 4,557,353</u>	<u>\$ -0-</u>	<u>\$ 4,557,353</u>
EXPENDITURES/EXPENSES			
Service Operations:			
Professional Fees	\$ 64,775	\$	\$ 64,775
Contracted Services	574,242		574,242
Grant Matching Funds, Note 6	100,026		100,026
Grant Operations and Maintenance, Note 6	620,092		620,092
Administrative	<u>23,575</u>		<u>23,575</u>
TOTAL EXPENDITURES/EXPENSES	<u>\$ 1,382,710</u>	<u>\$ -0-</u>	<u>\$ 1,382,710</u>
NET CHANGE IN FUND BALANCE	\$ 3,174,643	\$ (3,174,643)	\$
CHANGE IN NET POSITION		3,174,643	3,174,643
FUND BALANCE/NET POSITION – JANUARY 1, 2012, AS ADJUSTED, NOTE 11	<u>4,183,518</u>	<u>-0-</u>	<u>4,183,518</u>
FUND BALANCE/NET POSITION – DECEMBER 31, 2012	<u>\$ 7,358,161</u>	<u>\$ -0-</u>	<u>\$ 7,358,161</u>

The accompanying notes to 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, 2012**

Net Change in Fund Balance - Governmental Fund \$ 3,174,643

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

No adjustments were required this year to reconcile governmental funds with the statement of activities.

Change in Net Position - Governmental Activities \$ 3,174,643

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

HOUSTON SHIP CHANNEL SECURITY DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

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 80th 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 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 Position and a Statement of Activities. It requires the classification of net assets into three components: Net Investment in Capital Assets; Restricted; and Unrestricted. These classifications are defined as follows:

HOUSTON SHIP CHANNEL SECURITY DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Statement Presentation (Continued)

- Net Investment in Capital Assets – This component of net position 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 Position – This component of net position consists of external constraints placed on the use of 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 Position – This component of net position consists of assets that do not meet the definition of “Restricted” or “Net Investment in Capital Assets.”

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 Position and the Statement of Activities display information about the District as a whole. The District’s Statement of Net Position 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 Position 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 Position.

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 FINANCIAL STATEMENTS
DECEMBER 31, 2012

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 2012 assessments collected during the period August 15, 2012 to December 31, 2012, and 2011 assessments collected in the 2012 fiscal year.

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 February 14, 2012. 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 FINANCIAL STATEMENTS
DECEMBER 31, 2012

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 Position 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 position, financial position, and cash flows. All assets and liabilities associated with the activities are reported. Fund equity is classified as net position.

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 appropriate resources. Operating statements of governmental fund types report increases and decreases in available spendable resources. Fund balances in governmental funds are classified 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.

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.

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.

HOUSTON SHIP CHANNEL SECURITY DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 May 14, 2013, which is the date these statements were available to be issued.

New Pronouncements

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which is effective for fiscal years beginning after December 15, 2011, provides guidance for reporting the financial statement elements of deferred outflows of resources, which represent the consumption of the District's net assets that is applicable to a future reporting period, and deferred inflows of resources, which represent the District's acquisition of net assets applicable to a future reporting period. GASB Statement No. 63 has been implemented in these financial statements.

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is effective for fiscal years beginning after December 15, 2012, establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. GASB Statement No. 65 has been early implemented in these financial statements.

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.

HOUSTON SHIP CHANNEL SECURITY DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 3. DEPOSITS AND INVESTMENTS (Continued)

Deposits (Continued)

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 \$8,002,320 and the bank balance was \$8,002,838. Of the bank balance, \$542,403 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 Position at December 31, 2012, as listed below:

	Cash
GENERAL FUND	\$ 8,002,320

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

HOUSTON SHIP CHANNEL SECURITY DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 3. DEPOSITS AND INVESTMENTS (Continued)

Investments (Continued)

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, 2012, the District had no investments.

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 2012 fiscal year, \$4,310,000 of assessment installment payments were due. At the fiscal year end, \$4,295,000 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.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012**

NOTE 5. AGREEMENT FOR ADMINISTRATIVE SERVICES (Continued)

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 \$117,769 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. The agreement was supplemented by an addendum on March 13, 2012. It was further amended on October 1, 2012.

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 \$100,026 in grant matching funds and \$620,092 for grant operations and maintenance costs. Grant matching refunds of \$110,333 were issued to the District during the current fiscal year for items which were not purchased as previously planned by the County.

The contract term is from March 8, 2011 through September 30, 2013. 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 was for the period July 1, 2011 to September 30, 2012, and called for a payment to the District by the Authority of \$150,000. On November 7, 2012, the District executed a third agreement with the Authority. The agreement is for the period of October 1, 2012 to September 30, 2013, and calls for a payment to the District by the Authority of \$150,000. 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.

HOUSTON SHIP CHANNEL SECURITY DISTRICT
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 8. INTERLOCAL AGREEMENT WITH THE CITY OF HOUSTON

On April 24, 2012, the District executed an agreement with City of Houston (the "City"). The agreement calls for the City to conduct regular helicopter training and patrol flights within the boundaries of the District in exchange for the District reimbursing the City for certain of its fuel costs, not to exceed \$270,600 in the aggregate. The contract term is for one year. The contract may be terminated by either party upon default by either party for convenience, and without cause or default by the other party. During the current fiscal year, the District paid \$72,911 for fuel costs related to this agreement.

NOTE 9. AGREEMENT WITH THE CHERTOFF GROUP, LLC

On August 8, 2012, the District executed an agreement with The Chertoff Group, LLC ("Chertoff"). The agreement called for Chertoff to develop and implement a strategic plan for the District. This project was completed during the current fiscal year and the District paid Chertoff \$350,000 for its services.

NOTE 10. 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 public officials and general liability.

NOTE 11. PRIOR PERIOD ADJUSTMENT

During the current fiscal year, the District discovered it had improperly assessed four facilities in previous years per its assessment plan and made plans to issue refunds. The District adjusted its beginning fund balance and net position balance to correct the overbilling. The effect of this correction is as follows:

Fund Balance/Net Position – January 1, 2012	\$ 4,453,518
Subtract: Refunds Due	<u>(270,000)</u>
Fund Balance/Net Position – January 1, 2012, As Adjusted	<u>\$ 4,183,518</u>

DRAFT SUBJECT TO CHANGE

HOUSTON SHIP CHANNEL SECURITY DISTRICT

REQUIRED SUPPLEMENTARY INFORMATION

DECEMBER 31, 2012

**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, 2012**

	Original and Final Budget	Actual	Variance Positive (Negative)
REVENUES			
Assessment Revenue	\$ 4,445,000	\$ 4,310,000	\$ (135,000)
Penalty and Interest		1,350	1,350
Contract Revenue	150,000	127,500	(22,500)
Grant Refund		110,333	110,333
Investment Revenues	<u>2,350</u>	<u>8,170</u>	<u>5,820</u>
TOTAL REVENUES	<u>\$ 4,597,350</u>	<u>\$ 4,557,353</u>	<u>\$ (39,997)</u>
EXPENDITURES			
Service Operations:			
Professional Fees	\$ 56,000	\$ 64,775	\$ (8,775)
Contracted Services	362,250	574,242	(211,992)
Grant Matching Funds	560,000	100,026	459,974
Grant Operations and Maintenance	3,258,600	620,092	2,638,508
Administrative	<u>18,940</u>	<u>23,575</u>	<u>(4,635)</u>
TOTAL EXPENDITURES	<u>\$ 4,255,790</u>	<u>\$ 1,382,710</u>	<u>\$ 2,873,080</u>
NET CHANGE IN FUND BALANCE	\$ 341,560	\$ 3,174,643	\$ 2,833,083
FUND BALANCE – JANUARY 1, 2012	<u>4,183,518</u>	<u>4,183,518</u>	<u>-0-</u>
FUND BALANCE – DECEMBER 31, 2012	<u>\$ 4,525,078</u>	<u>\$ 7,358,161</u>	<u>\$ 2,833,083</u>

See accompanying independent auditor's report.

DRAFT SUBJECT TO CHANGE

HOUSTON SHIP CHANNEL SECURITY DISTRICT

OTHER SUPPLEMENTARY INFORMATION

DECEMBER 31, 2012

**HOUSTON SHIP CHANNEL SECURITY DISTRICT
GENERAL FUND EXPENDITURES
FOR THE YEAR ENDED DECEMBER 31, 2012**

PROFESSIONAL FEES:	
Auditing	\$ 9,000
Legal	<u>55,775</u>
TOTAL PROFESSIONAL FEES	<u>\$ 64,775</u>
CONTRACTED SERVICES	
Administrator	\$ 117,769
Consultants	383,562
Houston Police Department Security	<u>72,911</u>
TOTAL CONTRACTED SERVICES	<u>\$ 574,242</u>
GRANT MATCHING FUNDS	<u>\$ 100,026</u>
GRANT OPERATIONS AND MAINTENANCE	<u>\$ 620,092</u>
ADMINISTRATIVE EXPENDITURES:	
Telephone	\$ 669
Insurance	8,011
Board Meetings	6,933
Office Supplies	4,852
Postage	262
Travel and Entertainment	2,549
Other	<u>299</u>
TOTAL ADMINISTRATIVE EXPENDITURES	<u>\$ 23,575</u>
TOTAL EXPENDITURES	<u>\$ 1,382,710</u>

See accompanying independent auditor's report.

THIS PAGE INTENTIONALLY LEFT BLANK

**HOUSTON SHIP CHANNEL SECURITY DISTRICT
 CHANGES IN ASSESSMENTS RECEIVABLE
 FOR THE YEAR ENDED DECEMBER 31, 2012**

	<u>Assessments</u>	
ASSESSMENTS RECEIVABLE – JANUARY 1, 2012	\$ 15,000	
Adjustments to Beginning Balance	<u> </u>	\$ 15,000
Original 2012 Assessment Levy	\$ 4,445,000	
Adjustment to 2012 Assessment Levy	<u>(135,000)</u>	<u>4,310,000</u>
TOTAL TO BE ACCOUNTED FOR		\$ 4,325,000
ASSESSMENT COLLECTIONS:		
Prior Years	\$ 15,000	
Current Year	<u>4,295,000</u>	<u>4,310,000</u>
ASSESSMENTS RECEIVABLE – DECEMBER 31, 2012		<u>\$ 15,000</u>
ASSESSMENTS RECEIVABLE BY YEAR: 2012		<u>\$ 15,000</u>

See accompanying independent auditor's report.

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

	Amounts		
	<u>2012</u>	<u>2011</u>	<u>2010*</u>
REVENUES			
Assessment Revenue	\$ 4,310,000	\$ 4,310,000	\$ 4,310,000
Penalty and Interest	1,350	22,222	44,500
Contract Revenue	127,500	135,000	75,000
Grant Refund	110,333		
Investment Revenues	8,170	7,440	
Miscellaneous Revenues		160	840
TOTAL REVENUES	<u>\$ 4,557,353</u>	<u>\$ 4,474,822</u>	<u>\$ 4,430,340</u>
EXPENDITURES			
Professional Fees	\$ 64,775	\$ 112,582	\$ 37,497
Contracted Services	574,242	106,556	54,461
Grant Matching Funds	100,026	4,127,509	
Grant Operations and Maintenance	620,092	236,446	
Administrative	23,575	28,632	17,961
TOTAL EXPENDITURES	<u>\$ 1,382,710</u>	<u>\$ 4,611,725</u>	<u>\$ 109,919</u>
NET CHANGE IN FUND BALANCE	\$ 3,174,643	\$ (136,903)	\$ 4,320,421
BEGINNING FUND BALANCE	<u>4,183,518</u>	<u>4,320,421</u>	<u>-0-</u>
ENDING FUND BALANCE	<u>\$ 7,358,161</u>	<u>\$ 4,183,518</u>	<u>\$ 4,320,421</u>

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

See accompanying independent auditor's report.

DRAFT SUBJECT TO CHANGE

		Percent of Total Revenues				
<u>2009</u>	<u>2008</u>	<u>2012</u>	<u>2011</u>	<u>2010*</u>	<u>2009</u>	<u>2008</u>
\$	\$	94.6%	96.3%	97.3%		
		2.8	0.5	1.0		
		2.4	3.0	1.7		
		0.2	0.2			
\$	\$	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>		
\$	\$	1.4%	2.5%	0.8%		
		12.6	2.4	1.2		
		2.2	92.2			
		13.6	5.3			
		<u>0.5</u>	<u>0.6</u>	<u>0.4</u>		
\$	\$	<u>30.3%</u>	<u>103.0%</u>	<u>2.4%</u>		
\$	\$	<u>69.7%</u>	<u>(3.0)%</u>	<u>97.6%</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, 2012

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

District Telephone Number - (713) 671-0947

Board Members	Term of Office (All are <u>Appointed</u>)	Fees of Office for the year ended December 31, <u>2012</u>	Expense Reimbursements for the year ended December 31, <u>2012</u>	<u>Title</u>
Robin C. Riley	01/2012 – 01/2014	\$ -0-	\$ 552	Chairperson
Tom Schroeter	01/2011 – 01/2013	\$ -0-	\$ 1,980	Secretary
Clayton Curtis	01/2012 – 01/2014	\$ -0-	\$ -0-	Treasurer
Raymond V. Yellig	01/2011 – 01/2013	\$ -0-	\$ -0-	Vice-Chair
Mike Stewart	01/2012 – 01/2014	\$ -0-	\$ -0-	Assistant Secretary
Richard L. Henderson	01/2011 – 01/2013	\$ -0-	\$ -0-	Director
Gary Scheibe	01/2011 – 01/2013	\$ -0-	\$ -0-	Director
Steve Stewart	01/2012 – 01/2014	\$ -0-	\$ -0-	Director
Charles King	01/2011 – 01/2013	\$ -0-	\$ -0-	Director
Lewis Brown	01/2012 – 01/2014	\$ -0-	\$ -0-	Director
Jake Leavins	01/2012 – 01/2014	\$ -0-	\$ -0-	Director

See accompanying independent auditor's report.

**HOUSTON SHIP CHANNEL SECURITY DISTRICT
BOARD MEMBERS, KEY PERSONNEL AND CONSULTANTS
DECEMBER 31, 2012**

<u>Consultants:</u>	<u>Date Hired</u>	<u>Fees for the year ended December 31, 2012</u>	<u>Title</u>
Schwartz, Page & Harding, L.L.P 1300 Post Oak, Blvd., Suite 1400 Houston, TX 77056-3078	06/25/10	\$ 55,775	Attorney
McCall Gibson Swedlund Barfoot PLLC 13100 Wortham Center Drive Suite 235 Houston, TX 77065	09/13/11	\$ 9,000	Auditor
Greater Houston Port Bureau, Inc. 111 East Loop North Houston, TX 77029	08/17/10	\$ 121,439	Administrator

See accompanying independent auditor's report.