

Mayor
A.J. Holloway

Council Members
George Lawrence, Ward 1
Felix Gines, Ward 2
Dixie Newman, Ward 3
Robert L. Deming III, Ward 4
Paul A. Tisdale, Ward 5
Kenny Glavan, Ward 6
David Fayard, Ward 7



P.O. Box 429
Biloxi, Mississippi 39533

June 2, 2014

Mayor and City Council
City of Biloxi, Mississippi

We are pleased to submit the Comprehensive Annual Financial Report of the City of Biloxi (municipal government and its component unit) for the fiscal year ended September 30, 2013. The Administration of the City of Biloxi is responsible for the information presented in this report. We believe that the accompanying information is accurate and complete and fairly presents the financial position of the municipal government of the City of Biloxi as of September 30, 2013 and results of operations for the fiscal year then ended.

Control Environment

The City's management is responsible for maintaining a system of internal controls sufficient to provide reasonable assurance that City assets are safeguarded from loss and that financial transactions are recorded timely and accurately. Reasonable assurance means that internal controls are selected or designed to reduce the risk of asset loss or inaccurate bookkeeping to an acceptable level, considering the constraint that the cost of the control should not exceed the expected benefit. Management is responsible for communicating the purpose and importance of internal controls to employees and for providing the resources necessary to establish and maintain the control system.

Budgetary Controls

Prior to the beginning of each fiscal year, each department director prepares a projection of expenditures for his department. The City's budget staff develops a projection of revenues for all funds and a projection of the expenditures not included in the departmental budgets. The revenue projections and proposed expenditures are presented to the Mayor. After reviewing the draft budget proposal, the Mayor will meet with department directors to discuss their budget requests. Each director must justify his department's budget request by explaining the cost of the programs they propose for the coming year. When the Mayor is satisfied that the proposed budget conforms to the objectives and goals he has set for the coming year, the entire budget proposal is presented to the City Council. During a series of budget workshops, the City Council will review, discuss, question and debate the proposed budget and make modifications to it. The Council will invite public comment on the taxing and spending plan at a special public hearing. After determining that the revenue projections in the budget are sound and that the proposed spending is necessary to provide the level of services and to accomplish the program goals and

capital improvements proposed in the budget, the City Council will publish the proposed budget. After adopting the budget for the coming year the City Council will set the property tax rate at a level that will generate the property tax revenue necessary to raise the budgeted ad valorem tax revenue.

Mississippi law prohibits spending in excess of the budget formally adopted by the City Council and spread upon the Council's minutes. The formal budget adopted by the Council sets a limit for total expenditures for each department. For management and control purposes, a budget with greater detail is utilized by City management personnel to monitor spending. For this purpose, the total budget of each department is spread to the expenditure accounts of each department's various divisions and sections. Programmatic constraints within the City's computerized purchasing system prohibit unauthorized purchases in excess of the budget at the expenditure account level.

The City utilizes an encumbrance accounting system in monitoring spending. An encumbrance system provides for charges against the budget at the time goods or services are ordered rather than waiting until the invoice is received or the payment is made.

Independent Audit

In accordance with Section 21-35-31, Miss Code of 1972 and guidelines prescribed by the State Auditor, the financial statements presented herein have been audited by Culumber Harvey & Associates, P.A., an independent firm of Certified Public Accountants. The objective of the auditor's work is to provide the auditor with a basis upon which to express an opinion on the fairness of the City's financial statements. The auditor's opinion is included in The Financial Section of this report. The auditor's work involves examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation.

State Department of Audit regulations require the independent auditor to disclose any instance of non-compliance with certain state laws, that may come to their attention during the audit of the City's financial statements. The auditor must test for non-compliance with federal requirements applicable to each major federal program under which the City of Biloxi receives federal financial assistance.

Management's Discussion and Analysis

Management's Discussion and Analysis follows the opinion of the independent auditor and provides a narrative overview and analysis of the basic financial statements.

Profile of the City of Biloxi (The Reporting Entity)

The City of Biloxi, Mississippi was incorporated in 1838. Biloxi is located in Harrison County, and its southern corporate boundary is the Gulf of Mexico. Biloxi is part of the Biloxi, Gulfport, Pascagoula Combined Statistical Area (MSA). This area has a diverse economic base which includes tourism, casino gaming, fishing, seafood processing, shipping, shipbuilding, and petroleum and chemical processing. Keesler Air Force Base, Naval Construction Battalion Center-Gulfport and Northrop Grumman Shipbuilding's Pascagoula facility are located within

this Combined Statistical Area. The City of Biloxi's employees provide a full range of services to the City's citizens and visitors including planning and zoning, police and fire protection, culture and recreation, infrastructure maintenance, water and sanitation.

This report includes all funds of the City of Biloxi and any entity that management has determined to be a component unit of the City of Biloxi municipal government. Component units are entities for which the primary government (the City) is financially accountable and other entities whose relationship with the City is such that its exclusion would create misleading or incomplete financial information. The Point Cadet Development Corporation, a non-profit organization, is blended in the financial statements of the City of Biloxi as a proprietary fund. During the fiscal year 03/04, the City of Biloxi assumed responsibility for the assets, liabilities and operation of the Biloxi Port Commission. This activity is presented as a business-type activity in the City's Government-wide financial statements and as a proprietary fund in the City's fund financial statements.

Long-Term Financial Planning

The City ended fiscal 12/13 with a General Fund balance of \$12 million which is adequate for the City. However, fund balance is not a recurring resource therefore, its use to pay recurring operating expenses cannot continue indefinitely. The City's Governing Authority initiated cost reduction measures in fiscal 08/09 and 09/10. Those steps to reduce costs, included employee attrition, hiring freezes, reductions in longevity pay, and reductions in over-time and increases in employee share of health insurance costs. Also, the City has decreased General Fund cash funding of capital projects. Because of these continued policies, the City's general fund deficiency or revenues over expenditures was \$4.2 million (page 24) on a modified accrual basis and \$2.5 million (page 27) on a budget basis for the fiscal year ended September 30, 2013. City management's goal is to equalize General Fund revenues and expenditures in fiscal 13/14.

Local Economy and Relevant Financial Policies

In response to the national economic contraction, City management initiated policies to restrict expenditures early in fiscal 08/09 including a policy of attrition and a hiring freeze. These policies were continued in fiscal 09/10, 11/12, and 12/13 and the City's management is continuing these in fiscal 13/14.

The City's governing authority increased sewer rates at the end of fiscal 08/09 and again at the end of fiscal 09/10 and the increased rates produced revenue more than adequate to cover costs in fiscal 11/12. The City governing authority has committed to annual reviews of its public utility fee structure with the goal of stabilizing its Water and Sewer Enterprise Fund.

The City has not changed its ad valorem tax rate since fiscal year 2001 when it decreased the rate by 34.8 percent. As shown in Figure 1 below, the City's ad valorem tax revenue and sales tax revenue remained about the same as in prior year while gaming tax increased slightly.

The following charts disclose financial data for the City's governmental funds including the General Fund, Special Revenue, Capital Projects Funds and Debt Service Funds.

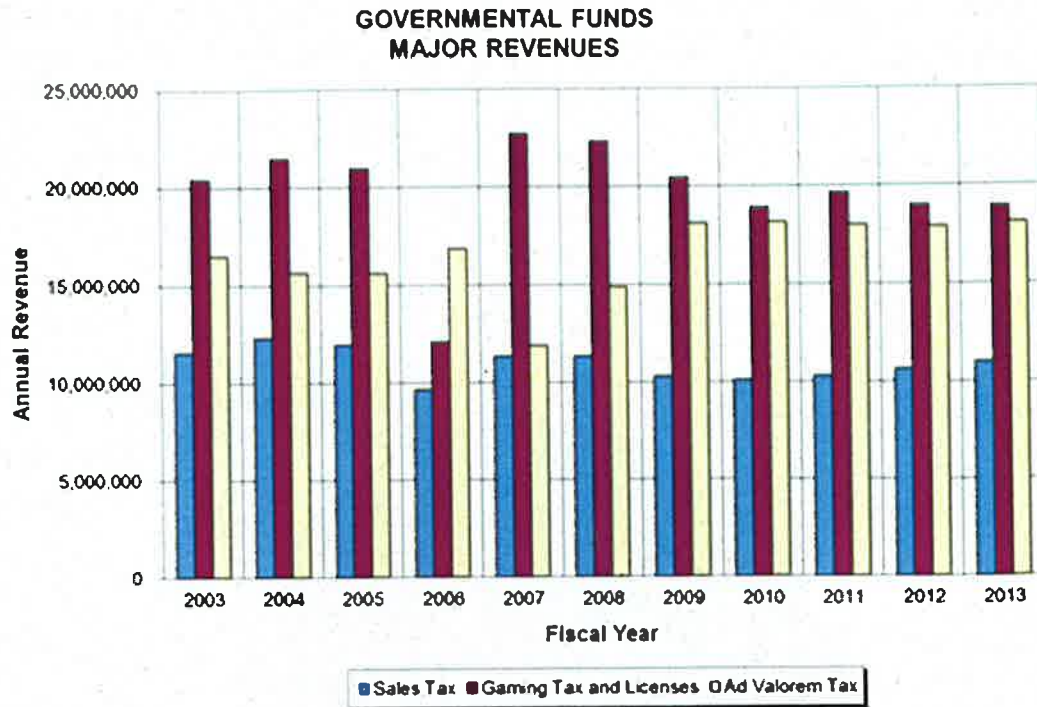


Figure 1

The amount of construction and reconstruction in fiscal 12/13 increased from fiscal 11/12 but is still below the post-Katrina peak in 06/07 as measured by the number and value of building permits issued. The City issued 3,237 building permits with a total valuation of \$146,817,657. (Fig. 2).

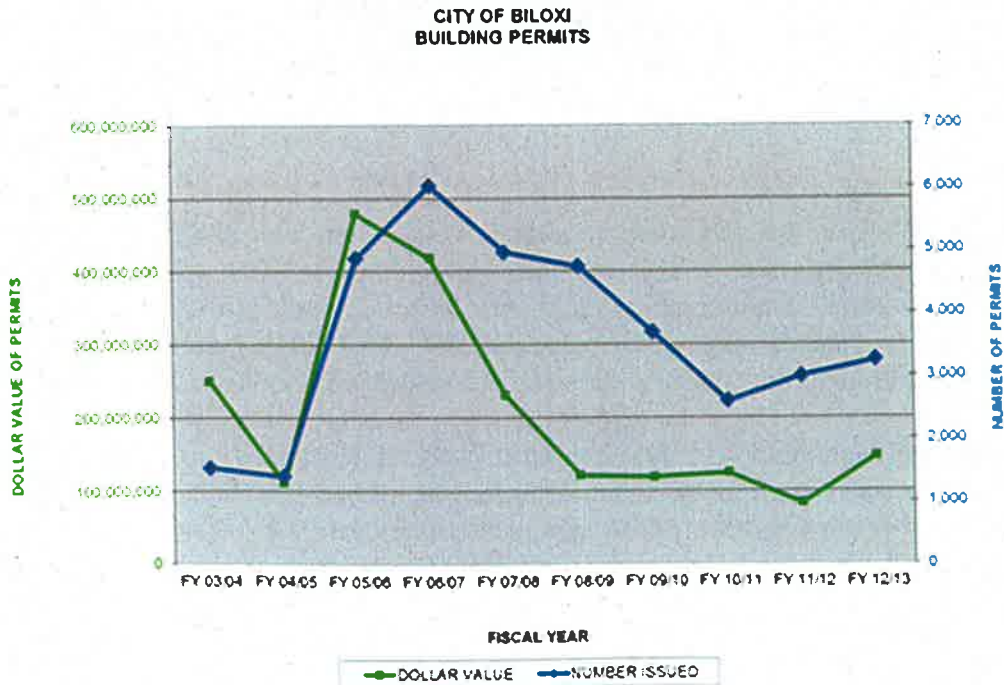


Figure 2

Governmental funds are used to account for most City functions and operations including the various City departments, the City's two closed retirement plans, Community Development Block Grants, capital projects, and the City's general obligation debt payments. Figure 3 illustrates the relative amounts of various general governmental revenues for the fiscal year. Usually, the City's three largest sources of operating revenues for general governmental activities are gaming tax, ad valorem tax and sales tax. In FY 12/13 the City's governmental funds received \$2.3 million in operating grants and \$34.9 million in capital grants for its governmental activities. The largest granting Federal departments were the Department of Homeland Security (FEMA) and the Department of Housing and Urban Development. Federal grant revenues are included in Other Intergovernmental.

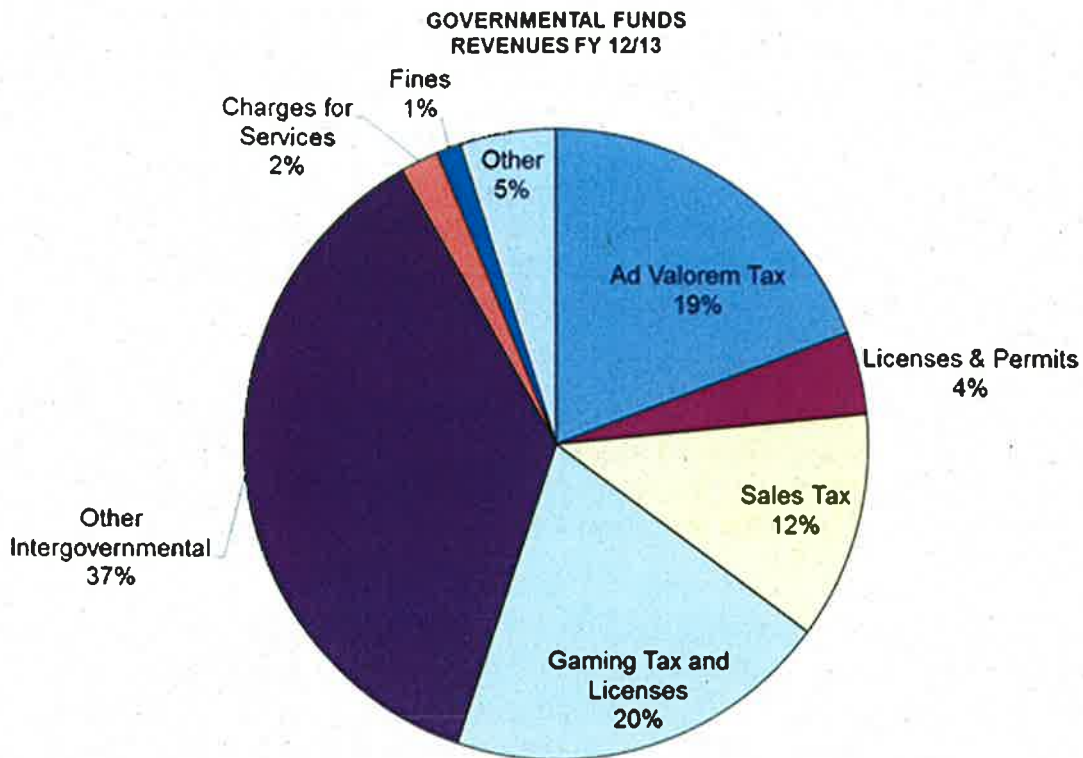


Figure 3

Gaming tax and sales tax are shown separately here but are included in the City's governmental funds financial statements on the line titled "Intergovernmental Revenues". Intergovernmental revenues are collected by other governmental entities such as state government and distributed to the City. Other Intergovernmental Revenue includes other taxes collected by Harrison County and the State of Mississippi and state and federal grants

Property Taxes - In Mississippi, property taxes are levied by municipalities and counties on the assessed value of land and buildings, mobile homes, automobiles, business inventory and equipment. Assessed value is a prescribed percentage of the true (appraised) value of each class of property. Classes of property and assessment ratios are defined in Section 112 of the Mississippi Constitution of 1890.

<u>Class of Property</u>	<u>Ratio</u>
Class I Single-family, owner-occupied, residential real	10%
Class II All other real property, except Class I or IV	15%
Class III Personal property, except motor vehicles and Class IV	15%
Class IV Public Utility property	30%
Class V Motor vehicles	30%

Ad valorem taxes are collected in arrears. The taxes for a calendar tax year are due by February 1 of the subsequent calendar year. Each year the governing authorities of the City of Biloxi determine the total assessed value of property situated within the City limits. Prior to the beginning of a new fiscal year, October 1, they set the tax rate (levy) that will generate the tax revenue needed for the upcoming fiscal year. In each fiscal year, the City collects the ad valorem taxes for the prior calendar tax year. To summarize, the formula for determining tax revenues from each class of property is “Appraised value X assessment ratio X tax levy = tax amount”.

Sales Tax - State law requires sellers of goods and services to collect and remit to the state sales taxes of various rates specified in the statutes. A tax rate of 7% applies to retail sales of tangible personal property. Of the taxes collected by the state each month, 18.5% of the sales tax revenue from activities within a municipal corporation is remitted to the municipal government.

Gaming Taxes - All taxes on gross gaming revenue and gaming devices are collected by the State Tax Commission, including those taxes levied by municipalities. The Gaming control act of 1990 provided a tax of eight tenths of one percent (.8%) on casino gross gaming income. This tax revenue is divided between Harrison County and the City in the proportion of the population of each.

House Bill 1504, Regular Session of 1992 (Local and Private Legislation) provided for a tax of three and two tenths of one percent (3.2%) of gross gaming revenue. On the tenth day of each month the State Tax Commission remits the taxes collected in the previous month to the municipality to be distributed in the following ratios:

- 20% for public safety
- 20% for education purposes (Biloxi sends this 20% to the Biloxi Separate School District)
- 10% to Harrison County for public safety purposes
- 10% for educational purposes in Harrison County (This 10% is distributed to the various school districts in Harrison County in the proportion of each district student enrollment to total enrollment of all school districts in the county.)

House Bill 1504 also provided for a licensing fee of \$150, annually, for each gaming device. In addition to local taxes, the Mississippi Gaming Control Act, codified in chapter 76, in title 75 of the Mississippi Code of 1972, provides that casinos pay a fee of 8% of gross gaming revenue to the State of Mississippi.

Figure 4 illustrates the trends in annual totals of revenue sources for the City’s governmental funds. Casino gaming and the resulting gaming taxes were implemented in 1992, and since that time, gaming tax revenues have become the largest, regular revenue source for the

City. Note that Other Intergovernmental Revenue increased significantly in fiscal year 05/06 due to grants for Hurricane Katrina debris removal received by the City of Biloxi from the Department of Homeland Security, Federal Emergency Management Agency.

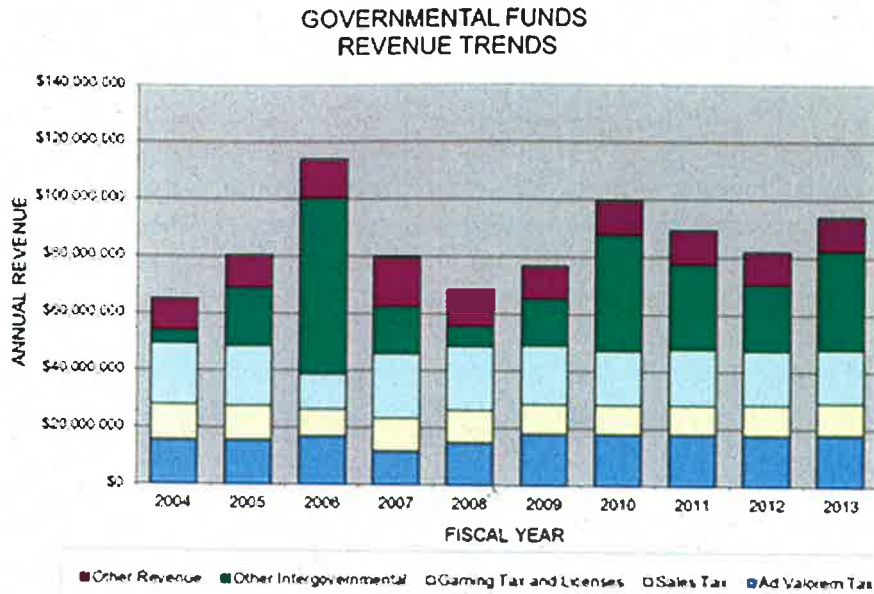


Figure 4

General Governmental Expenditures

Figure 5 illustrates the trends in spending for the various services and functions accounted for in the City’s governmental funds. Normally, public safety and capital projects are the largest expenditure categories of the City’s governmental funds. In FY 05/06 expenditures for Public Works increased due to the cost of removing debris left by Hurricane Katrina and capital project spending was curtailed. Debris removal costs were completed in FY 06/07.

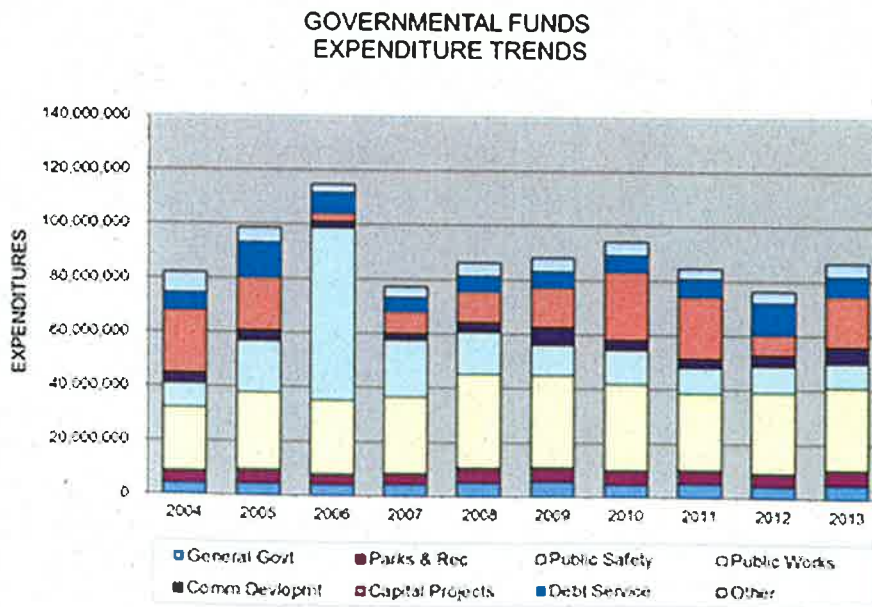


Figure 5

Water and Sewer Fund

The City of Biloxi provides water production and distribution and sewer collection and treatment services. The City accounts for the cost of these services and related revenues in an enterprise fund. The City's goal is to pay the cost of the services with the revenue generated by billing customers for their use of the service. In 2005 the City lost approximately twelve percent of its customer base to the destruction of Hurricane Katrina.

A large portion of the cost of water/sewer service is the City's share of the debt service of the Harrison County Utility Authority, which provides sewer treatment service. Because the debt service is a "fixed" cost (does not vary due to the number of customers served) the City's rates, applied to the consumption of the reduced number of customers, did not generate revenue sufficient to cover the cost of services. The City increased water and sewer rates at the end of fiscal year 08/09 and again at the end of 09/10. The City decreased rates slightly in 11/12. The City's governing authority has committed to annual cost and rate adjustments in order to reach and maintain 100 percent cost recovery.

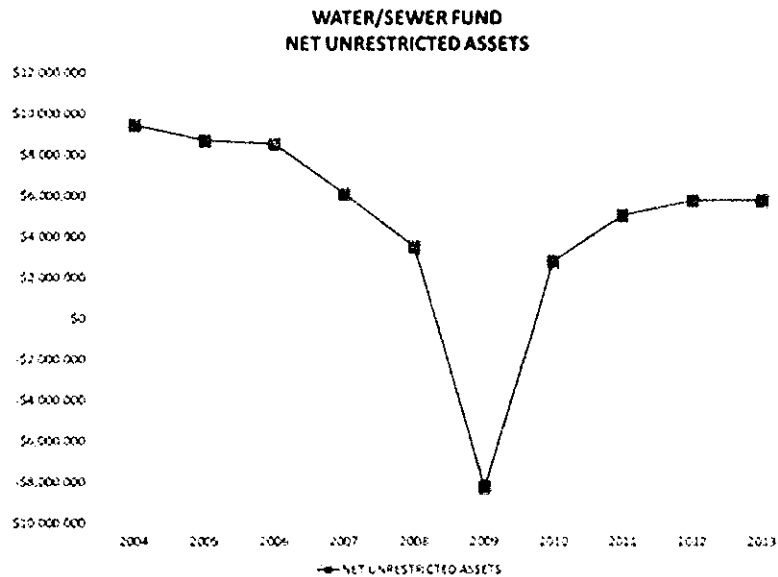


Figure 6

Respectfully submitted,

David Nichols, Chief Administration Officer

Scott McElroy, Controller