

Buddy Garcia, *Chairman*
Larry R. Soward, *Commissioner*
Glenn Shankle, *Executive Director*



TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

October 12, 2007

Stephen Troy Toland, P.E.
City of Conroe
P.O. Box 3066
Conroe, Texas 77305

Joanna Comer
Teas Estates Homeowners Association, Inc.
4808 Teas Court
Conroe, Texas 77304

Re: TCEQ Docket No. 2007-0334-UCR; Consideration of a request for a Commission Order approving a contract designating service areas between the City of Conroe (City) and Teas Estates Homeowners Association, Inc. (HOA).

Dear Mr. Toland and Mrs. Comer:

This letter is to inform you that the above-referenced application has been set on the Agenda for consideration by the Texas Commission on Environmental Quality (TCEQ). This Agenda will occur on October 24, 2007, at 1 p.m. in Building E, Room 201S, 12100 Park 35 Circle, Austin, Texas. Included with this letter are the Agenda backup materials to be considered by the Commission.

Persons with disabilities who plan to attend this hearing and who need special accommodations at the Agenda should call the TCEQ Office of Public Assistance at 1-800-687-4040 or 1-800-RELAY-TX (TDD) at least one week prior to the hearing. If you have any procedural questions, you may contact the TCEQ Office of Public Interest Counsel at 1-512-239-6363. If you have any other questions about this matter, you may contact Lisa Fuentes from the Water Supply Division at 1-512-239-4691 or me at 1-512-239-0575.

Sincerely,

A handwritten signature in cursive script that reads "Stefanie Skogen".

Stefanie Skogen
Staff Attorney
Environmental Law Division

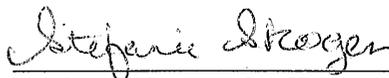
Enclosure

cc: Mailing List

2007 OCT 12 AM 10:24
CHIEF CLERKS OFFICE
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

CERTIFICATE OF SERVICE

I certify that on October 12, 2007, a copy of the foregoing document was sent by first class, agency mail, and/or facsimile to the persons on the attached Mailing List.



Stefanie Skogen, Staff Attorney
Environmental Law Division

Mailing List

City of Conroe

TCEQ Docket No. 2007-0334-UCR

CITY OF CONROE:

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**TEAS ESTATES HOMEOWNERS
ASSOCIATION, INC.:**

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Phone: (936) 539-3679

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Conroe, Texas 77304

CUSTOMERS:

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Conroe, Texas 77304

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Juanita Siller
4626 Teas Court
Conroe, Texas 77304

Mary Stichler
7 Queens Court
Conroe, Texas 77304

Guillermo Valdez
4562 Teas Court
Conroe, Texas 77304

**REPRESENTING THE OFFICE OF
PUBLIC INTEREST COUNSEL:**

Blas J. Coy, Jr.
Texas Commission on Environmental Quality
Office of Public Interest Counsel, MC-103
P. O. Box 13087
Austin, Texas 78711-3087
Phone: (512) 239-6363
Fax: (512) 239-6377

OFFICE OF THE CHIEF CLERK:

LaDonna Castañuela
Texas Commission on Environmental Quality
Office of the Chief Clerk, MC-105
P.O. Box 13087
Austin, Texas 78711-3087
Phone: (512) 239-3300
Fax: (512) 239-3311

Texas Commission on Environmental Quality

INTEROFFICE MEMORANDUM

TO: Texas Commission on Environmental Quality **DATE:** October 10, 2007
THRU: LaDonna Castañuela, Chief Clerk
FROM: Stefanie Skogen, Environmental Law Division
SUBJECT: TCEQ Docket No. 2007-0334-UCR. Consideration of a request for a Commission Order approving a contract designating service areas between the City of Conroe and Teas Estates Homeowners Association, Inc.

DESCRIPTION OF APPLICATION

Applicant: City of Conroe
Regulated Activity: Retail water utility service
Type of Application: Request for a Commission Order approving a contract
Commission Action: Hearing regarding approval of the contract
Authority: Texas Water Code § 13.248 and 30 Texas Administrative Code § 291.117

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CHIEF CLERKS OFFICE
TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

FACTUAL BACKGROUND

The City of Conroe (City), water certificate of convenience and necessity (CCN) No. 10339, and Teas Estates Homeowners Association, Inc. (HOA), water CCN No. 12117, provide retail water service in Montgomery County, Texas. On August 5, 2005, the City and the HOA entered into an agreement regarding their respective water service areas pursuant to section 13.248 of the Texas Water Code. Under the agreement, the HOA will transfer its entire CCN area to the City, thereby incorporating the area into the City's CCN area. The City annexed the area covered by the CCN on November 13, 2003, and is proposing to provide service to the customers in that area.

LEGAL AUTHORITY

The Texas Water Code prohibits a utility, a utility operated by an affected county, or a water supply corporation from rendering retail water or sewer utility service directly or indirectly to the

public without first obtaining a CCN.¹ Conversely, a municipality is not required to obtain a CCN to provide retail water service.² However, a municipality may not provide service to an area within its boundaries that is certificated to another retail public utility without first obtaining a CCN for that area.³

The Texas Water Code and TCEQ rules allow retail public utilities to enter into service area agreements and have the Commission affirm the agreements by amending the entities' respective CCNs.⁴ The request to approve a 13.248 agreement is not subject to the notice provisions of Title 30, section 291.106 of the Texas Administrative Code, which apply to applications for new and amended CCNs. The Commission may approve the service area agreement pursuant to section 13.248 of the Texas Water Code with the appropriate notice under the Open Meetings Act. The Executive Director will mail notice of the hearing upon the setting of an Agenda date.

BASIS FOR STAFF RECOMMENDATION

The following items were considered in developing the staff's recommendation:

1. Request for a Commission Order approving the 13.248 agreement filed by the City on October 6, 2005 (Application No. 35170-C);
2. Agreement between the City and the HOA, executed on August 5, 2005;
3. Map of the service area subject to the 13.248 agreement submitted by the City; and
4. Financial, managerial, and technical analysis of the City to operate in the affected area.

STAFF RECOMMENDATION

Based on the facts stated in the application and the supporting documentation submitted by the City, staff supports the request for a Commission Order approving a contract designating service areas between the City and the HOA. Staff has confirmed that both parties are retail public utilities with active water CCNs and that the area the parties are seeking to transfer is either

¹ TEX. WATER CODE ANN. § 13.242(a) (Vernon Supp. 2006).

² A municipality is a "retail public utility" under section 13.002(19) of the Texas Water Code but is not a "utility" under section 13.002(23). Therefore, the section 13.242(a) requirement that a "utility" must obtain a CCN before providing retail water utility service does not apply to a municipality.

³ TEX. WATER CODE ANN. § 13.247(a).

⁴ TEX. WATER CODE ANN. § 13.248 (Vernon 2000); 30 TEX. ADMIN. CODE § 291.117 (West 2006). Section 13.248 states, "Contracts between retail public utilities designating areas to be served and customers to be served by those retail public utilities, when approved by the commission after public notice and hearing, are valid and enforceable and are incorporated into the appropriate areas of public convenience and necessity."

dually certificated to both parties or abuts the CCN of the entity receiving the CCN. Further, staff is satisfied that the City possesses the adequate financial, managerial, and technical capability to provide continuous and adequate service to the area being transferred.

STAFF CONTACTS

Stefanie Skogen, Environmental Law Division (239-0575)
Lisa Fuentes, Water Supply Division (239-6117)

CAPTION
CITY OF CONROE
Application No. 35170-C

TCEQ Docket No. 2007-0334-UCR. Consideration of a request for a Commission Order approving a contract designating service areas between the City of Conroe, water certificate of convenience and necessity (CCN) No. 10339, and Teas Estates Homeowners Association (HOA), Inc., water CCN No. 12117, in Montgomery County, Texas pursuant to section 13.248 of the Texas Water Code. Currently, Teas Estates HOA holds a CCN for the area in question. The City of Conroe has annexed the area and is proposing to provide service to the customers in the area. Under the contract, Teas Estates HOA will transfer its entire CCN to the City of Conroe. No facilities are proposed to be transferred. (Stefanie Skogen, Lisa Fuentes)

Texas Commission on Environmental Quality

INTEROFFICE MEMORANDUM

To: Environmental Law Division Date: August 16, 2007
Thru: Lisa Fuentes/Tammy Benter *LB*
From: Dan Smith *DS*
Subject: Contract Agreement Under Water Code Section 13.248 for the City of Conroe (Conroe), Certificate of Convenience and Necessity (CCN) No. 10339, to Transfer CCN No. 12117 from Teas Estates Homeowners Association, Inc., (HOA) and to Amend CCN No. 10339, in Montgomery County; Application No. 35170-C

CN: 600650311 RN: 101386068

In my opinion, Conroe has demonstrated adequate financial, managerial and technical capability to provide service to the area contracted for transfer.

Signed: *Dan Smith* Date: August 16, 2007

I have secured and reviewed an unqualified audit for Conroe, for the fiscal year ended 9/30/06, of which the more important schedules and notes have been reduced, copied and added to the original of this memorandum. It shows total water and sewer fund assets of \$70.9 mil., long-term liabilities of \$17.1 mil., and net assets (equity) of \$50.0 mil., for a debt-to-equity ratio of .34:1. The statement of revenues and expenses showed a net loss before transfers of \$2.2 mil. after covering depreciation of \$4.5 mil. and interest of \$345,359, so cash available for debt service was still \$2.6 mil., and the debt service coverage ratio was 2.13:1.

This information supports a finding of more than adequate capability to provide service to a small, existing, contiguous CCN area of 1174 acres and 18 current customers. In fact, it would not have been considered a material addition (more than 10%) to Conroe's present CCN area and would not have received a review of financial and managerial capability in a routine STM application procedure. Conroe presently provides service to about 29,000 acres and nearly 17,000 connections from our database information, and is ranked "superior."



Hereford, Lynch, Sellars & Kirkham
Certified Public Accountants • A Professional Corporation

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Conroe, Texas 77305

Members of the
American Institute of Certified Public Accountants
Texas Society of Certified Public Accountants
Private Companies Practice Section
of the AICPA Division for Firms

Conroe (936) 756-8127
Fax (936) 756-8132
Houston Metro 936-441-1338

Independent Auditor's Report

Honorable Mayor and
Members of City Council
City of Conroe, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Conroe, Texas as of and for the year ended September 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Conroe, Texas's management. 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 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 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 City'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, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Conroe, Texas as of September 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund and Major Special Revenue Funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will issue at a later date, our report on our consideration of City of Conroe, Texas'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 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis identified as Required Supplementary Information in the table of contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements which collectively comprise the City of Conroe, Texas's basic financial statements. The accompanying introductory section, combining and individual nonmajor fund financial statements and budgetary schedules, and statistical tables are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements and budgetary schedules as listed in the table of contents have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and the statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Hereford, Lynch, Sellars & Kirkham, P.C.
HEREFORD, LYNCH, SELLARS & KIRKHAM, P.C.
Certified Public Accountants

Conroe, Texas
January 26, 2007

STATEMENT OF NET ASSETS
SEPTEMBER 30, 2006

ASSETS	Governmental Activities		Business-type Activities		Total
Peaked Cash and Cash Equivalents	\$ 10,617,217	\$ --	\$ 10,617,217		
Non-peaked Cash and Cash Equivalents	931,447	1,350	932,797		
Investments	10,421,886	(4,083,194)	20,004,700		
Receivables (net of allowances for uncollectibles)					
Taxes	234,428	--	234,428		
Accounts	--	1,457,643	1,457,643		
Lease	48,774	--	48,774		
Interest	824,935	9,213	844,248		
Other	193,023	230	193,253		
Interest Balances	(8,319,547)	6,319,947	--		
Due from Other Governments	4,000,370	--	4,000,370		
Inventories	--	1,104,007	1,104,007		
Restricted Assets	58,595	--	58,595		
Cash and Cash Equivalents	221,558	2,055,025	2,276,583		
Accrued Interest Receivable	--	237	237		
Investments	--	185,455	185,455		
Capital Assets:					
Land	12,748,551	205,022	12,953,573		
Buildings and Improvements	36,430,235	1,041,700	37,471,935		
Machinery and Equipment	11,245,515	6,020,611	17,266,126		
Infrastructure (Paving, Bridges & Damages)	34,523,110	60,387,005	94,910,115		
Construction in Progress	5,070,723	8,480,883	13,551,606		
Less Accumulated Depreciation	(86,450,260)	(54,728,537)	(141,178,797)		
Total Capital Assets (net of depreciation)	66,548,869	19,697,283	86,246,152		
TOTAL ASSETS	96,558,467	70,887,418	167,445,885		
LIABILITIES					
Current Liabilities:					
Accounts Payable and Other Current Liabilities	3,614,400	1,750,013	5,364,413		
Accrued Interest Payable	245,123	--	245,123		
Noncurrent Liabilities:					
Due within One Year	11,746,000	2,184,025	13,930,025		
Due in more than One Year	62,709,133	--	62,709,133		
TOTAL LIABILITIES	77,679,616	3,934,038	81,613,654		
NET ASSETS	18,878,851	36,953,380	55,832,231		
Invested in Capital Assets, Net of Related Debt	5,521,797	36,580,725	42,102,522		
Restricted For:					
Federal and State Programs	90,823	--	90,823		
Debt Service	896,287	--	896,287		
Capital Projects	7,710,554	--	7,710,554		
CIDC	8,650,112	--	8,650,112		
Other Purposes	879,744	--	879,744		
Unassigned	(3,347,300)	13,315,205	9,967,905		
Total Net Assets	18,878,851	36,953,380	55,832,231		

D/E 35:1 90:1

The accompanying notes are an integral part of the basic financial statements.

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2006

Functions/Programs	Program Revenues		
	Expenses	Charges for Services	Grants and Contributions
Governmental Activities:			
General Government	\$ 13,254,977	\$ 6,688,317	\$ 855,888
Finance	523,356	--	--
Public Safety	17,028,857	2,501,118	--
Parks	4,818,033	594,503	--
Public Works	5,935,872	787,265	--
Debt Service	--	--	--
Interest and Fiscal Charges	3,631,719	--	--
Other	183,126	--	--
Total Governmental Activities	45,781,142	10,171,203	855,888
Business-type Activities:			
Enterprises	12,084,224	11,043,310	--
Service Center	(600,502)	543,740	--
Total Business-type Activities	11,483,722	11,587,050	--
Total Primary Government	\$ 57,264,864	\$ 21,758,253	\$ 855,888
General Revenues:			
Property Taxes	\$ 8,870,807	--	\$ 8,870,807
In Lieu of Taxes	379,802	--	379,802
Gross Receipts Tax	3,034,455	--	3,034,455
Sales and Other Taxes	27,297,584	--	27,297,584
Hotel Occupancy Taxes	175,416	--	175,416
Mixed Beverage Taxes	119,215	--	119,215
Miscellaneous	1,876,280	--	1,876,280
Unrestricted Investment Earnings	889,750	303,324	1,193,074
Gain (Loss) on Investments	(733,375)	(187,807)	(921,182)
Gain on Sale of Capital Assets	323,205	161,882	485,087
Transfers	11,150,165	(1,150,165)	9,999,999
Total General Revenues	43,887,343	(870,853)	43,016,490
Change in Net Assets	9,023,704	(3,487,290)	5,536,414
Net Assets - Beginning	10,887,026	84,711,750	95,608,776
Prior Period Adjustment	(200,543)	(67,821)	(268,364)
Net Assets - Ending	19,910,730	81,243,930	101,154,660

Net (Expense) Revenue and Changes in Net Assets		
Governmental Activities	Business-type Activities	Total
\$ (8,011,092)	\$ --	\$ (8,011,092)
(883,059)	--	(883,059)
(4,024,738)	--	(4,024,738)
(4,024,530)	--	(4,024,530)
(5,278,607)	--	(5,278,607)
(2,021,719)	--	(2,021,719)
(193,126)	--	(193,126)
(24,865,295)	--	(24,865,295)
--	\$ (2,440,914)	\$ (2,440,914)
--	(166,259)	(166,259)
--	(2,887,672)	(2,887,672)
(26,954,238)	(2,887,672)	(29,841,910)

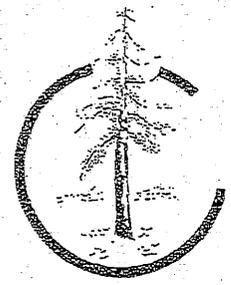
The accompanying notes are an integral part of the basic financial statements.

CITY OF CONROE, TEXAS
BALANCE SHEET - GOVERNMENTAL FUNDS
SEPTEMBER 30, 2006

ASSETS	General Fund		Debt Service Fund		Street Improvements		Other Governmental Funds		Total Governmental Funds	
Peaked Cash and Cash Equivalents	\$ 10,617,217	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ 10,617,217	
Non-peaked Cash and Cash Equivalents	14,861	--	--	--	--	--	--	--	14,861	
Investments	12,052,293	3,057,460	3,005,555	223,763	916,800	2,000,098	--	--	18,040,193	
Receivables (net of allowances for uncollectibles)										
Taxes	144,530	--	92,889	--	--	--	--	--	237,419	
Lease	48,774	--	--	--	--	--	--	--	48,774	
Interest	707,912	57,847	5,000	379	--	3,787	--	--	771,925	
Other	84,729	--	--	--	--	--	--	--	84,729	
Due from Other Funds	--	3,050,005	284,707	--	--	3,832,723	--	--	6,167,435	
Due from Other Governments	4,000,370	--	--	--	--	--	--	--	4,000,370	
Inventories	58,595	--	--	--	--	--	--	--	58,595	
Restricted Assets	--	--	--	--	--	--	--	--	--	
Cash and Cash Equivalents	221,558	2,055,025	221,558	221,558	221,558	221,558	221,558	221,558	8,800,485	
TOTAL ASSETS	29,200,870	6,705,336	6,231,362	224,142	7,070,990	44,827,551	221,558	221,558	44,827,551	
LIABILITIES, EQUITY AND OTHER CREDITS										
LIABILITIES										
Accounts Payable	\$ 612,570	\$ --	\$ --	\$ 458,831	\$ 184,100	\$ 1,255,510	\$ --	\$ --	\$ 2,450,911	
Retainage Payable	880,104	--	--	162,912	101,418	1,144,434	--	--	2,188,468	
Accrued Compensation/Earnings	12,044,681	--	--	2,354,138	2,590	15,777,428	--	--	20,176,837	
Due to Other Funds	54,997	--	--	--	470,629	54,997	--	--	600,623	
Due to Other Governments	--	--	--	--	--	--	--	--	--	
Customer Deposits	170,582	--	--	--	15,463	15,463	--	--	176,045	
Deferred Revenues	14,249,824	--	52,858	2,875,881	783,215	16,991,928	--	--	28,100,738	
TOTAL LIABILITIES	27,162,654	--	52,858	2,875,881	783,215	16,991,928	--	--	47,804,526	
EQUITY AND OTHER CREDITS										
Fund Balances:										
Reserved for Inventories	58,395	--	--	--	--	58,395	--	--	116,790	
Reserved for Debt Service	--	--	870,322	--	--	870,322	--	--	1,740,644	
Unassigned, Designated for, Restricted in	--	--	--	--	--	--	--	--	--	
CIDC - Special Revenue Fund	--	6,768,030	--	--	--	6,768,030	--	--	13,536,060	
Retained Risk	881,417	--	--	--	3,103	884,520	--	--	1,765,937	
Unassigned, Undesignated for, Reported in:										
Capital Projects	--	--	--	--	--	--	--	--	--	
Special Revenues	--	--	--	(2,751,739)	5,577,735	2,826,006	--	--	5,651,262	
Unreserved, Unassigned	12,573,154	--	--	--	1,207,837	13,780,991	--	--	26,254,981	
TOTAL EQUITY AND OTHER CREDITS	12,038,216	6,768,030	870,322	(2,751,739)	6,859,765	13,536,124	--	--	29,200,870	
TOTAL LIABILITIES, EQUITY AND OTHER CREDITS	39,200,870	6,768,036	6,231,362	224,142	7,070,990	44,827,551	221,558	221,558	44,827,551	

The accompanying notes are an integral part of the basic financial statements.

EXHIBIT A-3



CITY OF CONROE, TEXAS
 RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
 TO THE STATEMENT OF NET ASSETS
 SEPTEMBER 30, 2006

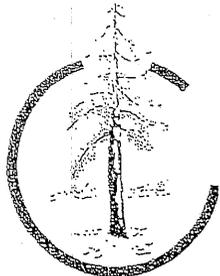
EXHIBIT A-4

Total fund balances - governmental funds balance sheet	\$ 26,235,622
Amounts reported for governmental activities in the statement of net assets ("SMA") are different because:	
Capital assets used in governmental activities are not reported in the funds	65,548,690
Property taxes receivable unavailable to pay for current period expenditures are deferred in the funds.	303,120
The assets and liabilities of internal service funds are included in governmental activities in the SMA.	700,214
Payables for bond principal which are not due in the current period are not reported in the funds.	(63,520,000)
Payables for capital leases which are not due in the current period are not reported in the funds.	(2,738,405)
Payables for interest which are not due in the current period are not reported in the funds.	(345,123)
Payables for notes which are not due in the current period are not reported in the funds.	(1,555,566)
Payables for compensated absences which are not due in the current period are not reported in the funds.	(4,025,732)
Other long-term assets are not available to pay for current period expenditures and are deferred in the funds.	42,155
Grant and/or agreement receivable unavailable to pay for current period expenditures not in the funds	173,204
	<u>\$ 10,219,551</u>

Net assets of governmental activities - statement of net assets

The accompanying notes are an integral part of the basic financial statements.

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CITY OF CONROE, TEXAS
 STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
 IN FUND BALANCES - GOVERNMENTAL FUNDS
 FOR THE YEAR ENDED SEPTEMBER 30, 2006

	General Fund	Conroe Intra- Gov Develop- ment Corp.
REVENUES		
Taxes	\$ 20,303,232	\$ 6,562,819
Licenses and Permits	2,234,233	-
Charges for Services	816,409	-
Lease Income	101,614	-
Fees and Fictitious	1,215,703	-
Intergovernmental	1,023,687	-
Investment Income	403,593	152,261
Gain/Loss on Investment	(202,184)	(26,472)
Penalties and Interest	72,179	-
Land Sales	-	1,093,843
Other	218,246	288,809
TOTAL REVENUE	<u>23,325,266</u>	<u>8,727,841</u>
EXPENDITURES		
Current		
General Government Administration	1,125,740	4,625,514
Legal	235,725	-
Municipal Court	476,554	-
COBG	17,110	-
Warehouses/Purchasing	207,542	-
Information Technology	200,113	-
Human Resources	275,026	-
Non-Compensated	820,065	-
Police	981,831	-
Public Safety		
Police Administration	3,446,020	-
Police Patrol	4,238,225	-
Police Investigation	1,830,320	-
Fire	6,245,827	-
Parks		
Parks and Recreation	1,157,800	-
Recreation Center	823,085	-
Oscar Johnson, Jr. Community Center	515,538	-
Swim Center	525,949	-
PUBLIC WORKS		
Community Development	1,422,620	-
Geology Construction	232,002	-
Streets	2,237,289	-
Building Maintenance	208,514	-
Debt Service		
Principal Refunded	499,157	840,000
Interest and Fleet Charges	60,800	281,000
Capital outlay	1,616,314	-
TOTAL EXPENDITURES	<u>21,375,268</u>	<u>5,227,256</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	2,015,058	2,760,445
OTHER FINANCING SOURCES (USES)		
Issuance of Debt	-	4,155,026
Issuance of Capital Lease	1,612,663	-
Operating Transfers In	1,260,082	-
Operating Transfers Out	(522,232)	(1,237,681)
TOTAL OTHER FINANCING SOURCES (USES)	<u>2,350,513</u>	<u>2,917,345</u>
Excess of Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Uses	6,142,518	1,282,184
Fund Balances at Beginning of Year	8,299,435	6,283,125
FUND BALANCES AT END OF YEAR	<u>\$ 14,452,223</u>	<u>\$ 7,565,309</u>

The accompanying notes are an integral part of the basic financial statements.

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CITY OF CONROE, TEXAS
 RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
 AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
 TO THE STATEMENT OF ACTIVITIES
 FOR THE YEAR ENDED SEPTEMBER 30, 2006

Net change in fund balances - total governmental funds	\$ 7,246,855
Amounts reported for governmental activities in the statement of activities ("SOA") are different because:	
Capital outlays are not reported as expenses in the SOA.	7,255,208
The depreciation of capital assets used in governmental activities is not reported in the funds.	(3,045,073)
All proceeds from the sale of capital assets are reported in the funds but not in the SOA.	(1,175,845)
Deferred property tax revenues are deferred in the funds. This is the change in these amounts this year.	(14,170)
Revenues in the SOA not providing current financial resources are not reported as revenues in the funds.	(4,703,723)
Repayment of bond principal is an expenditure in the funds but is not an expense in the SOA.	2,856,337
Repayment of capital lease principal is an expenditure in the funds but is not an expense in the SOA.	409,157
Repayment of loan principal is an expenditure in the funds but is not an expense in the SOA.	(231,060)
Bond issuance costs and similar items are amortized in the SOA but not in the funds.	(87,027)
(Increase) decrease in accrued interest from beginning of period to end of period	(32,114)
The net revenue (expense) of internal service funds is reported with governmental activities.	729,314
Compensated absences are reported as the amount earned in the SOA but as the amount paid in the funds.	(464,032)
Grant and/or agreement revenues not in the funds.	128,284
Change in net assets of governmental activities - statement of activities	<u>\$ 6,032,704</u>

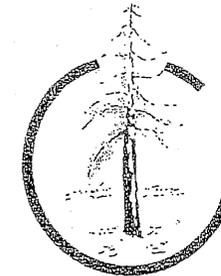
The accompanying notes are an integral part of the basic financial statements.

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EXHIBIT A-5

Direct Service Fund	Street Improvements	Other Governmental Funds	Total Governmental Funds
\$ 4,142,512	\$ -	\$ -	\$ 4,142,512
-	-	2,314,206	2,314,206
-	-	316,000	316,000
-	-	207,937	207,937
-	-	-	1,315,160
-	-	-	308,251
-	-	-	1,200,074
87,970	27,640	1,672,455	3,502,665
(28,402)	22,876	202,264	1,200,074
(20,380)	(76,426)	(71,287)	(733,272)
-	-	-	141,260
-	-	-	1,293,043
-	-	-	184,170
<u>4,271,166</u>	<u>(15,629)</u>	<u>2,222,271</u>	<u>\$ 6,537,808</u>
-	-	1,284,254	1,284,254
-	-	-	326,225
-	-	-	476,254
-	-	-	1,710
-	-	-	107,240
-	-	-	200,113
-	-	-	275,026
70,000	14,185	50,362	95,547
-	-	-	95,547
-	-	-	3,446,020
-	-	-	4,238,225
-	-	-	1,830,320
-	-	-	6,245,827
-	-	-	1,157,800
-	-	-	823,085
-	-	-	242,538
-	-	-	525,949
-	-	-	1,422,620
-	-	-	232,002
-	-	-	2,237,289
-	-	-	208,514
-	-	-	522,256
-	-	-	2,856,337
3,520,000	-	62,200	3,582,200
2,412,481	-	71,873	2,484,354
-	2,621,468	2,256,242	4,877,710
<u>6,016,481</u>	<u>2,621,468</u>	<u>2,256,242</u>	<u>\$ 11,294,191</u>
(1,733,324)	(6,715,262)	(1,642,269)	(10,090,855)
-	-	-	4,155,026
-	-	-	1,612,663
1,264,081	-	1,008,978	2,273,059
-	-	-	(522,232)
-	-	-	(1,237,681)
<u>1,264,081</u>	<u>-</u>	<u>9,894,721</u>	<u>\$ 11,294,191</u>
115,157	(2,715,262)	3,412,258	7,246,855
755,165	663,643	2,448,162	3,866,970
<u>870,322</u>	<u>(2,051,619)</u>	<u>6,244,185</u>	<u>\$ 4,962,888</u>

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CITY OF CONROE, TEXAS
GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE - BUDGET (GAAP BASIS) AND ACTUAL
FOR THE YEAR ENDED SEPTEMBER 30, 2005

EXHIBIT A-7
Page 2 of 2

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE - BUDGET (GAAP BASIS) AND ACTUAL
FOR THE YEAR ENDED SEPTEMBER 30, 2005

Page 2 of 2

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes	\$ 26,225,587	\$ 26,225,083	\$ 26,200,292	\$ 2,027,900
Licenses and Permits	2,058,009	2,032,024	2,284,236	252,202
Charges for Services	792,851	806,851	916,490	119,639
Losses Income	55,149	55,149	55,149	25,155
Fines and Penalties	1,430,238	1,430,239	1,315,755	(114,470)
Intergovernmental	420,375	900,129	1,203,407	487,899
Investment Income	120,895	120,595	403,392	283,788
Gain (Loss) on Investment	-	-	(320,184)	(320,184)
Penalties and Interest	55,233	55,233	72,179	16,946
Other	16,200	122,025	218,148	49,923
TOTAL REVENUE	31,210,431	31,812,327	33,589,358	2,775,029
EXPENDITURES				
Current				
Administration	1,120,286	1,125,350	1,150,740	45,618
Legal	402,500	420,320	326,725	93,595
Municipal Court	497,222	498,743	475,854	12,889
COOG	134,148	144,841	117,110	140,191
Warehouses/Purchasing	254,760	245,200	207,542	37,318
Information Technology	350,000	329,507	330,115	2,395
Human Resources	505,243	541,990	576,506	(34,516)
Non-Departmental	2,719,105	2,104,243	590,955	49,255
Police	789,874	789,842	961,021	(101,789)
Public Safety				
Police Administration	3,375,879	3,405,324	3,446,009	50,215
Police Patrol	3,072,059	4,145,514	4,252,352	(118,526)
Police Investigation	1,255,022	1,259,022	1,032,252	79,279
Fire	6,764,443	6,093,023	6,243,827	345,098
Fire				
Parks and Recreation	1,056,500	1,059,920	1,157,200	(58,000)
Recreation Center	805,000	826,277	823,055	15,202
Osceola Johnson, Jr. Community Center	600,700	1,016,259	945,208	71,022
Swim Center	650,800	349,022	900,949	(102,524)
Public Works				
Community Development	1,544,102	1,555,231	1,455,053	58,208
Ordinary Construction	622,500	622,721	625,755	25,255
Streets	3,135,200	3,174,080	3,287,033	(53,500)
Water	378,210	376,210	326,514	(52,704)
Debt Service				
Principal Retirement	524,867	552,867	498,167	52,710
Interest and Fiscal Charges	55,455	59,490	56,809	2,511
Capital Outlay	455,213	3,200,899	4,516,114	1,386,255
TOTAL EXPENDITURES	32,359,289	33,519,225	31,810,288	1,509,001
Excess (Deficiency) of Revenues Over (Under) Expenditures	(944,815)	(2,004,898)	3,910,058	6,224,026

The accompanying notes are an integral part of the basic financial statements.

CITY OF CONROE, TEXAS
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
SEPTEMBER 30, 2005

EXHIBIT A-8

	Enterprise Fund		Internal Water and Sewer Service Funds
	Water	Internal Water and Sewer Service Funds	
ASSETS			
Current Assets:			
Non-scheduled Cash and Cash Equivalents	\$ 1,350	\$ -	\$ -
Investments	4,320,192	-	491,270
Receivables (net of allowance for uncollectibles):			
Accounts	1,457,543	-	-
Interest	9,310	-	-
Other	250	-	-
Due from Other Funds	6,344,018	-	1,830,592
Inventory	1,104,637	-	-
Total Current Assets	13,200,290	-	1,821,862
Noncurrent Assets:			
Restricted Assets			
Cash and Cash Equivalents	7,625,025	-	-
Accrued Interest Receivable	227	-	-
Investments	182,455	-	-
Fixed Assets (net of accumulated depreciation)	54,799,227	-	-
Total Noncurrent Assets	7,807,404	-	-
TOTAL ASSETS	21,007,694	\$ 1,821,862	\$ 1,821,862
LIABILITIES			
Current Liabilities:			
Accounts Payable	\$ 409,727	\$ 531	\$ -
Retainage Payable	420,710	-	-
Accrued Expenses/Deposits	176,160	1,100,501	-
Due to Other Funds	-	-	24,870
Customer Deposits-Current	182,425	-	-
Capital Lease-Current	371,000	-	-
Revenue Bonds Payable-Current	715,000	-	-
Total Current Liabilities	2,375,071	1,101,032	-
Noncurrent Liabilities, net of current portion			
Contingent Absences Payable	806,640	102,212	-
Payable from Restricted Assets	-	-	-
Accrued Interest Payable	333,455	-	-
Customer Deposits	242,224	-	-
Capital Leases	6,016,033	-	-
Revenue Bonds, Net	17,112,325	-	-
Total Noncurrent Liabilities	17,390,376	102,212	-
TOTAL LIABILITIES	20,568,086	1,305,456	1,305,456
NET ASSETS			
Investment in Capital Assets, net of Related Debt	56,422,133	-	-
Unrestricted, Designated for Retained Risk	155,454	-	33,419
Unrestricted, Unrestricted Net Assets	17,430,007	-	520,986
TOTAL NET ASSETS	83,007,594	584,395	584,395

17,129,573 =
D/E .3411

The accompanying notes are an integral part of the basic financial statements.

CITY OF CONROE, TEXAS
STATEMENT OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET ASSETS - PROPRIETARY FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2005

EXHIBIT A-10

	Enterprise Fund		Internal Water and Sewer Service Funds
	Water	Internal Water and Sewer Service Funds	
OPERATING REVENUES			
Changes for Sales and Services	\$ 11,043,310	\$ 4,630,149	\$ -
TOTAL OPERATING REVENUES	11,043,310	4,630,149	-
OPERATING EXPENSES			
Public Works	511,222	-	590,502
Utility Billing and Collection	727,248	-	-
Water Production	2,870,751	-	-
Waste Treatment	3,732,773	-	-
General Government	-	3,305,151	-
Depreciation	4,425,114	-	-
TOTAL OPERATING EXPENSES	12,146,808	3,305,653	-
OPERATING INCOME (LOSS)	(1,103,498)	\$44,496	-
NON-OPERATING REVENUES (EXPENSES)			
Investment Income	303,334	6,759	-
Gain (Loss) on Investment	(107,307)	-	-
Gain (Loss) on Sale of Capital Assets	161,297	-	-
Interest Expense	(345,253)	-	-
Bad Debt Recovery (Expense)	1,840	-	-
Gross Receipts Transfer	(608,750)	-	-
Other	(607,743)	-	-
TOTAL NON-OPERATING REVENUES (EXPENSES)	(1,092,887)	6,759	-
INCOME (LOSS) BEFORE OPERATING TRANSFERS	(2,196,385)	\$51,255	-
Transfer Out	(1,159,545)	-	-
NET TRANSFERS	(1,159,545)	-	-
CHANGE IN NET ASSETS	(3,355,930)	\$51,255	\$51,255
Net Assets at Beginning of Year	54,212,750	-	-
Prior Period Adjustments	(847,221)	-	-
NET ASSETS AT END OF YEAR	50,856,820	\$51,255	\$51,255

CADS (BEFORE XPRS) 2,647,578
PFI 1,240,875
DEBT SERVICE COVERAGE RATIO - 2.13:1

The accompanying notes are an integral part of the basic financial statements.

CONROE INDUSTRIAL DEVELOPMENT CORPORATION
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE - BUDGET (GAAP BASIS) AND ACTUAL
FOR THE YEAR ENDED SEPTEMBER 30, 2005

EXHIBIT A-9

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes	\$ 5,609,411	\$ 5,608,411	\$ 5,062,210	\$ 1,254,406
Investing Income	-	-	159,251	119,251
Gain (Loss) on Investment	45,000	45,000	(236,472)	(236,472)
Land Sales	-	-	1,000,000	1,000,000
Other	-	-	280,000	280,000
TOTAL REVENUE	5,654,411	5,653,411	6,225,821	2,674,229
EXPENDITURES				
Current				
General Government	4,021,682	4,021,682	4,102,514	(4,832)
Debt Service	-	-	940,000	-
Principal Retirement	940,000	940,000	951,000	(11,000)
Interest and Fiscal Charges	527,820	527,820	527,820	-
TOTAL EXPENDITURES	5,489,502	5,489,502	6,527,334	(1,047,813)
Excess (Deficiency) of Revenues Over (Under) Expenditures	164,909	163,909	2,700,046	2,516,438
OTHER FINANCING SOURCES (USES)				
Operating Transfers Out	(1,337,601)	(1,337,601)	(1,337,601)	-
TOTAL OTHER FINANCING SOURCES (USES)	(1,337,601)	(1,337,601)	(1,337,601)	-
Excess of Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Uses	(1,172,692)	(1,173,692)	1,362,445	2,516,438
Fund Balances at Beginning of Year	5,433,156	5,433,156	5,433,156	-
FUND BALANCES AT END OF YEAR	4,260,464	4,260,464	6,795,601	2,535,137

The accompanying notes are an integral part of the basic financial statements.

CITY OF CONROE, TEXAS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2005

EXHIBIT A-11

	Enterprise Fund		Internal Water and Sewer Service Funds
	Water	Internal Water and Sewer Service Funds	
Cash Flows from Operating Activities:			
Cash Received from Customers	\$ 10,930,243	\$ -	\$ 543,740
Cash Received from Employees	-	-	816,330
Cash Receipts (Payments) from Other Funds for Services	-	-	3,288,075
Cash Payments to Employees for Services	-	(5,111,540)	(557,235)
Cash Payments to Other Suppliers for Goods and Services	(2,337,532)	-	(734,295)
Cash Payments for Taxes Collected	-	-	(1,513,453)
Net Cash Provided (Used) by Operating Activities	8,592,711	(5,111,540)	1,709,022
Cash Flows from Non-capital Financing Activities:			
Increase in Customer Deposits	10,624	-	-
Transfer from (To) Other Funds	(6,145,035)	-	(1,288,007)
Net Cash Provided (Used) by Non-capital Financing Activities	(6,134,411)	-	(1,288,007)
Cash Flows from Capital and Related Financing Activities:			
Proceeds from Issuance of Long-term Debt	-	17,184,228	-
Principal and Interest Paid	-	(852,225)	-
Acquisition or Construction of Capital Assets	-	(8,016,335)	-
Proceeds from Sale of Capital Assets	-	275,341	-
Net Cash Provided (Used) by Capital & Related Financing Activities	-	8,391,009	-
Cash Flows from Investing Activities:			
Purchase of Investment Securities	(4,531,285)	-	(461,373)
Proceeds from Sale and Maturity of Securities	2,057,202	-	-
Interest and Dividends on Investments	189,020	-	8,750
Net Cash Provided (Used) by Investing Activities	(2,285,063)	-	(452,623)
Net Increase (Decrease) in Cash and Cash Equivalents:			
Cash and Cash Equivalents at Beginning of Year	2,025,375	-	-
Cash and Cash Equivalents at End of Year	1,000	-	-
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:			
Operating Income (Loss)	\$ (1,100,680)	\$ -	\$ 51,255
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:			
Depreciation	4,405,114	-	-
Change in Assets and Liabilities:			
Decrease (Increase) in Receivables	(54,207)	-	-
Increase (Decrease) in Inventories	(245,025)	-	-
Increase (Decrease) in Accounts Payable	335,100	-	(2,170)
Increase (Decrease) in Retainage Payable	420,710	-	-
Increase (Decrease) in Contingent Absences	-	-	102,212
Increase (Decrease) in Lease Liabilities	-	-	102,212
Increase (Decrease) in Accrued Expenses	(254,723)	-	(23,284)
Total Adjustments	4,746,989	-	321,036
Net Cash Provided (Used) by Operating Activities	2,674,229	-	2,674,229

The accompanying notes are an integral part of the basic financial statements.

A. Summary of Significant Accounting Policies

The combined financial statements of City of Conroe, Texas (the "City") have been prepared in conformity with accounting principles applicable to governmental units which are generally accepted in the United States of America. The Governmental Accounting Standards Board ("GASB") has issued standards setting forth the basic principles for establishing governmental accounting and financial reporting principles. The following are some of the more significant accounting policies.

1. Reporting Entity

The City's combined financial statements include the accounts of all its operations. The City evaluated whether any other entity should be included in these financial statements. The criteria for including organizations as component units within the City's reporting entity, as set forth in GASB Statement No. 14 "The Financial Reporting Entity," include whether:

- the organization is legally separate
- the City holds the corporate powers of the organization
- the City appoints a voting majority of the organization's board
- the City is able to impose its will on the organization
- the organization has the potential to impose a financial burden on the City
- there is fiscal dependency by the organization on the City

BLENDED COMPONENT UNITS

The following entities are included in the financial statements as blended component units based upon their significant financial and operational relationships to the City:

Conroe Industrial Development Corporation - (CIDC) Directors are appointed by the governing body of the City. Although it is legally separate from the City, CIDC is reported as if it were part of the primary government because its sole purpose is to expand the proceeds of any sales and use taxes levied for the City's bond in order to finance major capital construction by the City.

Conroe Endowment Inc. - (CEBI) Directors are appointed by the governing body of the City, although it is legally separate from the City. CEPI is reported as if it were part of the primary government because its sole purpose is to take title of real property and transfer it to the City to promote and develop the City's park.

Oscar Johnson Jr. Community Center Volunteers Inc. - (OJCCV) A nonprofit corporation organized under the Texas Non-Profit Corporation Act to engage in charitable and educational activities related to the Oscar Johnson, Jr. Community Center, a municipal community center owned by the City. The Directors are appointed by the Mayor subject to confirmation by a majority vote of the City Council.

RELATED ORGANIZATIONS

The City officials are also responsible for appointing the members of other organizations, but the City's accountability for these organizations does not extend beyond making the appointments.

The following organizations are related organizations, which have not been included in the reporting entity:

Club Conroe, Board - (Conroe) The purpose of the Council is to promote tourism and the hotel industry and to develop and maintain the vicinity of certain annexed properties, including the promotion of the Dui Lago Golf Resort and Conference Center. The Center is required by the City to collect and remit the hotel occupancy tax imposed by the City as authorized by the Code, Chapter 251. From such funds collected, the City shall disburse to the Center a sum equal to 37% of the total occupancy taxes actually remitted to the City by the Center. The City is responsible for the approval of budgets submitted by the Council. Prior to September 30, 2006, the City had reported the Center as a blended component unit. The remainder of the Center received the governmental activities net assets by \$21,814.

recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Fund Financial Statements: Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The City recognizes all revenues reported in the governmental funds to be available if the revenues are collected within sixty days after year-end. The City does not consider revenues collected after its year-end to be available in the current period. Revenues from local sources consist primarily of property taxes. Property tax revenues and revenues received from the State are recognized under the susceptible-to-audit concept. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned since they are both measurable and available. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt and claims and judgments which are recognized as responsibilities in the event they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

When the City incurs an expenditure or expense for which both restricted and unrestricted resources may be used, it is the City's policy to use restricted resources first, then unrestricted resources.

Under GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," all enterprise funds will continue to follow Financial Accounting Standards Board ("FASB") standards based on or before November 30, 1992. However, from that date forward, enterprise funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements), or 2) continuing to follow new FASB pronouncements unless they conflict with GASB guidance. The City has chosen to apply future FASB standards.

4. Financial Statement Accounts

a. Cash and Investments

The City maintains and controls cash and investment pools in which the primary government's funds share. Each fund's portion of pooled cash has been consolidated and displayed on the general fund balance sheet as "pooled cash and cash equivalents." In addition, non-pooled cash and investments are separately listed and reflected in their respective funds as "non-pooled cash and cash equivalents" and "investments," some of which may be restricted assets.

The City, as a reporting entity, considers highly liquid investments (excluding restricted assets) with an original maturity of three months or less when purchased to be cash equivalents.

The City is authorized by the Public Funds Investment Act of 1987 to invest in: a) Obligations of the United States and its agencies or instrumentalities, b) Obligations of the State of Texas, c) Obligations of states, agencies, political subdivisions, and municipalities having a rating of not less than A, and d) fully collateralized direct repurchase agreements.

The City reports its investments as required by Statement 21 of the Governmental Accounting Standards Board, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools." Investments with a maturity of less than one year at acquisition are reported at amortized cost. Investments in open-end mutual funds are reported at fair value, as determined by the fund's current share price. This value approximates cost. The City's investments in the state's public funds investment pool are reported at fair value based on the value per share of the pool's underlying portfolio. Historically, the value per share in this public fund investment pool has approximated cost; therefore, the City's investments in this pool are reported at amortized cost.

Conroe Fireman's Relief and Retirement Fund - (CFRF) A local retirement plan covering active paid and volunteer firefighters of the City of Conroe. The City makes contributions to the fund as the fireman's employer, but has no control over investments or pension benefits. Two of the fund's trustees are the Mayor and Finance Director of the City, or their appointees.

Montgomery County 911 - (911) An entity created to manage the emergency telephone response system. The City appoints one member to the 911 Board.

Local Emergency Communications Center - (LECC) An entity created to manage fire and emergency medical responses in Montgomery County. The City provides partial funding and appoints one member to the governing board.

Houston/Galveston Area Council - (HGAC) A council of local governments in the Houston/Galveston area. The City appoints a representative.

Conroe Independent School District. The City of Conroe provides no funding and has no appointive or budgetary authority.

Montgomery County. The City of Conroe provides no funding and has no appointive or budgetary authority.

Montgomery County Hospital District. The City of Conroe provides no funding and has no appointive or budgetary authority.

Montgomery Central Appraisal District. The City of Conroe provides some funding and casts votes for board members.

2. Implementation of New Standards

In the current year, the City implemented the following new standards:

GASB Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments as it relates to the retrospective reporting of infrastructure assets only. For more information, see Note D - Capital Assets.

GASB Statement No. 44, Economic Condition Reporting: The Statistical Section - an Amendment of NCGA Statement 1, which amends the portions of NCGA Statement 1, Governmental Accounting and Financial Reporting Principles, that guide the preparation of the statistical section. The implementation of GASB Statement No. 44 created a need for the presentation of new information in the statistical section. This statement was implemented by the City for the fiscal year ending September 30, 2006.

3. Basis of Presentation, Basis of Accounting

a. Basis of Presentation

Government-wide Statements: The statement of net assets and the statement of activities include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double-counting of internal activities. These statements distinguish between the governmental and business-type activities of the City. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties.

The statement of activities presents a comparison between direct expenses and program revenues for the different business-type activities of the City and for each function of the City's governmental activities.

b. Property Taxes

Property taxes attach as an enforceable lien on property on February 1. Taxes are levied and become payable on October 1. The County is responsible for billing and collecting City property taxes. City property tax revenues are recognized when levied to the extent that they result in current receivables. The combined current tax rate to finance general governmental services and payment of principal and interest on long-term debt for the year ended September 30, 2006 was \$0.435 per \$100, allocated \$0.243 for the General Fund and \$0.190 for the Debt Service Fund. The tax rate for the year ended September 30, 2005 was \$0.335 per \$100, which was allocated \$0.2235 to the General Fund and \$0.1120 to the Debt Service Fund.

c. Inventories and Prepaid Items

Inventories consist primarily of supplies, valued at cost, which approximates market. Cost is determined using a weighted average method. The cost of inventories is recorded as expenditures/expenses when consumed rather than when purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

d. Capital Assets

Purchased or constructed capital assets are reported at cost or estimated historical cost. Donated maintenance and repairs that are estimated fair value at the date of the donation. The cost of new assets is capitalized. A capitalization threshold of \$5,000 is used.

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

Asset Class	Estimated Useful Lives
Buildings and Improvements	20-50
Machinery and Equipment	2-15
Infrastructure	50

a. Receivable and Payable Balances

The City believes that sufficient detail of receivable and payable balances is provided in the financial statements to avoid the obscuring of significant amounts by aggregation. Therefore, no disclosure is provided which disaggregates these balances.

There are no significant receivables which are not scheduled for collection within one year of year end.

f. Compensated Absences

Full-time, permanent employees are granted vacation benefits in varying amounts to specified maximums depending on tenure with the City. Sick leave accrues to full-time, permanent employees to specified maximums. After five years of service, employees are entitled to a portion of their sick leave balance not to exceed 90 days or 720 hours. Employees are also entitled to a portion of vacation leave with no minimum years of service requirement. Police officers and firefighters are not entitled to their proportionate sick leave balance until they retire or become disabled. However, some employees historically remain with the City until retirement.

Selected management employees are entitled to an accrued sick and vacation leave balances at resignation. All accrued time to sick and vacation leave balances are accrued when incurred in the

Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. The City does not allocate indirect expenses to the statement of activities. Program revenues include (a) fees, fines, and charges paid by the recipients of goods or services offered by the program and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the City's funds, with separate statements presented for each fund category. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental funds are aggregated and reported as nonmajor funds.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as royalties and investment earnings, result from nonexchange transactions or ancillary activities.

The City reports the following major governmental funds:

General Fund. This is the City's primary operating fund. It accounts for all financial resources of the City except those required to be accounted for in another fund. The principal sources of revenue of the General Fund are property taxes, sales and use taxes, licenses and permits, charges for services, and fines and forfeitures.

Conroe Industrial Development Corporation. This is a special revenue fund used to account for specific revenues that are legally restricted to expenditure for particular purposes by the City of Conroe.

Debt Service Fund. This fund is used to account for the accumulation of resources and payment of general obligation bonds, certificate obligations, and certificates of obligation. The primary source of revenue for Debt Service is property taxes.

Street Improvements. This is a capital projects fund used to account for the acquisition and construction of major capital facilities other than those financed by Proprietary Funds and Special Revenue Funds. The principal resources of the City's Projects Fund are capital grants, certificates of obligation, proceeds from the sale of bonds and special assessments.

The City reports the following major proprietary funds:

Water and Sewer Fund. This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the costs (expenses, including depreciation) of providing water and sewer services to the general public on a continuing basis are financed through user charges.

Internal Service Funds: These funds - Service Center and Self-Insured Insurance - are used to account for revenues and expenses related to services provided to parties inside the City. The fund indicates distribution of support costs to the users of the internal services are the City's business-type activities. This fund type is included in the "Business-type Activities" column of the government-wide financial statements.

These financial statements are reported using the economic resources measurement focus. The government-wide and proprietary fund financial statements are reported using the accrual basis of accounting. Revenues are recognized when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements, and donations. On an accrual basis, revenue from property taxes is

government-wide and proprietary fund financial statements. A liability for these amounts is reported only if they have matured, for example, as a result of employee resignations and retirements.

g. Interfund Activity

Interfund activity results from loans, services provided, reimbursements or transfers between funds. Loans are reported as interfund receivables and payables as appropriate and are subject to elimination upon liquidation. Services are provided, deemed to be at market or near market rates, are treated as revenues and expenditures or expenses. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers in and Transfers Out are netted and presented as a single transaction in the government-wide statement of activities. Similarly, interfund receivables and payables are netted and presented as a single "Internal Balances" line of the government-wide statement of net assets.

h. Use of Estimates

The preparation of financial statements in conformity with GAAP requires the use of management's estimates. Actual results could differ from these estimates.

5. Budgetary Control

The following procedures are followed in establishing the budgetary data reflected in the basic financial statements:

- a. Prior to the beginning of the fiscal year, the City prepares a budget for the next succeeding fiscal year. The operating budget includes proposed expenditures and the means of financing them.
- b. A meeting of the City Council is then called for the purpose of adopting the proposed budget. At least ten days' public notice of the meeting must have been given.
- c. Prior to the start of the fiscal year, the budget is legally enacted through passage of a resolution by the City Council.

Once a budget is approved, it can be amended only by approval of a majority of the members of the City Council. As required by law, such amendments are made before the fact, are reflected in the official minutes of the City Council and are not made after fiscal year end. During the year, the budget may be amended as necessary. All budget appropriations lapse at year end.

The appropriated budget is prepared by fund, function, and department. The City's department heads may make transfers of appropriations within a department. Transfers of appropriations between departments require the approval of the Council. The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriations) is the department level.

B. Compliance and Accountability

1. Deficit Fund Balance or Fund Net Assets of Individual Funds

Following are funds having deficit fund balances or fund net assets at year end, if any, along with remarks which address such deficits:

Fund Name	Deficit Amount	Remarks
Street Improvements	(2,751,739)	Deficit funded by debt during 2007
Service Center	(146,750)	City has substantially recovered the deficit in 2007

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2. Reconciliation of Government-wide and Fund Statements for Business-Type Activities

Description	Government-wide		Adjustments	Reconciling
	Assets	Liabilities		
Total Assets	\$12,867,418	\$10,917,237	(\$2,950)	
Total Liabilities	\$20,850,481	\$20,866,036	\$17,700	

C. Investments

The City's funds are required to be deposited and invested under the terms of a depository contract. The depository bank deposits for safekeeping and custodial services the City's general fund approved pledged securities in an amount sufficient to protect City funds on a day-to-day basis during the period of the contract. The pledge of approved securities is valued only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation (FDIC) insurance.

Cash Deposits

At September 30, 2006, the carrying amount of the City's deposits (cash, and interest-bearing savings accounts are included in temporary investments) was \$10,617,219 and the bank balance was \$12,356,129. The City's cash deposits at September 30, 2006 and during the year ended September 30, 2006, were entirely covered by FDIC insurance or by FDIC collateral held by the City's name in the City's name.

Investments

The City is required by Government Code Chapter 2556, The Public Funds Investment Act, to adopt, implement, and publicize an investment policy. That policy must be written primarily emphasizing the safety of principal and liquidity, avoid investment diversification, yield, and maturity are the quality and capacity of investment management and include a list of the types of authorized investments in which the investing entity's funds may be invested; state the maximum allowable stated maturity of any individual investment owned by the entity.

The Public Funds Investment Act ("Act") requires an annual audit of investment practices. Audit procedures in this area conducted as a part of the audit of the financial statements disclosed that in the areas of investment practices, management reports and establishment of investment policies, the City adhered to the requirements of the Act. Additionally, investment practices of the City were in accordance with best practices. The Act defines the types of investments which are allowable for the City. These include, with certain restrictions, (1) obligations of the U.S. Treasury, certain U.S. agencies, and the State of Texas; (2) certificates of deposit; (3) certain municipal securities; (4) money market savings accounts; (5) reverse repurchase agreements; (6) bankers acceptances; (7) mutual funds; (8) investment pools; (9) guarantee investment contracts; and (10) common trust funds.

Investment Type	Fair Value	Weighted Average Maturity (Years)
Money Market	\$ 1,371,254	0.00
Treasury	5,503,269	0.01
U.S. Government Securities, Long-term	4,355,242	0.25
U.S. Government Securities, Short-term	6,338,119	0.25
Commercial Paper	6,331,711	0.49
Total Fair Value	\$ 21,900,595	
Portfolio Weighted Average Maturity		1.76

Interest rate risk: The City's investment policy is to concentrate its portfolio in short-term securities in order to limit principal risk caused by changes in interest rates. The maximum dollar-weighted average maturities for the entire portfolio shall be limited to 305 days unless the securities are being held for long-term goals.

Investment Acquisition Policy

The City's general policy is to report money market investments and short-term participating interest-bearing investment contracts of amortized cost and to report nonparticipating interest-bearing investment contracts using a cost-based measure. However, if the fair value of an investment is significantly affected by the impairment of the credit standing of the issuer or by other factors, it is reported at fair value. All other investments are reported at fair value unless a legal contract exists which guarantees a higher value. The term "nonparticipating" refers to investments which have a remaining term of one year or less at the date of purchase. The term "nonparticipating" means that the investment's value does not vary with market interest rate changes. Nonparticipating certificates of deposit are examples of nonparticipating interest-bearing investment contracts.

D. Capital Assets

Capital asset activity for the year ended September 30, 2006, was as follows:

Governmental activities:	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land	\$ 137,950,007	\$ 34,070	\$ (1,046,220)	\$ 137,917,857
Construction in progress	1,255,951	4,814,772	-	6,070,723
Total capital assets not being depreciated	150,205,958	4,848,842	(1,046,220)	154,008,580

Capital assets being depreciated:	Beginning Balance	Increase	Decrease	Ending Balance
Road Network (1)	20,608,742	-	-	20,608,742
Buildings and improvements	36,447,013	365,522	-	36,812,535
Machinery and Equipment	10,320,192	1,415,224	(475,281)	11,260,135
Infrastructure	7,834,256	-	7,034,308	809,948
Total capital assets being depreciated	75,208,203	2,146,248	(475,281)	76,879,170
Less accumulated depreciation for:				
Road Network (1)	(16,620,100)	(800,208)	-	(17,420,308)
Buildings and improvements	(8,214,297)	(370,027)	-	(8,584,324)
Machinery and Equipment	(2,108,620)	(174,309)	345,782	(1,937,147)
Infrastructure	(225,558)	(222,754)	-	(448,312)
Total accumulated depreciation	(27,168,575)	(1,573,338)	345,782	(28,395,130)
Total capital assets being depreciated, net	48,039,628	572,910	(129,509)	48,483,003
Governmental activities capital assets, net	\$ 202,245,586	\$ 5,421,752	\$ (1,175,729)	\$ 206,591,609

(1) The beginning balance for Road Network has been restated. This increase resulted from the partial implementation of the portion of GASB Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, as it pertains to retrospective reporting of Infrastructure assets. These assets were acquired prior to the implementation of GASB Statement No. 34 in the fiscal year ended September 30, 2003.

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2. Transfers To and From Other Funds

Transfers to and from other funds at September 30, 2006, consisted of the following:

Transfers From	Transfers To	Amount	Reason
General Fund	Other Governmental	\$ 113,036	In fee of rent to Conroe Tower
General Fund	Other Governmental	124,500	Allocation of revenue 782 P2
General Fund	Other Governmental	411,829	Allocation of revenue 1952 P1
Water and Sewer	Other Governmental	116,020	In fee of rent to Conroe Tower
Water and Sewer	General Fund	1,037,700	Administrative Cost and Budget Stabilization Fund
ODC	Debt Service	1,337,851	P & I related to Park Debt
	Total	\$ 3,146,966	

Long-Term Obligations

Long-term debt consists of general obligation bonds, commercial and certificates of obligation and revenue bonds. The City's bonded liability for compensated absences and compensatory time, and capital leases, principal and interest payments on the City's bonded debt are secured solely by all valid property taxes levied on all taxable property within the City limits. Payments are reported in the Debt Service Fund and ODC Fund.

1. Long-Term Obligation Activity

A summary of the long-term bonded debt of the City at September 30, 2006 is presented below:

Refunding Bonds:	Rate	Issue Date	Maturity Date	Bonds Outstanding
Refunding Bonds, Series 1999	3.00-5.00	% 2008	2015	\$ 6,820,000
Refunding Bonds, Series 2005	3.00	% 2005	2013	2,850,000
Total Refunding Bonds Payable				\$ 9,670,000
Contractual and Certificates of Obligation				
Series 1997 ODC	4.40	% 1997	2017	1,315,000
Series 1998	4.65	% 1998	2011	2,025,000
Series 1999 ODC	3.85	% 1999	2017	1,750,000
Series 2002	4.70-5.00	% 1997	2013	3,425,000
Series 2001	4.20-5.70	% 1998	2016	5,800,000
Series 2002	4.20-5.00	% 2000	2017	7,500,000
Series 2003	4.00-5.00	% 2001	2017	8,500,000
Series 2004	4.00-5.00	% 2002	2022	3,370,000
Series 2005	4.25	% 2005	2010	3,885,000
Total Contractual and Certificates of Obligation Payable				\$ 52,370,000
Revenue Bonds				
Waterworks and Sewer System				
Revenue Refunding	3.70-4.30	% 2003	2008	\$ 1,200,000
Bonds, Series 2006	4.275-5.00	% 2006	2030	10,850,000
Total Revenue Bonds, Net				\$ 12,050,000

Long-term obligations include debt and other long-term liabilities. Changes in long-term obligations for the year ended September 30, 2006, are as follows:

Governmental activities:	Beginning Balance	Increase	Decrease	Ending Balance	Amount Due Within One Year
General obligation bonds	\$ 12,103,000	\$ -	\$ 1,480,000	\$ 10,623,000	\$ 1,385,000
Certificates of obligation	11,495,000	3,385,000	2,390,000	12,490,000	3,245,000
Less deferred amounts	(128,185)	-	87,027	(215,212)	(14,158)
Total bonds payable	23,470,000	3,385,000	2,577,027	24,277,973	4,575,842
Capital leases	1,825,166	2,425,465	493,157	3,757,474	800,018
Notes	1,428,000	290,600	50,000	1,668,600	75,000
Health Claims Liability	895,451	972,867	-	1,868,318	1,768,318
Compensated absences	4,053,167	462,016	-	4,515,183	4,355,786
Total governmental activities	21,671,824	7,645,948	4,947,284	24,370,488	11,788,964

Business-type activities:	Beginning Balance	Increase	Decrease	Ending Balance
Revenue bonds	\$ 1,715,000	\$ 10,800,000	\$ 685,000	\$ 11,830,000
Less deferred amounts	(102,829)	-	51,455	(154,284)
Revenue bonds, net	1,612,171	10,800,000	633,545	11,778,626
Customer Deposits	275,134	40,005	-	315,139
Capital leases	102,238	3,334,420	51,390	3,485,268
Compensated absences	720,050	203,055	-	923,105
Total business-type activities	2,710,601	14,377,480	735,930	16,352,151

Other long-term liabilities: The funds typically used to liquidate other long-term liabilities in the past are as follows:

Liability	Activity Type	Fund
Compensated absences	Governmental	General
Compensated absences	Business-type	Water and Sewer
Health Claims Liability	Governmental	Self-Funded Insurance

2. Debt Service Requirements

Debt service requirements on long-term debt at September 30, 2006, are as follows:

Year Ending September 30:	Principal	Interest	Total
2007	\$ 4,820,000	\$ 2,886,135	\$ 7,706,135
2008	4,820,000	2,362,940	7,182,940
2009	5,245,000	2,122,355	7,367,355
2010	5,890,000	1,874,202	7,764,202
2011	6,010,000	1,617,016	7,627,016
2012-2016	24,545,000	4,770,208	29,315,208
2017-2021	7,470,000	1,262,311	8,732,311
2022-2026	3,075,000	608,397	3,683,397
2027-2031	1,215,000	193,214	1,408,214
Totals	\$ 63,020,000	\$ 17,502,533	\$ 80,522,533

Business-type activities:	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets being depreciated:				
Land	\$ 205,222	\$ -	\$ -	\$ 205,222
Construction in progress	1,340,800	7,130,088	-	8,470,888
Total capital assets not being depreciated	1,546,022	7,130,088	-	8,676,110
Capital assets being depreciated:				
Buildings and improvements	1,044,720	-	-	1,044,720
Machinery and Equipment	5,112,450	1,182,202	(275,342)	6,019,510
Infrastructure	93,303,531	503,854	-	93,807,385
Total capital assets being depreciated	50,460,601	1,686,056	(275,342)	51,871,315
Less accumulated depreciation for:				
Buildings and improvements	(104,170)	(26,042)	-	(130,212)
Machinery and Equipment	(1,797,400)	(402,228)	-	(2,199,628)
Infrastructure	(45,720,020)	(4,617,140)	-	(50,337,160)
Total accumulated depreciation	(47,621,590)	(4,645,410)	121,892	(52,145,108)
Total capital assets being depreciated, net	2,839,011	2,040,646	(153,448)	4,726,209
Business-type activities capital assets, net	\$ 4,837,111	\$ 9,170,734	\$ (176,738)	\$ 13,871,107

Depreciation expense was charged to functions as follows:

Governmental activities:	Amount
General Government	\$ 280,200
Police	22,424
Public Department	741,208
Public Safety	551,238
Public Works	581,743
	\$ 2,778,013

Business-type activities:

Enterprise	\$ 2,456,114
	\$ 2,456,114

B. Intergovernmental Activity

1. Due To and From Other Funds

Business due to and due from other funds at September 30, 2006, consisted of the following:

Due To Fund	Due From Fund	Amount	Purpose
ODC	General Fund	\$ 1,050,205	Pooled Cash
Water and Sewer Fund	General Fund	5,019,417	Pooled Cash
Other Governmental Funds	General Fund	5,007,427	Pooled Cash
Total		\$ 11,077,049	

All amounts due are scheduled to be repaid within one year.

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Business-Type Activities

Year Ending September 30:	Principal	Interest	Total
2007	\$ 718,000	\$ 828,885	\$ 1,546,885
2008	415,000	321,889	736,889
2009	355,000	252,563	607,563
2010-2014	1,455,000	2,317,415	3,772,415
2015-2019	1,905,000	1,501,127	3,406,127
2020-2024	2,400,000	1,399,256	3,799,256
2025-2029	3,555,000	742,181	4,297,181
2030-2034	1,500,000	222,201	1,722,201
Total	\$ 13,840,000	\$ 7,995,722	\$ 21,835,722

Interest on the Section 105 Loan Guarantee to paid at 0.20% plus LIBD

1. Capital Leases

Commitments under capitalized lease agreements for buildings and equipment provide for minimum future lease payments as of September 30, 2006, are as follows:

Year Ending September 30:	Governmental Activities
2007	\$ 1,131,086
2008	1,033,553
2009	875,282
2010	346,086
2011	71,002
2012-2016	308,159
2017-2021	308,159
Total Minimum Lease Payments	\$ 5,207,607
Less: amount representing interest	509,222
Present Value of Minimum Lease Payments	\$ 4,698,385

The gross amount of capital assets (machinery, equipment and improvements) acquired through governmental activities capital leases is \$4,012,730 as of September 30, 2006.

Year Ending September 30:	Business-type Activities
2007	\$ 623,819
2008	509,282
2009	509,282
2010	509,282
2011	509,282
2012-2016	2,846,411
2017-2021	2,846,411
Total Minimum Lease Payments	\$ 8,857,720
Less: amount representing interest	2,205,000
Present Value of Minimum Lease Payments	\$ 6,652,720

The City pays the administrator a monthly fixed fee for various claim administration services on a per enrolled employee basis.

The City pays all claims. The third-party administrator submits weekly preliminary check registers for all processable claims. The City issues payment to the plan administrator who in turn issues individual claim checks. The City corrects stop-loss insurance applied catastrophic losses. Stop-loss insurance recoverable at September 30, 2006 was \$0. The premiums for these policies are billed monthly by the third-party administrator on a per enrolled employee basis. The claims liability reported in the fund at September 30, 2006 was estimated by third party administrators. It is based on the requirements of Governmental Accounting Standards Board Statement No. 12 which requires that a liability for unpaid claims costs, including estimates of costs relating to incurred but not reported claims, be reported. Costs relating to the plan are recorded in the Internal Service Fund, Self-Funded Insurance.

Changes in the health claims for the two fiscal years ended September 30, 2006 and 2005 are as follows:

	2006	2005
Health Claim Liability, beginning of year	\$ 895,451	\$ 210,030
Current-year Claims and Changes in Estimates	2,655,435	3,221,407
Claim payments	(2,112,558)	(2,858,284)
Health Claim Liability, End of Year	\$ 1,438,328	\$ 595,153

Additionally, the City has designated fund balances/net assets for possible retained risk.

4. Pension Plan

a. Plan Description

The City's pension plan ("Plan") is a non-traditional, joint contributory, hybrid defined benefit plan which provides retirement benefits to Plan members through its affiliation with Texas Municipal Retirement System ("TMRS"), an agent multiple-employer public employee retirement system. TMRS operates under the authority of Texas Government Code, Title 8, Subtitle G. The Texas Legislature has the authority to establish or amend benefit provisions and the governing body of the City adopts the plan provisions within the options and constraints established by the legislature. TMRS issues a publicly available financial report that includes financial statements and required supplementary information for TMRS. This report may be obtained by writing to Texas Municipal Retirement System, P.O. Box 149153, Austin, TX 78714-9153 or calling (800) 934-8277. Additional non-confidential information is available at the TMRS web site, <http://www.tmrstx.org>.

b. Funding Policy

Plan members are required to contribute 7% of their annual covered salary. This City is required to contribute at an actuarially determined rate the current matching portion is 2 to 1 of annual covered payroll. A member's vesting occurs after five years. Members can retire at age 60 and above with 10 or more years of service or with 25 years of service regardless of age. The plan provisions are accepted by the governing body of the City, which has the options available in the state statutes governing TMRS and within the actuarial constraints also in the statutes.

c. Annual Pension Cost

The City's annual pension cost of \$1,831,016 for the Plan was equal to the City's required and actual contributions. Under the state law governing TMRS, the actuary annually determines the City's contribution rate. This rate consists of the normal cost contribution rate and the prior service contribution rate, both of which are calculated by a level percent of payroll from year to year. The normal cost contribution rate forecasts the currently accruing monetary credits due to the City matching percent, which are the obligation of the City as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the City to each employee at the time his/her retirement becomes effective. The prior service contribution rate amortizes

the unfunded (overfunded) actuarial liability (asset) over the remainder of the plan's 25-year amortization period. When the City periodically adopts updated service credits and increases in annualized in effect, the increased unfunded actuarial liability is to be amortized over a new 25-year period. Currently, the unfunded actuarial liability is being amortized over the 25-year period which began January 1997. The unit credit actuarial cost method is used for determining the City's contribution rate. Since the City needs to know its contribution rate in advance to budget for it, there is a one-year delay between the actuarial valuation that is the basis for the rate and the calendar year when the rate goes into effect (i.e., December 31, 2005 valuation is effective for rates beginning January 2007).

Since the TMRS does not value the assets of individual cities, the actuarial assumptions used to set the required contribution rate of the City are based on TMRS as a whole. For the December 31, 2004 valuation date, an 8% investment rate of return was assumed. No assumptions were made for projected salary increases, inflation or cost of living adjustments.

4. Trend Information for the Plan

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Cost/Unfunded Liability	Net Pension Obligation
9/30/04	\$ 1,472,372	100%	\$ -
9/30/05	1,714,000	100%	-
9/30/06	1,813,016	100%	-

5. Schedule of Funding Progress for the Retirement Plan for Employees of City of Conroe: (Expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded AAL (b-a)	Funded Rate (%)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b/c)
12/31/03	\$35,765	\$5,819	\$29,946	8.23%	\$12,103	75.82%
12/31/04	27,729	36,539	8,810	75.6%	12,818	68.70%
12/31/05	29,140	38,816	9,676	75.1%	14,377	67.36%

1. City of Conroe Fire Fighters' Retirement Fund

The City participates in funding a contributory, defined benefit retirement plan: City of Conroe Fire Fighters' Retirement Fund. The Fund was established in accordance with the provisions of M.S. 250 passed by the Texas State Legislature in 1937, with the purpose of providing pension benefits to volunteer, part-time and full-time firefighters. The Fund is administered in accordance with State laws by the members of the Fund's Pension Board of Directors. The plan is a City-wide single employer funded plan that covers substantially all active paid and volunteer fire fighters. The fiscal year of the pension fund ends December 31. The most recently available financial statements of the pension fund is for the year ended December 31, 2005.

While contribution requirements are not actuarially determined, state law requires that a qualified actuary approve each plan adopted. The actuary of the plan has certified that the contribution commitment by the participants and the City provides an adequate financing arrangement. The City's annual pension cost was equal to the City's required and actual contribution as noted below. The City does not have any net pension obligations.

Fiscal Year Ending	City	Employees	Total Contributions
12/31/03	\$ 384,453	\$36,633	\$701,260
12/31/04	384,160	343,011	727,271
12/31/05	456,383	364,812	821,195

Actuarial valuation of the plan is performed every three years. Actuarial updates are done in each year following the full valuation. The latest actuarial valuations were completed as of December 30, 2005.

The following are actuarial assumptions:

Actuarial Cost Method	Entry age normal cost method
Amortization Method	Level Percentage, closed
Amortization Period	22 Years
Asset Valuation Method	Market
Investment Rate of Return	8.00%
Projected Salary Increase	4.00%
Inflation Rate	3.00%
Cost of Living Adjustment	0.00%

Information pertaining to the latest actuarial valuations for the plan is as follows:

Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	UAAL (1)	Funded Ratio	Annual Covered Payroll	Percentage of UAAL to Covered Payroll
12/31/03	\$4,646,787	\$ 2,282,132	\$ 1,635,345	74.0%	\$ 2,285,641	71.2%
06/30/04	\$5,389,828	\$ 2,927,000	\$ 3,676,138	59.5%	\$ 2,971,623	112.2%
12/31/05	\$7,111,055	\$ 3,745,237	\$ 3,634,432	66.2%	\$ 3,369,324	107.9%

(1) UAAL - Unfunded Actuarial Accrued Liability (Excess)

The plan's accounting records are maintained on the accrual method. Their investments are valued at current market value determined by the following methods: investments traded on a national securities exchange are valued at the reported closing price as of the last business day of the year; and the investments traded over-the-counter are valued at the last reported bid price. Mutual funds are reported at net asset value.

Financial reports that include financial statements for the plan is publicly available by contacting: Conroe Fire Fighters' Retirement Fund, 804 W. Dallas, Suite 11, Conroe, Texas 77381, or (833) 700-1600.

6. Commitments and Contingencies

1. Contingencies

The City participates in grant programs which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the City has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectability of any refund receivable may be impaired. In the opinion of the City, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying basic financial statements for such contingencies.

2. Litigation

The City is a defendant or plaintiff in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of the City attorney, the resolution of these matters will not have a material, adverse effect on the financial condition of the City.

3. Deferred Compensation Plan

The City offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all City employees, permits them to defer a portion of their salary

until further years. The deferral compensation is not available to employees until termination of employment, retirement, death or unforeseeable emergency.

All amounts of compensation deferred under the plan, at property and rights purchased with these amounts, and all income attributable to these amounts, property, or rights are assets of the plan, and are required to be held in trust for the exclusive benefit of the participants and their beneficiaries. A fiduciary relationship does not exist between the City and the plan; therefore, in accordance with GASB Statement 31, "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans," the plan is not reported within the City's financial statements.

3. Closure and Postclosure Costs

State and Federal laws and regulations require that a landfill permit holder place a final cover on its landfill when closed and perform certain maintenance and monitoring functions at the landfill site for thirty years after closure. The City has transferred the financial obligation relating to these costs to another party. Therefore, no liability has been recorded for these costs.

4. Lease Purchase Agreement

During the fiscal year ended September 30, 1997, the City of Conroe, acting as lessee, entered into an agreement with the Greater Chamber of Commerce, Inc. (GCC), whereby land and other improvements located at 505 West Davis, Conroe, Texas were acquired by the lessee through means of a lease-purchase agreement in the amount of \$235,000. The lease is payable in 120 equal monthly principal and interest payments of \$4,064 with an interest rate of 8.00%. The City provides the Chamber with a rental credit for the principal and interest payments for the services they provide to the Convention and Visitors Bureau and Greater Conroe Economic Development Council. Lease Income is recognized for those services the Chamber provides for the City. The total minimum lease payments to be received are \$46,772.

A schedule of the minimum lease payments until the lease's maturity is as follows:

Year Ended	
September 30, 2007	\$ 48,772
	\$ 48,772

5. Non-Accounting Restatement

The Governmental Accounting Standards Board (GASB) has recently issued several new statements. A listing follows of those that apply to the City. These statements will be implemented in subsequent years, as required by the GASB.

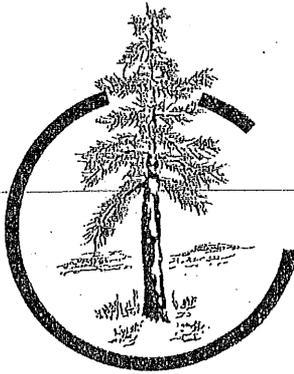
GASB Statement No. 45, Accounting and Financial Reporting for Employees for Postemployment Benefits Other than Pensions, which establishes standards for the measurement, recognition, and display of other postemployment benefit expenditures and related liabilities, and note disclosures in the financial report. This statement will be effective for the City for the fiscal year ending September 30, 2009.

GASB Statement No. 47, Accounting for Termination Benefits, which requires employers to recognize a liability and provision for voluntary termination benefits when the offer is accepted and the amount can be estimated. This statement will be effective for the City for the fiscal year ending September 30, 2009.

GASB Statement No. 48, Accounting for Financial Reporting for Pollution Remediation Obligations, which establishes accounting and reporting standards for pollution (including contamination) remediation obligations. This statement will be effective for the City for the fiscal year ending September 30, 2009.

6. Prior Period Adjustments

The City's financial statements contain the following prior period adjustments: (1) overstatement of governmental activities capital assets, (2) overstatement of business-type activities capital assets, (3) the reclassification of a governmental activities capital projects fund to a business-type fund and (4) the removal of an entity that was previously presented as a blended component unit.



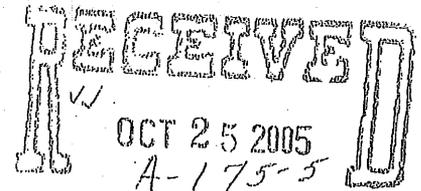
ED KHARBAT, P.E., R.P.L.S.
CAPITAL PROJECTS DEPARTMENT
DIRECTOR OF ENGINEERING & CONSTRUCTION

CITY OF CONROE

300 W. DAVIS • P. O. BOX 3066 • CONROE, TEXAS 77305 • (936) 539-4431

October 6, 2005

Tammy Benter
T.C.E.Q.
Utilities & District Section
MC 153
P.O. Box 13087
Austin, TX 78711-3087



WATER QUALITY APPLICATIONS TEAM

600650311
161386008

RE: De-certification of CNN 12117

Dear Ms. Benter,

The City has annexed an area that has an existing CCN (19 connections). The water system, owned by the H.O.A., is to be taken out of service and replaced by a City of Conroe line.

CCN # 12117 (Teas Estates Homeowners Association, Inc.) is to be de-certified and the area transferred to the City of Conroe (CCN # 10339) pursuant to the Texas Water Code Chapter 13.248.

Please find attached:

1. City's Annual Financial Report,
2. the CCN Maps,
3. the agreement between the City and the H.O.A.,
4. Ordinance from Council approving annexation, and
5. Service Area Agreement from Annexation.

Please call if you have any questions.

Sincerely,

Stephen Troy Toland, P.E.
Assistant Director of Capital Projects

STT/crl

RECEIVED

OCT 24 2005

TEXAS COMMISSION
ON
ENVIRONMENTAL QUALITY

Agreement

THIS AGREEMENT is made and effective this 5TH day of AUGUST 2005 by and between the City of Conroe, Texas (hereinafter referred to as the "CITY"), and *Teas Estates Homeowners Association, Inc.*, (hereinafter referred to as the "HOA") for the transfer of the provider of service for the water utility, de-certification of the HOA's Certificate of Convenience and Necessity (CCN) # 12117 and for that area served by the CCN# 12117 to be transferred and serviced by the City of Conroe, CCN # 10339. The Association will sign all future forms necessary to facilitate this transfer of service.

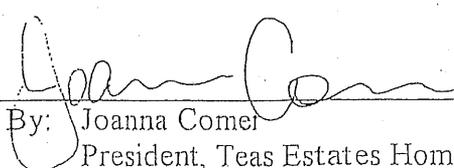
Upon completion of construction of new facilities by the City, the HOA will cease operations of the water utility, and the individual home owners will obtain the necessary permits to tap homes into the City system. All previously existing facilities remain the property of the HOA. The 19 customers serviced, in acceptance of this agreement via the President of the Association's signature below, will be notified of the change by certified mail.

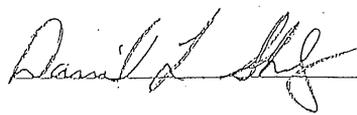
IN WITNESS WHEREOF, the parties to these presents have executed this Agreement in the year and day first above written.

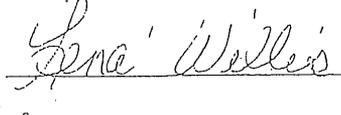
Party of the First Party (City of Conroe)

Party of the Second Party (HOA)


By: Ed Kharbat, P.E.
Director of Engineering and
Construction


By: Joanna Comer
President, Teas Estates Homeowners
Association, Inc.

Attest By: 

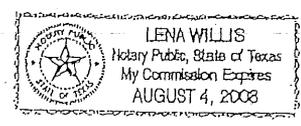
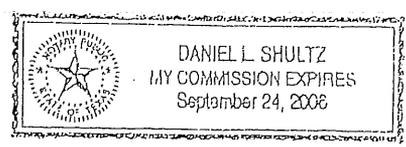
Attest By: 

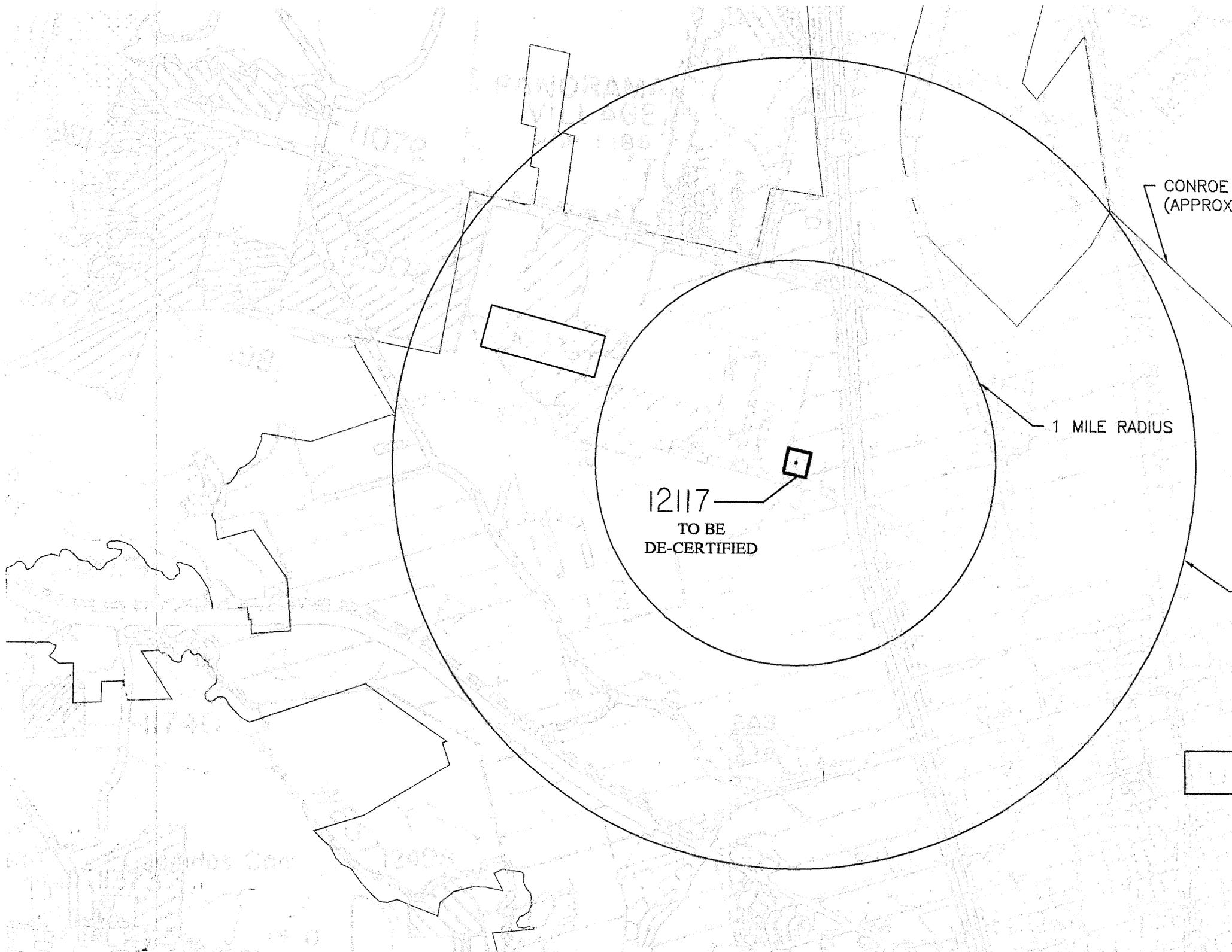
Title: Director of Engineering

Title: Secretary

SEAL

SEAL





CONROE
(APPROX)

1 MILE RADIUS

12117
TO BE
DE-CERTIFIED

11072

12902

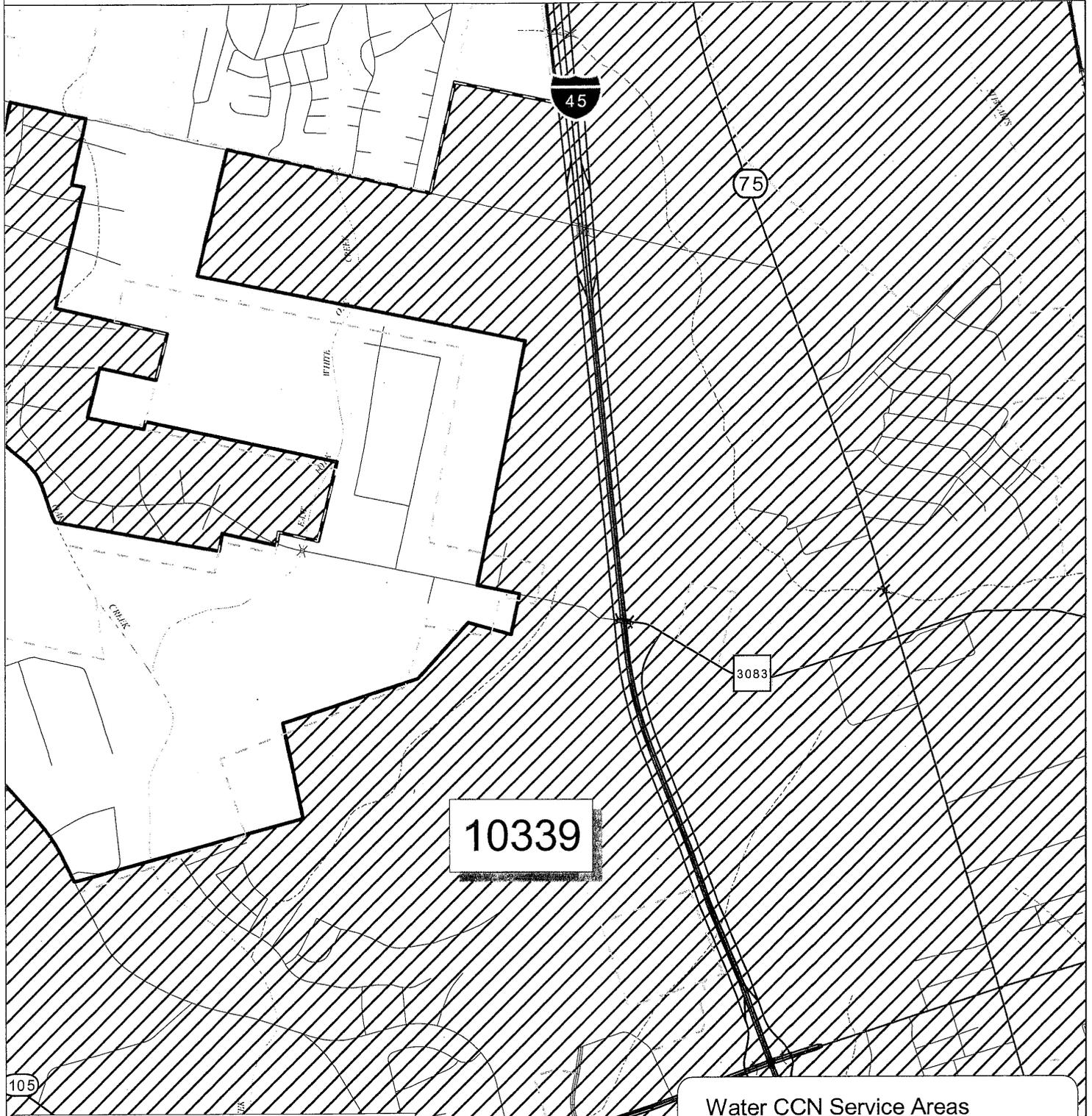
12402

12402



City of Conroe / Teas Estates Homeowners Assoc., Inc. 13.248 Agreement
Portion of City of Conroe's Water Service Area
CCN No. 10339

Application No. 35170-C (Decertified and Cancelled CCN 12117, Teas Estates Homeowners Assoc, Inc.)
Montgomery County



10339

Water CCN Service Areas

 10339 - CITY OF CONROE

2000 0 2000 Feet

1 inch = 2,000 feet



Map by S. Jaster 2/1/2007
Data path: c:\gis\ccn_working\ccn.shp
Project path: c:\gis\projects\applications\35170-c.apr





Texas Commission On Environmental Quality

By These Presents Be It Known To All That

City of Conroe

having duly applied for certification to provide water utility service for the convenience and necessity of the public, and it having been determined by this commission that the public convenience and necessity would in fact be advanced by the provision of such service by this Applicant, is entitled to and is hereby granted this

Certificate of Convenience and Necessity No. 10339

to provide continuous and adequate water utility service to that service area or those service areas in Montgomery County as by final Order or Orders duly entered by this Commission, which Order or Orders resulting from Application Nos. 35170-C are on file at the Commission offices in Austin, Texas; and are matters of official record available for public inspection; and be it known further that these presents do evidence the authority and the duty of City of Conroe to provide such utility service in accordance with the laws of this State and Rules of this Commission, subject only to any power and responsibility of this Commission to revoke or amend this Certificate in whole or in part upon a subsequent showing that the public convenience and necessity would be better served thereby.

Issued at Austin, Texas, this _____

For the Commission

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



AN ORDER approving an agreement designating service areas between the City of Conroe and Teas Estates Homeowners Association, Inc., pursuant to Texas Water Code Section 13.248; TCEQ Docket No. 2007-0334-UCR.

A request for a Commission Order approving a contract designating service areas between the City of Conroe (City), Certificate of Convenience and Necessity (CCN) No. 10339, and Teas Estates Homeowners Association, Inc. (HOA), CCN No. 12117, in Montgomery County, Texas, was presented to the Texas Commission on Environmental Quality (Commission) for approval pursuant to section 13.248 of the Texas Water Code and Title 30, section 291.117 of the Texas Administrative Code.

On November 13, 2003, the City annexed an area that included the area covered by the HOA's CCN. The parties entered into an agreement dated August 5, 2005, under which the HOA would transfer its entire CCN area to the City, thereby incorporating the area into the City's CCN area. The HOA would maintain ownership of its water utility facilities, and the homeowners would tap into the City's system. The Agreement is attached to this Order. The City is proposing to provide service to this area.

Contracts between retail public utilities that designate areas to be served and customers to be served by those retail public utilities, when approved by the Commission after public notice and hearing, are valid and enforceable and are incorporated into the appropriate areas of public convenience and necessity. TEXAS WATER CODE § 13.248.

The Executive Director of the Commission mailed notice of the hearing date on which the Commission was to consider the request to the City, the HOA, and the customers in the affected area.

The Commission held a hearing on the request at its October 24, 2007, Agenda meeting and found the request had merit.

The City is capable of rendering continuous and adequate water service to every customer in the area covered by the Agreement. The transfer of the HOA's authority to provide service in the affected area, which results in the City as the sole service provider remaining in the area, is necessary for the service, accommodation, convenience, or safety of the public.

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY that:

1. The Agreement addressing the transfer of the HOA's CCN No. 12117 and designating that retail water service shall be provided by the City, CCN No. 10339, in that area is hereby approved.
2. CCN No. 10339, held by the City of Conroe, in Montgomery County is hereby amended in accordance with the Agreement. CNN No. 12117, held by Teas Estates Homeowners Association, Inc., in Montgomery County is hereby cancelled in accordance with the Agreement.
3. The Executive Director is directed to redraw the City of Conroe's CCN No. 10339 as provided in the Agreement and as set forth on the map attached to this Order and to amend the Commission's official water service area map for Montgomery County, Texas.
4. The Chief Clerk of the Texas Commission on Environmental Quality shall

forward a copy of this Order and the attached map to the parties.

5. If any provision, sentence, clause, or phrase of this Order is for any reason held to be invalid, the invalidity of any portion shall not affect the validity of the remaining portions of the Order.

Issue Date:

TEXAS COMMISSION ON
ENVIRONMENTAL QUALITY

For the Commission