TEXAS SOUTHMOST COLLEGE DISTRICT

ANNUAL FINANCIAL REPORT

AUGUST 31, 2006

TEXAS SOUTHMOST COLLEGE DISTRICT
ANNUAL FINANCIAL REPORT

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TEXAS SOUTHMOST COLLEGE DISTRICT

ORGANIZATIONAL DATA

FOR THE FISCAL YEAR 2006

Board of Trustees

Officers

Chester Gonzalez	Chairperson
Rosemary Breedlove	Vice-chairperson
Eduardo A. Campirano	Secretary

Members

		Term Expires
Roman Esparza	Brownsville, Texas	May, 2008
Rosemary Breedlove	Brownsville, Texas	May, 2010
David G. Oliveira	Brownsville, Texas	May, 2012
Chester Gonzalez	Brownsville, Texas	May, 2010
Dolly Zimmerman	Port Isabel, Texas	May, 2008
Dr. Roberto Robles	Brownsville, Texas	May, 2012
Eduardo A. Campirano	Brownsville, Texas	May, 2010

Principal Administrative Officers

Dr. Juliet V. Garcia	President, UTB/TSC
Dr. Wayne J. Moore	Vice President for Administration and Partnership Affairs, UTB/TSC
Melba M. Sanchez, CPA	District Controller

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Texas Southmost College District
Brownsville, Texas

We have audited the accompanying financial statements of Texas Southmost College District, as of and for the years ended August 31, 2006 and 2005 as listed in the table of contents. These financial statements are the responsibility of the College'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 College'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 the 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Texas Southmost College District, as of August 31, 2006 and 2005, and the changes in its net assets and, cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis information on pages 7 through 22, 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 an opinion on the financial statements of Texas Southmost College District taken as a whole. The accompanying supplementary information on pages 63 through 80 is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying schedule of expenditures of federal awards and schedule of expenditures of state awards are presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the State of Texas Single Audit Circular, and are also not a required part of the financial statements. Such information, except for the portion marked "unaudited" on which we express no opinion, has been subjected to the auditing procedures applied in the

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audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Long Chilton LLP

Brownsville, Texas
November 7, 2006

TEXAS SOUTHMOST COLLEGE

MANAGEMENT'S DISCUSSION AND ANALYSIS

AUGUST 31, 2006

Management's Discussion and Analysis of Texas Southmost College's (the College) financial performance provides an overview of the College's financial activities for the fiscal year ended August 31, 2006. This discussion and analysis is to be read in conjunction with the College's financial statements which begin on page 23.

USING THIS ANNUAL REPORT

The financial statements presented in Exhibits 1, 2 and 3 are prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments,* and Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public College's and Universities.* The required statements are: the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows.

As required by GASB No. 34 and No. 35, the current and prior year financials are prepared using the accrual basis of accounting, which is the same method used by most private sector companies, and focus on the financial condition of the College, results of operations and cash flows of the College as a whole. For purposes of discussion and analysis, we have provided a year to year comparative analysis of the financial statements.

The notes to the financial statements starting on page 27 provide narrative explanations and additional data needed for full disclosure in the financial statements.

USING THIS ANNUAL REPORT
(Continued)

The Statement of Net Assets

The Statement of Net Assets includes all the College's assets and liabilities and change in net assets as of the end of the fiscal year. The difference between total assets and total liabilities is the net assets. Increases and decreases to net assets is one indicator of whether the overall financial condition has improved or deteriorated during the year when considered with other factors such as enrollment, contact hours of instruction, student retention and other non-financial information. Finally, the statement of net assets is useful when determining the assets available for continuing the College's operations as well as how much the College owes to vendors, bondholders, and other entities at the end of the year.

The Statement of Net Assets includes assets and liabilities, and current and non-current and net assets. Current assets are those which are available to satisfy current liabilities or liabilities that are due within one year. Non-current assets include capital assets, long-term investments and other assets, not classified as current. Non-current liabilities include bonds payable and other long-term commitments.

The Net Assets are divided into three major categories. The first category, Invested in Capital Assets Net of Related Debt, represents the College's net investment in property, plant and equipment owned by the institution. The next category is restricted net assets, which is further divided into two categories: nonexpendable and expendable. Expendable restricted net assets are available for expenditures but must be spent in accordance with the restrictions of donors and other external entities. The College only has Expendable Restricted Net Assets. The final category is Unrestricted Net Assets which are assets available to the institution for any lawful purpose of the College. Further detail regarding assets, liabilities and net assets is presented in the statement of net assets and notes to the financial statements.

The Statement of Revenues, Expenses and Changes in Net Assets

The statement of revenues, expenses and changes in net assets represents the College's overall results of operations. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred regardless of when the cash is received or paid. The statement is divided into operating revenues and expenses and non-operating revenues and expenses. The College is primarily

The Statement of Revenues, Expenses and Changes in Net Assets (continued)

dependent upon four sources of revenues: state allocations, tuition and fees, grants and contracts and property taxes. Since state allocations and property taxes are classified as non-operating revenues (per GASB requirements), the College will generally display an operating deficit before taking into account its non-operating revenues. Therefore, total revenues and total expenses should be considered in assessing the change in the College's financial position. When total revenues exceed total expenses, the result is an increase in net assets. When the contrary occurs, the result is a decrease in Net Assets. Further detail is presented in the Statement of Revenues, Expenses and Changes in Net Assets and in the Notes to the Financial Statements.

The College's net assets (the difference between assets and liabilities) provide one measure of the College's financial health or financial position. Over time, increases or decreases in the College's net assets are one indicator of whether its financial health is improving or deteriorating. To fully assess the overall health of the College, however, non-financial factors should be considered as well, such as changes in the College's enrollment, property tax base, and the condition of the College's facilities.

The Statement of Cash Flows

The Statement of Cash Flows provides the College's cash receipts and payments for the year. This statement is not intended to replicate, on a cash basis, the operating statement. Instead, it is intended to compliment the accrual-basis financial statements by providing functional information about financing, capital and investing activities. The cash flow approach concentrates on the underlying nature of a transaction.

The information contained in the Statement of Cash Flows assesses the College's ability to generate future net cash flows, meet obligations as they come due and needs for external financing. In addition, differences between operating income and associated cash receipts and payments and the effects on the financial position of both its cash and its non-cash investing, capital and financing transactions can be identified.

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FINANCIAL ANALYSIS

Statement of Net Assets

The following analysis focuses on the Statement of Net Assets, which is condensed in Table 1.

TABLE 1
CONDENSED STATEMENT OF NET ASSETS
(in millions)

		August 31, 2006		August 31, 2005		August 31, 2004
Current Assets	$	20.3	$	19.8	$	18.6
Noncurrent Assets						
Cash and Cash Equivalents - Restricted		69.1		22.5		1.4
Capital Assets, Net of Accumulated Depreciation		59.2		60.7		59.5
Other Non-Current Assets		1.7		0.8		0.2
Total Assets		150.3		103.8		79.7
Current Liabilities		17.5		14.9		11.2
Noncurrent Liabilities		76.9		33.0		15.4
Total Liabilities		94.4		47.9		26.6
Net assets:						
Invested in capital assets, net of related debt		42.9		25.5		42.6
Restricted Expendable		8.8		27.7		7.7
Unrestricted		4.2		2.6		2.7
Total Net Assets	$	55.9	$	55.8	$	53.0

Total Assets increased by $46.5 million. The major factors affecting this net increase are the sale and reinvestment of the following: $13.6 million in Wellness Center revenue bonds, $24.945 million in general obligation tax bonds, $4.835 million in maintenance tax notes and $6.590 million in revenue refunding and improvement bonds. All issuances will be used for various construction and renovation projects on campus which began this fiscal year.

Statement of Net Assets (continued)

Total liabilities increased by $46.5 million. Included in this increase are: $13.655 in Wellness Center revenue bonds, $24.945 million in general obligation tax bonds, $4.835 million in maintenance tax notes and an additional $1.815 million in revenue refunding and improvement bonds. Deferred revenues also increase by almost $1.9 million which represents tuition and fees for the Fall 2006 semester and is indicative of a growing enrollment.

Net assets (assets less liabilities) increased slightly in fiscal year 2006, from $55.844 million at August 31, 2005 to $55.926 million at August 31, 2006. Unrestricted net assets – the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements – represents $4.2 million of total net assets at August 31, 2006.

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Statement of Revenues, Expenses and Changes in Net Assets

The following analysis focuses on the Statement of Revenues, Expenses and Changes in Net Assets presented in condensed form in Table 2.

TABLE 2
CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
(in millions)

		Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2004
Operating Revenues	$	28.5	$	23.7	$	21.0
Operating Expenses		46.6		40.6		38.2
Non-Operating Revenues		27.1		20.7		21.5
Non-Operating Expenses		2.5		1.0		0.9
INCREASE IN NET ASSETS	$	6.5	$	2.8	$	3.4
NET ASSETS - Beginning of Year	$	55.9	$	53.1	$	49.1
Prior Period Adjustments		-6.5				0.6
NET ASSETS - End of Year	$	55.8	$	55.9	$	53.1

Statement of Revenues, Expenses and Changes in Net Assets (continued)

Table 3 details the College's sources of operating revenue. The key sources of operating revenues are: Tuition and Fees (net of scholarship discounts) and Grants and Contracts.

TABLE 3
OPERATING REVENUE
(in millions)

	Fiscal Year 2006		Fiscal Year 2005		
	Amount	Percentage of Total	Amount	Percentage of Total	Increase/ (Decrease)
Net Tuition and Fees	$ 23.8	83.3%	$ 19.4	82.0%	$ 4.4
Grants and Contracts	4.4	15.3%	3.9	16.4%	0.5
Auxiliary Enterprises	0.3	1.2%	0.3	1.4%	0.0
Other Operating Revenues	0.0	0.2%	0.1	0.2%	(0.0)
Total Operating Revenues	$ 28.6	100.1%	$ 23.7	100.0%	$ 4.9

Operating revenues were affected by the following key factors:

- Tuition and fees (net of scholarship discounts) increased as a result of a 14% increase in enrollment. Other factors affecting the tuition and fee increase are: a $2 per semester credit hour increase in resident in-district tuition, a $2 per semester credit hour increase in resident out-of-district tuition, a $20 per semester credit hour increase in non-resident tuition, an increase of $6 in building use fee and the implementation of a $2 international education fee, $20 medical services fee and $70 student recreation fee for all students.
- Grants and Contracts revenues increased primarily as a result of an increase in Texas Grant Program awards which increased from $1.049 million to $1.420 million. In addition, Texas Educational Opportunity Grant Program (TEOG) awards in the amount of $.153 million were made available to students.

Statement of Revenues, Expenses and Changes in Net Assets (continued)

Table 4 details the College's sources of non-operating revenues. The key sources of non-operating revenues are: State Appropriations and Ad Valorem Taxes.

NON-OPERATING REVENUE
(in millions)

	Fiscal Year 2006		**Fiscal Year 2005**		
	Amount	Percentage of Total	Amount	Percentage of Total	Increase/ (Decrease)
State Appropriations	$ 12.3	45.3%	$ 10.8	52.4%	$ 1.4
Ad Valorem Taxes	12.2	45.1%	9.1	43.9%	3.1
Investment Income	2.1	7.7%	0.7	3.3%	1.4
Other Non-Operating Revenues	0.5	1.9%	0.1	0.4%	0.4
Total Non-Operating Revenues	$ 27.1	100.0%	$ 20.7	100.0%	$ 6.3

Non-operating revenues were affected by the following key factors:

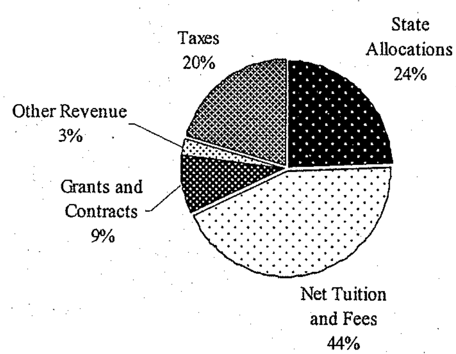
- State appropriations were awarded for the 2006-2007 biennia and increased 13% as compared to the 2004-2005 biennia.
- Property tax revenue increased by more than $3 million as a result of a 16% increase in assessed property valuations and the increase in tax rate resulting from the $68 million in bonds that were approved by the voters in November 2004. The tax rate for the Texas Southmost College District was increased from $0.128782 per $100 valuation in fiscal year 2005 to $0.162772 per $100 valuation in fiscal year 2006.

Statement of Revenues, Expenses and Changes in Net Assets (continued)

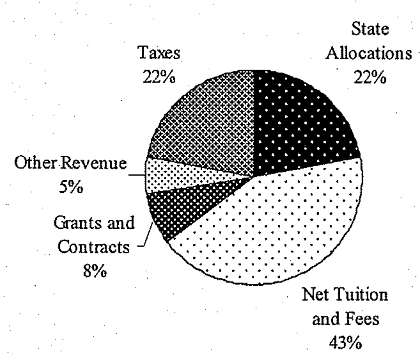
Key sources of revenue in total for the College are state allocations, grants and contracts, property taxes and tuition and fees (net of scholarship discounts). Table 5 shows a comparison of the breakdown of total revenues by source for the College in Fiscal Years 2006 and 2005.

TABLE 5
Total Revenues
(Operating and Non-operating)

Fiscal Year 2005



Fiscal Year 2006



In both fiscal year 2005 and 2006, tuition and fees account for the largest source of revenue (44% and 43%, respectively) for the College. State allocations are the next largest revenue source at 24% in fiscal year 2005 and 22% in fiscal year 2006. Property taxes increased from 20% to 22% of total revenues in fiscal year 2005 and 2006, respectively.

Statement of Revenues, Expenses and Changes in Net Assets (continued)

Table 6 displays the breakdown of operating expenses by natural classification for the College.

TABLE 6
OPERATING EXPENSES
Natural Classification
(in millions)

	Fiscal Year 2006	Fiscal Year 2005	Change
Salaries	$ 0.5	$ 0.3	$ 0.1
Benefits	0.1	0.0	0.0
Supplies and Services	3.6	2.9	0.7
Contract Services - UTB	40.3	35.8	4.4
Depreciation	2.2	1.5	0.7
Total Operating Expenses	$ 46.7	$ 40.5	$ 5.9

Table 7 displays the breakdown of the College's expenses by functional classification.

TABLE 7

OPERATING EXPENSES
Functional Classification
(in millions)

	2006	2005	Change
Educational and General			
Institutional Support	$ 1.7	$ 1.7	$ 0.1
Operation and Maintenance of Plant	1.7	1.1	0.6
Contract Services - UTB	40.3	35.8	4.4
Depreciation	2.2	1.5	0.7
Total Educational Activites	45.9	40.1	5.8
Auxiliary Enterprises	0.7	0.5	0.2
Total Operating Expenses	$ 46.6	$ 40.6	$ 6.0

Statement of Revenues, Expenses and Changes in Net Assets (continued)

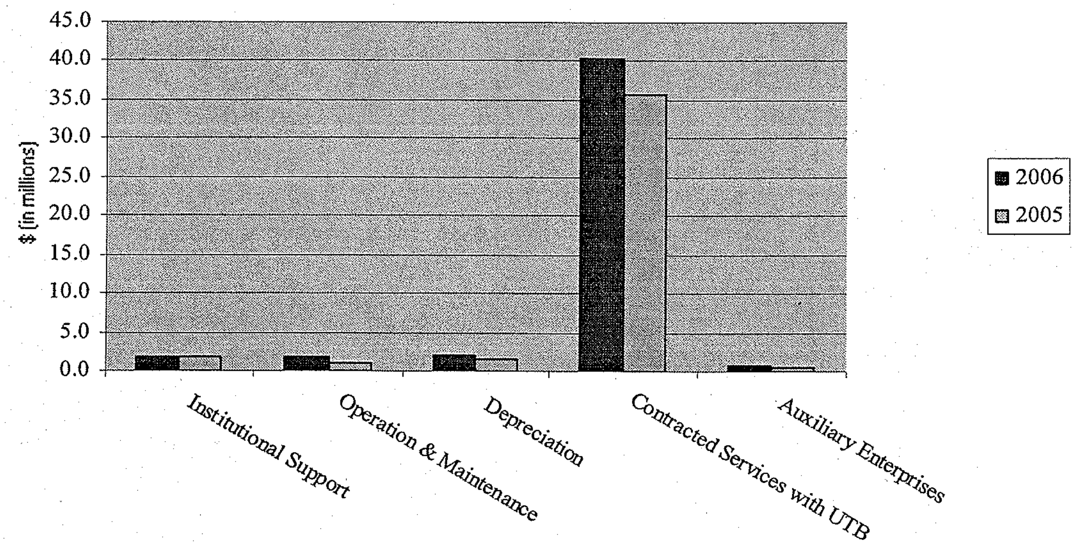
Table 8 also displays the breakdown of the College's expenses by functional classification.

TABLE 8

OPERATING EXPENSES

Functional Classification

(in millions)



The College operates under a partnership agreement with The University of Texas at Brownsville. Under this agreement, the College contracts with UTB to provide instruction and other related essential services. This contract is the largest expense for the College as is reflected in the Contract Services-UTB category. In fiscal year 2005 and 2006, this amount represented 88% and 86% of total expenses, respectively. The increase of $6 million from fiscal year 2005 to fiscal year 2006 is primarily as a result of increased tuition and fees that are committed to the partnership under the agreement. The University of Texas at Brownsville releases an Annual Financial Report detailing total expenses for both the College and University and should be reviewed in conjunction with this report for further information.

Statement of Cash Flows

The Condensed Statement of Cash Flows appears in Table 9. The complete Statement of Cash Flows appears in page 25 and 26 of this report.

TABLE 9
CONDENSED STATEMENT OF CASH FLOWS
(in millions)

		2006		2005		Change
Cash Provided/ Used By:						
Operating Activities	$	(14.2)	$	(15.7)	$	1.4
Noncapital Financing Activities		20.6		18.6		1.9
Capital and Related Financing Activities		36.5		16.4		20.0
Investing Activities		1.8		0.7		1.1
NET INCREASE (DECREASE) IN CASH	$	44.7	$	20.0	$	24.4
CASH - Beginning of Year	$	28.6	$	8.6		20.0
CASH - End of Year	$	73.4	$	28.6		44.5

Total Cash and Cash Equivalents increased by $44.6 million during the year. Major factors impacting cash and cash equivalents are described below by source.

Operating Activities: Cash flows from operating resulted in an outflow of $14.2 million. The major sources of cash receipts was from tuition and fees, net of scholarship allowances and discounts ($23.8 million). The College's major cash outlay was for contract services with UTB ($40.3 million).

Non-capital Financing Activities: The College had a positive cash flow of $20.6 million from the collection of property taxes and receipt of state appropriations. Property taxes were collected at a rate of 94% of the current year's tax levy. (See table 10 below for more information on property taxes.)

Capital and Related Financing Activities: Capital and related financing activities resulted in a cash inflow of $36.5 million. Cash outlays of approximately $17 million were made for construction of property, purchases of land and property and principal and interest payments for all outstanding bonds. Cash inflows of $53.5 million resulted from the issuance of the following bonds: $13.655 million in Wellness Center revenue bonds, $24.945 million in tax bonds, $4.835 million in maintenance tax notes and $6.590 in

Statement of Cash Flows (continued)

combined fee revenue refunding and improvement bonds. Additional cash inflows were generated from the collection of property taxes resulting from the $68 million in bonds that were approved by the voters in November 2004 and from the 1987/88 debt service obligation.

Investing Activities Cash flows from investing activities represent investment earnings generated from the College's various checking, savings and certificate of deposit accounts. The College almost tripled earnings on investments from prior year due to the investment of bond proceeds from the various issuances.

Property taxes are an essential source of revenue for the College. The following table provides information regarding tax collection and assessed valuation for the Texas Southmost College District.

Table 10

Property Tax Information

	Fiscal Year 2006	Fiscal Year 2005	Percent Change
Total Tax Rate per $100	$ 0.162772	$ 0.128782	26.4%
Total Tax Collections	$ 11,491,160	$ 8,492,378	7.3%
Tax Collection Rate	93.7%	93.8%	-
Assessed Valuation	$8,786,825,986	$7,663,218,167	14.7%

The District's total tax rate increased by more than 26 % from the previous year due to the additional tax rate for the service of debt as approved by the voters in November 2004. Total tax assessments increased by about 35% due to this increase in tax rate and an increase in valuation of 14.7%. Overall, the District's tax collection rate has remained strong over the past decade.

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CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of Fiscal Year 2006 the College had approximately $59.2 million (net of accumulated depreciation) invested in a broad range of capital assets, including instructional and athletic facilities, maintenance of buildings and equipment. Additions to capital assets totaled $7.8 million and approximately $5 million of the additions are for construction in progress on the various bond projects that have begun on campus. The most advanced construction projects include the ITECC Thermal Plant and Recreation Center. Another $2 million was added for the gift of property received in Raymondville and the purchase of condominiums on the peninsula.

Debt

The College's general obligation bond ratings, as assigned by *Fitch Ratings* and *Standard and Poor's* are AA- and A+ respectively. The rating for revenue bonds as assigned by *Standard and Poor's* is A. The College's bond ratings improved due to its increased financial stability.

At year-end, the College had approximately $78.4 million in outstanding debt. Table 11 summarizes these amounts by type of debt instrument.

TABLE 11

Bonds Payable at Fiscal Year End 2006

(in millions)

	Beginning of the Year	End of the Year
1987/1988 Tax Bonds/1994 & 2004 Refunded	$ 2.48	$ 1.35
2000 Student Union Revenue Bonds/2005 Refunded	8.94	8.65
2002 General Revenue Bond/2006 Refunded & Improvement	4.78	6.59
2005 Tax Bonds	19.81	18.37
2005 Wellness Center Revenue Bonds	0.00	13.66
2006 Tax Bonds	0.00	24.95
2006 Maintenance Tax Notes	0.00	4.84
Total Bonds Payable	**$ 36.01**	**$ 78.41**

Debt (continued)

Tax bonds were issued in 2004 to refund the 1994 bonds which had refunded the original 1987 tax bonds. The source of revenue for this debt service is ad valorem tax levy.

The Student Union Building Bonds were issued in March of 2000. They were sold for the construction, operation and maintenance of the Student Union Building. $7.1 million of the bonds outstanding for the Student Union Building were refunded in 2005. This obligation is paid by student union fees assessed to the students.

In May 2002, the College issued a $5 million Revenue Bond to fund various capital projects on campus. These projects included the ITECC and the development of the student housing project, The Village at Fort Brown, among other improvements. $4.775 million of these revenue bonds were refunded and an additional $1.815 million were secured for campus improvements for a total of $6.590 million in 2006. Pledged revenues derived from tuition and fees, student and employee parking fees and interest on investment earnings are the sources for debt service.

In February 2005, the College made the first bond issuance for $19.805 million out of the total $68 million in bonds that were approved by the voters in November of 2004. The second issuance for $24.945 million was made in April 2006. These issuances will be used for the construction of seven major capital projects on campus. The source of revenue for this debt service is ad valorem tax levy.

In May 2006, the College also issued $4.835 million in Maintenance Tax Notes to fund various renovation and restoration projects on campus. The source of revenue for this debt service is ad valorem tax levy.