

Houston Forensic Science Center, Inc.
(A Component Unit of the City of Houston)

Financial Statements
and Single Audit Reports
for the year ended June 30, 2018

Houston Forensic Science Center, Inc.

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Independent Auditors' Report

To the Board of Directors of
Houston Forensic Science Center, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the major fund of Houston Forensic Science Center, Inc. (a component unit of the City of Houston), as of and for the years ended June 30, 2018 and 2017 and the related notes to the financial statements, which comprise Houston Forensic Science Center, Inc.'s basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 our audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and the major fund of Houston Forensic Science Center, Inc. as of June 30, 2018 and 2017, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3-5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information included in the schedule of expenditures of federal awards for the year ended June 30, 2018 as required by Title 2 U. S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 14, 2018 on our consideration of Houston Forensic Science Center, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Houston Forensic Science Center, Inc.'s internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Houston Forensic Science Center, Inc.'s internal control over financial reporting and compliance.

Blazek & Vetterling

September 14, 2018

**Houston Forensic Science Center, Inc.
Management's Discussion and Analysis
For the years ended June 30, 2018 and 2017
(unaudited)**

The following discussion and analysis of Houston Forensic Science Center, Inc.'s (HFSC) financial performance provides an overview of the financial activities for the years ended June 30, 2018 and 2017. This discussion should be read in conjunction with HFSC's financial statements, which follow this section.

Financial Highlights

Financial highlights for the fiscal year ending June 30, 2018 include:

- HFSC's total net position increased by \$484,000 with revenue of \$26.4 million and expenses of \$26.0 million.
- \$21.4 million of HFSC's expenses were program expenses in connection with forensic science services.
- HFSC recognized revenue of \$25.6 million in appropriations received from the City in its statement of activities.
- HFSC added \$1.3 million in capital assets during the year.
- At the close of the current fiscal year, HFSC's general fund reported a fund balance of \$475,163, a decrease of \$272,139 in comparison with the prior year. This decrease is the result of expenditures associated with upgrading and improving IT infrastructure and moving off the Houston Police Department's (HPD) computer network.

Financial highlights for the fiscal year ending June 30, 2017 include:

- HFSC's total net position increased by \$163,000 with revenue of \$26.7 million and expenses of \$26.5 million.
- \$21.8 million of HFSC's expenses were program expenses in connection with forensic science services.
- HFSC recognized revenue of \$24.9 million in appropriations received from the City in its statement of activities.
- HFSC added \$1.4 million in capital assets during the year, which included \$14,000 in donated property from the City.
- At the close of the current fiscal year, HFSC's general fund reported a fund balance of \$747,302, a decrease of \$746,939 in comparison with the prior year. This decrease is the result of expenditures associated with hiring additional personnel, consultant costs, and expenditures related to software costs, offset by increased government grant revenue of \$1.4 million.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to HFSC's basic financial statements. The basic financial statements present combined government-wide and governmental fund financial statements. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

Government-wide financial statements reflect an economic resources measurement focus and are prepared using the accrual basis of accounting. The government-wide financial statements are designed to provide readers with a broad overview of HFSC's finances, in a manner similar to a private-sector business.

The statement of net position shows the financial position of HFSC at year end by presenting HFSC's assets and liabilities, with net position representing the difference between assets and liabilities. The statement of activities presents information showing changes in HFSC's net position during the year. Changes in net position are reported when an underlying event giving rise to a change occurs, regardless of the timing of related cash flows. Therefore, revenue and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

Governmental fund financial statements reflect a current financial resources measurement focus and are prepared using the modified accrual basis of accounting. Unlike the government-wide financial statements, the governmental fund financial statements present information showing the near-term inflows and outflows of spendable resources and the balances of spendable resources at year end.

During 2018 and 2017, there was a difference between the government-wide financial statements and the governmental fund financial statements as a result of capital outlays of \$1,270,000 and \$1,377,000, respectively, being recorded as expenditures on the governmental fund balance sheet, but recorded as capital assets on the statement of net position. There also is a difference of \$488,000 and \$433,000 in depreciation expense for 2018 and 2017, respectively, and \$5,000 and \$14,000, respectively, in donated property for 2018 and 2017 from the City/HPD recognized in the statement of activities and not in the governmental fund statement of revenue, expenditures, and changes in fund balance.

Condensed Government-Wide Financial Information and Financial Analysis

	AS OF JUNE 30		
	<u>2018</u>	<u>2017</u>	<u>2016</u>
<i>Condensed Statements of Net Position:</i>			
Current assets	\$ 2,233,991	\$ 2,677,455	\$ 3,980,876
Capital assets	<u>4,582,288</u>	<u>3,826,217</u>	<u>2,916,334</u>
Total assets	<u>\$ 6,816,279</u>	<u>\$ 6,503,672</u>	<u>\$ 6,897,210</u>
Total liabilities	<u>\$ 1,758,828</u>	<u>\$ 1,930,153</u>	<u>\$ 2,486,635</u>
Net position:			
Unrestricted	\$ 475,163	\$ 747,302	\$ 1,494,241
Invested in capital assets	<u>4,582,288</u>	<u>3,826,217</u>	<u>2,916,334</u>
Total net position	<u>\$ 5,057,451</u>	<u>\$ 4,573,519</u>	<u>\$ 4,410,575</u>

Fiscal Year 2018

The assets of HFSC consist primarily of cash, grants receivable from a federal government agency, prepaid expenses and capital assets. Liabilities consist primarily of operating expenses, including accrued salaries and paid time off. The increase in assets at June 30, 2018, as compared to June 30, 2017, primarily is the result of capital expenditures of \$1.3 million relating to IT infrastructure and \$256,000 relating to prepaid expenses offset by lower cash of \$581,000 and depreciation of \$488,000. Liabilities decreased primarily due to the timing of reimbursing the City/HPD for operating expenses.

Fiscal Year 2017

The assets of HFSC consist primarily of cash, grants receivable from a federal government agency, prepaid expenses and capital assets. Liabilities consist primarily of operating expenses, including accrued salaries and paid time off. The decrease in assets at June 30, 2017 as compared to June 30, 2016 primarily is the result of the timing of reimbursing the City/HPD for operating expenses. Liabilities decreased primarily due to the timing of reimbursing the City/HPD for operating expenses.

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<i>Condensed Statements of Activities:</i>			
Expenses:			
Program services	\$ 21,426,812	\$ 21,753,369	\$ 21,081,174
Management and general	<u>4,526,783</u>	<u>4,757,943</u>	<u>4,246,384</u>
Total expenses	<u>25,953,595</u>	<u>26,511,312</u>	<u>25,327,558</u>
Revenue:			
City of Houston – appropriation	24,160,344	23,420,344	22,680,344
City of Houston – direct overhead appropriation	1,460,000	1,460,000	1,460,000
U. S. Department of Justice – government grant revenue	744,654	1,770,631	349,651
Other revenue from local governments			8,952
Other revenue	102,834	71,363	117,776
Other income/(loss)	<u>(30,305)</u>	<u>(48,082)</u>	
Total revenue	<u>26,437,527</u>	<u>26,674,256</u>	<u>24,616,723</u>
CHANGES IN NET POSITION	483,932	162,944	(710,835)
Net position, beginning of year	<u>4,573,519</u>	<u>4,410,575</u>	<u>5,121,410</u>
Net position, end of year	<u>\$ 5,057,451</u>	<u>\$ 4,573,519</u>	<u>\$ 4,410,575</u>

Fiscal Year 2018

The statement of activities shows the expenses and revenue of HFSC and the corresponding effect on net position. The majority of HFSC's revenue is provided from appropriations from the City's budget. The City provides appropriated funds from its general fund, as well as an overhead allocation for space occupied at 1200 Travis St., Houston, Texas. HFSC also receives federal grant revenue funding from the U. S. Department of Justice, which is paid on a reimbursement basis.

Government grant revenue decreased by \$1 million as a result of HFSC being awarded less by the U. S. Department of Justice. This decrease is offset by the increase in appropriations of \$740,000 by the City. Expenses decreased by \$557,000.

Fiscal Year 2017

Total revenue increased due to government grant revenue increasing by \$1.4 million as a result of HFSC being awarded funds by the U. S. Department of Justice and greater appropriations from the City of \$740,000. Expenses increased by \$1.2 million.

Capital Assets

Fiscal Year 2018

HFSC's investment in capital assets as of June 30, 2018 totals \$4.6 million (net of accumulated depreciation). This investment in capital assets includes scientific forensic equipment, furniture and equipment, leasehold improvements, and vehicles. The total increase in capital assets for the current fiscal year was approximately 19.8%.

Major capital asset events during the year ended June 30, 2018 included purchases for improving the IT infrastructure.

Contacting Houston Forensic Science Center, Inc.'s Financial Management

The financial report is designed to discuss issues that may be material to the operation of HFSC. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Financial Officer and Treasurer, Houston Forensic Science Center, Inc., 1301 Fannin St., Suite 170, Houston, Texas, 77002.

Houston Forensic Science Center, Inc.

Governmental Fund Balance Sheet and Statement of Net Position as of June 30, 2018

	GENERAL FUND	ADJUSTMENTS (NOTE 2)	STATEMENT OF NET POSITION
ASSETS			
Current assets:			
Cash	\$ 1,658,826		\$ 1,658,826
Government grants receivable	108,308		108,308
Accounts receivable	7,607		7,607
Prepaid expenses	459,250		459,250
Noncurrent assets:			
Capital assets, net of depreciation (Note 5)	<u> </u>	\$ 4,582,288	<u>4,582,288</u>
TOTAL ASSETS	<u>\$ 2,233,991</u>	<u>\$ 4,582,288</u>	<u>\$ 6,816,279</u>
LIABILITIES			
Current liabilities:			
Accounts payable and accrued expenses	<u>\$ 1,758,828</u>		<u>\$ 1,758,828</u>
TOTAL LIABILITIES	<u>1,758,828</u>		<u>\$ 1,758,828</u>
FUND BALANCE AND NET POSITION			
Nonspendable prepaid expenses	459,250	\$ (459,250)	
Unassigned / unrestricted	15,913	459,250	\$ 475,163
Invested in capital assets	<u> </u>	<u>4,582,288</u>	<u>4,582,288</u>
TOTAL FUND BALANCE	<u>475,163</u>		
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 2,233,991</u>		
TOTAL NET POSITION		<u>\$ 4,582,288</u>	<u>\$ 5,057,451</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Governmental Fund Balance Sheet and Statement of Net Position as of June 30, 2017

	GENERAL FUND	ADJUSTMENTS (NOTE 2)	STATEMENT OF NET POSITION
ASSETS			
Current assets:			
Cash	\$ 2,239,716		\$ 2,239,716
Government grants receivable	226,812		226,812
Accounts receivable	7,265		7,265
Prepaid expenses	203,662		203,662
Noncurrent assets:			
Capital assets, net of depreciation (Note 5)	<u> </u>	\$ 3,826,217	<u>3,826,217</u>
TOTAL ASSETS	<u>\$ 2,677,455</u>	<u>\$ 3,826,217</u>	<u>\$ 6,503,672</u>
LIABILITIES			
Current liabilities:			
Accounts payable and accrued expenses	\$ 1,930,153		\$ 1,930,153
TOTAL LIABILITIES	<u>1,930,153</u>		<u>\$ 1,930,153</u>
FUND BALANCE AND NET POSITION			
Nonspendable prepaid expenses	203,662	\$ (203,662)	
Unassigned / unrestricted	543,640	203,662	\$ 747,302
Invested in capital assets	<u> </u>	<u>3,826,217</u>	<u>3,826,217</u>
TOTAL FUND BALANCE	<u>747,302</u>		
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 2,677,455</u>		
TOTAL NET POSITION		<u>\$ 3,826,217</u>	<u>\$ 4,573,519</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Governmental Fund Statement of Revenue, Expenditures, and Changes in Fund Balance
and Statement of Activities for the year ended June 30, 2018

	GENERAL FUND	ADJUSTMENTS (NOTE 9)	STATEMENT OF ACTIVITIES
EXPENDITURES / EXPENSES:			
Program services	\$ 21,022,038	\$ 404,774	\$ 21,426,812
Management and general	4,443,546	83,237	4,526,783
Capital expenditures	<u>1,269,627</u>	<u>(1,269,627)</u>	<u> </u>
Total expenditures / expenses	<u>26,735,211</u>	<u>(781,616)</u>	<u>25,953,595</u>
REVENUE:			
Grant from City of Houston – appropriation	24,160,344		24,160,344
Grant from City of Houston – direct overhead appropriation	1,460,000		1,460,000
U. S. Department of Justice – government grant revenue	744,654		744,654
Other revenue	98,074	4,760	102,834
Other income/(loss)	<u> </u>	<u>(30,305)</u>	<u>(30,305)</u>
Total revenue	<u>26,463,072</u>	<u>(25,545)</u>	<u>26,437,527</u>
EXCESS OF REVENUE OVER EXPENDITURES / CHANGES IN NET POSITION	(272,139)	756,071	483,932
Fund balance / net position, beginning of year	<u>747,302</u>	<u>3,826,217</u>	<u>4,573,519</u>
Fund balance / net position, end of year	<u>\$ 475,163</u>	<u>\$ 4,582,288</u>	<u>\$ 5,057,451</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Governmental Fund Statement of Revenue, Expenditures, and Changes in Fund Balance
and Statement of Activities for the year ended June 30, 2017

	GENERAL FUND	ADJUSTMENTS (NOTE 9)	STATEMENT OF ACTIVITIES
EXPENDITURES / EXPENSES:			
Program services	\$ 21,320,451	\$ 407,343	\$ 21,727,794
Management and general	4,757,943	25,575	4,783,518
Capital expenditures	<u>1,377,100</u>	<u>(1,377,100)</u>	<u> </u>
Total expenditures / expenses	<u>27,455,494</u>	<u>(944,182)</u>	<u>26,511,312</u>
REVENUE:			
Grant from City of Houston – appropriation	23,420,344		23,420,344
Grant from City of Houston – direct overhead appropriation	1,460,000		1,460,000
U. S. Department of Justice – government grant revenue	1,770,631		1,770,631
Other revenue	57,580	13,783	71,363
Other income/(loss)	<u> </u>	<u>(48,082)</u>	<u>(48,082)</u>
Total revenue	<u>26,708,555</u>	<u>(34,299)</u>	<u>26,674,256</u>
EXCESS OF REVENUE OVER EXPENDITURES / CHANGES IN NET POSITION	(746,939)	909,883	162,944
Fund balance / net position, beginning of year	<u>1,494,241</u>	<u>2,916,334</u>	<u>4,410,575</u>
Fund balance / net position, end of year	<u>\$ 747,302</u>	<u>\$ 3,826,217</u>	<u>\$ 4,573,519</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Notes to Financial Statements for the years ended June 30, 2018 and 2017

NOTE 1 – ORGANIZATION

Organization – Houston Forensic Science Center, Inc. (HFSC), a component unit of the City of Houston (the City), is a local government corporation created to provide independent forensic services to law enforcement agencies, primarily the Houston Police Department (HPD), and other judicial entities. The formation of HFSC was approved by City Council on June 26, 2012.

HFSC's Board of Directors are appointed by the Mayor of the City and approved by City Council. HFSC receives funding primarily from an interlocal agreement with the City in which funding is received subject to the City's approval of HFSC's annual budget. Funding received must be expended in accordance with the annual budget.

Federal income tax status – HFSC is a local government corporation created to accomplish a governmental purpose of the City and is not subject to federal income tax. Contributions to HFSC are deductible under §501(c)(3) of the Internal Revenue Code.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – These financial statements have been prepared in conformity with the accounting principles and reporting guidelines established by the Governmental Accounting Standards Board (GASB).

Measurement focus and basis of accounting – Measurement focus refers to *what* is being expressed in reporting financial position and performance, that is, *which* resources are being measured. The financial resources measurement focus measures only financial resources while the economic resources measurement focus measures both financial and capital resources. The measurement focus determines *whether* a fund balance sheet or statement of net position reports financial or economic resources. Basis of accounting refers to *when* those resources and commitments and uses of those resources should be recognized. It relates to the timing of the measurements made regardless of the measurement focus applied.

Governmental funds in the fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenue is recognized when it is measurable and available. *Measurable* means the amount of the transaction is known or reasonably estimable. *Available* refers to amounts collected in the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period, generally within 60 days after year end. Expenditures are recognized when the related liability is incurred.

Governmental funds in the government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenue is recognized when it is earned and becomes measurable and expenses are recognized in the period incurred.

Cash consists of demand deposits. Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, HFSC will be unable to recover deposits. At June 30, 2018, the carrying amount and the bank balance of HFSC's demand deposit account were \$1,658,826 and \$2,002,136, respectively. Amounts on deposit that are in excess of the Federal Deposit Insurance Corporation limit of \$250,000 are collateralized by a security agreement with the bank.

Fund balance is classified based upon the relative strength of spending constraints placed upon the purposes for which resources can be used, as follows:

- *Nonspendable fund balance* includes amounts that are either not in spendable form or are legally or contractually required to be maintained intact.
- *Restricted fund balance* includes amounts constrained to specific purposes by resource providers, through constitutional provisions, or by enabling legislation.
- *Unassigned fund balance* includes amounts that are available for HFSC's future use for any purpose.

Net position represents the difference between assets and liabilities. HFSC reports categories of net position, as follows:

- *Invested in capital assets* consists of net capital assets.
- *Restricted* is constrained to a particular purpose. Restrictions are imposed by external organizations such as City ordinances or grantors.
- *Unrestricted* is available for general use by HFSC.

Capital assets include forensic science equipment, office equipment, and leasehold improvements. HFSC capitalizes capital expenditures of \$5,000 or greater with an estimated useful life of more than one year. Purchased capital expenditures are carried at cost. Donated capital assets are recorded at fair value at the date of transfer. Depreciation expense is recognized using the straight-line method over estimated useful lives of 5 to 15 years.

Grants – Under both the modified accrual and the accrual basis of accounting, receivables from grants are recognized, net of uncollectible amounts, when all applicable eligibility requirements are met provided the commitment is verifiable and the resources are measurable and probable of collection. Revenue recognized as receivable in advance of the time period during which eligibility requirements are met or resources are available, is deferred under the modified accrual basis of accounting, but is recognized as revenue under the accrual basis of accounting and reflected as restricted net position when eligibility requirements are met.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenue, expenditures and expenses and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

NOTE 3 – NEW ACCOUNTING STANDARDS

GASB has issued Statement No. 87, *Leases*, which is effective for HFSC for fiscal year 2021. The statement requires recognition of lease assets and liabilities for certain leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the

foundational principle that leases are financings of the right to use an underlying asset. Under the statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. HFSC has not yet determined the impact of implementing this new statement.

NOTE 4 – RELATED PARTIES

HFSC is a component unit of the City and receives appropriated funds from the City's general fund, as well as an overhead allocation appropriation representing shared costs of the use of City/HPD facilities. HFSC's forensic functions are performed primarily to support HPD.

The City charged HFSC \$2.7 million and \$6.2 million for services provided to HFSC for fiscal years 2018 and 2017, respectively. The City also donated \$4,760 and \$13,800 in equipment to HFSC in fiscal years 2018 and 2017, respectively. The City provided \$1.5 million in overhead appropriations representing HFSC's use of the City's property in fiscal years 2018 and in 2017. In fiscal year 2018, the City also appropriated \$17 million for general operations and \$7.2 million for services provided by the City for total appropriations of \$24.2 million for operations. The City appropriated \$14.9 million for general operations and \$8.5 million for services provided by the City for total appropriations of \$23.4 million for operations in fiscal year 2017.

NOTE 5 – CAPITAL ASSETS

HFSC's investment in capital assets consists of the following:

	<u>BALANCE AT JULY 1, 2017</u>	<u>ADDITIONS</u>	<u>COMPLETIONS/ DISPOSITIONS</u>	<u>BALANCE AT JUNE 30, 2018</u>
Scientific forensic equipment	\$ 3,684,458	\$ 86,541		\$ 3,770,999
Furniture and office equipment	592,130	144,086		736,216
Leasehold improvements	161,214			161,214
Vehicles		100,379		100,379
Work-in-progress – database	504,338	974,322	\$ (30,305)	1,448,355
Less accumulated depreciation	<u>(1,115,923)</u>	<u>(488,011)</u>	<u>(30,941)</u>	<u>(1,634,875)</u>
Capital assets, net of depreciation	<u>\$ 3,826,217</u>	<u>\$ 817,317</u>	<u>\$ (61,246)</u>	<u>\$ 4,582,288</u>
	<u>BALANCE AT JULY 1, 2016</u>	<u>ADDITIONS</u>	<u>COMPLETIONS/ DISPOSITIONS</u>	<u>BALANCE AT JUNE 30, 2017</u>
Scientific forensic equipment	\$ 3,162,004	\$ 338,984	\$ 183,470	\$ 3,684,458
Furniture and office equipment	195,310	396,820		592,130
Leasehold improvements	161,214			161,214
Work-in-progress – database		684,338	(180,000)	504,338
Less accumulated depreciation	<u>(602,194)</u>	<u>(432,918)</u>	<u>(80,811)</u>	<u>(1,115,923)</u>
Capital assets, net of depreciation	<u>\$ 2,916,334</u>	<u>\$ 987,224</u>	<u>\$ (77,341)</u>	<u>\$ 3,826,217</u>

NOTE 6 – COMMITMENTS

In April 2015, HFSC entered into an operating lease agreement for the use of certain building space. The agreement includes HFSC's commitment to pay predetermined monthly rent, as well as operating expenses, which are determined annually based on the prior year's operating expenses. The operating lease agreement also stipulates that HFSC is to pay a termination penalty that includes tenant improvement costs and commission costs in the amount that is the lesser of \$254,174 or the unamortized balance of the scheduled lease payments, which is \$92,822 with interest of 3.0% at June 30, 2018, should it terminate the lease before the end of the lease term. Related occupancy expense of \$1,009,000 and \$1,016,000 were recognized during 2018 and 2017, respectively. Additionally, HFSC leases certain equipment under operating leases. Related lease expense of approximately \$39,000 and \$26,000 were recognized during 2018 and 2017, respectively. At June 30, 2018, future minimum lease payments of \$860,679 are due in 2019.

NOTE 7 – GOVERNMENT GRANTS

HFSC is party to contracts with a federal governmental agency. Should these contracts not be renewed, a replacement for this source of support may not be forthcoming and related expenses may not be incurred. Funding sources of government grants include amounts from the U. S. Department of Justice totaling approximately \$745,000 and \$1,770,000 during fiscal years 2018 and 2017, respectively.

Government grants require fulfillment of certain conditions as set forth in the contracts and are subject to review and audit by the awarding agency. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, the funding source may, at its discretion, request reimbursement for expenses or return of funds as a result of noncompliance by HFSC with the terms of the contracts. Management believes such disallowances, if any, would not be material to HFSC's financial position or changes in net position.

NOTE 8 – EMPLOYEE BENEFIT PLANS

HFSC has both a deferred compensation plan and a defined contribution retirement plan covering substantially all full-time employees. Under the terms of the deferred compensation plan, HFSC matches an amount up to 5% of each participant's annual salary. Under the terms of the defined contribution retirement plan, HFSC contributes an amount equal to 2% of each participant's annual salary. HFSC's contributions to these plans were approximately \$746,000 and \$631,000 in 2018 and 2017, respectively.

NOTE 9 – ADJUSTMENTS BETWEEN THE GOVERNMENTAL FUND STATEMENTS AND THE GOVERNMENT-WIDE STATEMENT OF NET POSITION AND STATEMENT OF ACTIVITIES

Total fund balance reported in the governmental fund balance sheet differs from net position reported in the government-wide statement of net position. Differences occur because of the current financial resources focus of the governmental fund statements and the long-term economic focus of the government-wide statement of net position and statement of activities. The provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, impose this change in focus. The adjustments show the difference between the statements that result from this difference in measurement focus.

Adjustments of \$4,582,288 and \$3,826,217 relating to capital assets are reported in the statements of net position for the years ended 2018 and 2017, which differ from the respective governmental fund balance sheets. Capital assets used in governmental activities are not current financial resources, and therefore, are not reported in the fund financial statements.

Adjustments reported in the statements of activities from the governmental fund statements of revenue, expenditures, and changes in fund balance consist of the following:

	<u>2018</u>	<u>2017</u>
Governmental funds report outlays for capital assets as expenditures because such outlays use current financial resources. The statements of activities recognizes the cost of outlays allocated over estimated useful lives as depreciation expense.		
Capital outlay	\$ 1,269,627	\$ 1,377,100
Depreciation expense	(488,011)	(432,918)
Governmental funds do not recognize as revenue contributions of donated property because such contributions do not increase current financial resources.		
Donated property	4,760	13,783
Governmental funds do not recognize losses on disposal of assets because such losses do not impact current financial resources.		
Loss on disposal	<u>(30,305)</u>	<u>(48,082)</u>
Net adjustment to increase net changes in fund balance to change in net position of governmental activities	<u>\$ 756,071</u>	<u>\$ 909,883</u>

Houston Forensic Science Center, Inc.

Schedule of Expenditures of Federal Awards for the year ended June 30, 2018

<u>FEDERAL GRANTOR</u> <u>Pass-through Grantor</u> <u>Program Title & Period</u>	<u>CFDA</u> <u>Number</u>	<u>Contract Number</u>	<u>Award</u> <u>Amount</u>	<u>Allowable</u> <u>Federal</u> <u>Expenditures</u>
U. S. DEPARTMENT OF JUSTICE				
DNA Backlog Reduction Program				
#1 01/16 – 12/17	16.741	2015-DN-BX-0072	\$1,172,752	\$ 374,286
#2 01/17 – 12/18	16.741	2016-DN-BX-0142	\$741,000	234,756
#3 01/18 – 12/19	16.741	2017-DN-BX-0027	\$867,755	<u>154,440</u>
Total U. S. Department of Justice				<u>763,482</u>
TOTAL FEDERAL AWARDS				<u>\$ 763,482</u>

See accompanying note to schedule of expenditures of federal awards.

Houston Forensic Science Center, Inc.

Note to Schedule of Expenditures of Federal Awards for the year ended June 30, 2018

NOTE 1 – SIGNIFICANT ACCOUNTING POLICY

Basis of presentation – The schedule of expenditures of federal awards (the schedule) is prepared on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U. S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Federal expenses include allowable expenses funded by federal grants. Allowable costs are subject to the cost principles of the Uniform Guidance, and include both costs that are capitalized and costs that are recognized as expenses in HFSC's financial statements in conformity with generally accepted accounting principles.

HFSC has elected not to use the 10% de minimus rate for indirect costs.

Because the schedule presents only a selected portion of the operations of HFSC, it is not intended to, and does not present the financial position or changes in net assets of HFSC.

Due to a return of funds to the grantor in fiscal year 2018 of approximately \$20,000, there is a difference between the expenditures per the SEFA and grant revenue recognized.

**Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

To the Board of Directors of
Houston Forensic Science Center, Inc.:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities of Houston Forensic Science Center, Inc. (HFSC), as of and for the year ended June 30, 2018, and have issued our report thereon dated September 14, 2018.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Blazek & Vetterling

September 14, 2018

**Independent Auditors' Report on Compliance for Each
Major Program and Report on Internal Control Over
Compliance Required by the Uniform Guidance**

To the Board of Directors of
Houston Forensic Science Center, Inc.:

Report on Compliance for Each Major Federal Program

We have audited Houston Forensic Science Center, Inc.'s (HFSC) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of HFSC's major federal programs for the year ended June 30, 2018. HFSC's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of HFSC's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U. S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about HFSC's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of HFSC's compliance.

Opinion on Each Major Federal Program

In our opinion, HFSC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

Report on Internal Control Over Compliance

Management of HFSC is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered HFSC's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of HFSC's internal control over compliance.

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

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Blazek & Vetterling

September 14, 2018

Houston Forensic Science Center, Inc.

Schedule of Findings and Questioned Costs for the year ended June 30, 2018

Section I – Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued: unmodified qualified adverse disclaimer

Internal control over financial reporting:

- Material weakness(es) identified? yes no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? yes none reported

Noncompliance material to the financial statements noted? yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? yes none reported

Type of auditors’ report issued on compliance with major programs: unmodified qualified adverse disclaimer

Any audit findings disclosed that are required to be reported in accordance with 2 CFR §200.516(a)? yes no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
16.741	DNA Backlog Reduction Program

Dollar threshold used to distinguish between Type A and Type B programs: \$750,000

Auditee qualified as a low-risk auditee? yes no

Section II – Financial Statement Findings

There were no findings related to the financial statements which are required to be reported in accordance with *Government Auditing Standards*.

Section III – Federal Award Findings and Questioned Costs

There were no findings for federal awards required to be reported in accordance with 2 CFR §200.516(a).