

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2015

is concluded and before adopting the proposed budget, the Council may make any changes it considers warranted by law or in the best interest of the taxpayers. The annual operating budget is then adopted through passage of an annual budget ordinance. Upon approval by the Council, the annual budget document becomes a matter of public record which is available for use and inspection by all interested persons and organizations. It is filed with the City Secretary.

The legal level of budgetary control is the department. Therefore, expenditures may not legally exceed budget appropriations at the department level. Each department head, with the approval of the City Manager, can reclassify items within the department without approval of the Council. However, to amend the total of a department, a budget amendment enacted by City ordinance is required.

Note 3. Deposits and Investments

The City maintains a cash pool that is available for use by the general, special revenue, and enterprise funds. At year end, several of the funds had overdrawn their share of funds in the pool. The amounts overdrawn are presented on the combined balance sheet as payables to other funds. The city conducts all its banking transactions with its depository bank, SouthStar Bank.

As of September 30, 2015, the City had investments in TexSTAR with maturities less than 60 days with a fair value of \$501,356. Additionally, the Hearne Economic Development Corporation held a certificate of deposit totaling \$142,294.

Interest rate risk

The investment policies of the City limit interest rate risk exposure by limiting investments primarily to certificates of deposits and local government investments pools.

Custodial credit risk

Custodial credit risk is the risk that, in the event of the failure of a depository financial institution, the government's deposits may not be returned to it. The City has a depository policy for custodial risk incorporated into its depository contract. Deposits of the City are insured or collateralized with securities held by the City, its agent, or by the pledging financial institution's trust department or agent in the name of the City.

Credit risk

It is the government's policy to limit its investments to local government investment pools, TexSTAR, or certificates of deposit. As of September 30, 2015, the City had investments in local government investment pools and certificates of deposit. TexSTAR was rated AAAm by Standard & Poor's as of September 30, 2015.

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Note 4. Restricted Assets

At September 30, 2015, restrictions on cash and investments were as follows:

	Governmental Funds	Proprietary Funds	Hearne Economic Development Corporation	Hearne Infrastructure/ Improvement Corporation
<u>Cash and Investments</u>				
Restricted for:				
Hotel/motel expenditures	\$ 98,453	\$ -	\$ -	\$ -
Police Special	1,087	-	-	-
Interest and sinking	1,836	615,476	-	-
Fire trucks	1,001	-	-	-
Court security	92,459	-	-	-
Court technology	24,695	-	-	-
Community Development				
Block Grant Program	-	510	-	-
Meter Sinking	-	152	-	-
Economic development	-	-	393,892	732,719
	<u>\$ 224,531</u>	<u>\$ 616,138</u>	<u>\$ 393,892</u>	<u>\$ 732,719</u>

Note 5. Receivables

Receivables at September 30, 2015, consist of the following:

	Governmental Funds	Proprietary Funds
Receivables:		
Taxes:		
Property	\$ 302,020	\$ -
Sales	102,794	-
Hotel/motel occupancy	12,710	-
Accounts	15,781	2,058,773
Grants	-	407,730
Less:		
Allowance for uncollectibles	-	(642,288)
Net total receivables	<u>\$ 433,305</u>	<u>\$ 1,824,215</u>

Property taxes attach as an enforceable lien on property as of February 1. Taxes are levied on October 1 and are payable by January 31. After which time they become delinquent, and penalties and interest may be assessed by the City.

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Note 6. Capital Assets

The following is a summary of capital asset activity during the year ended September 30, 2015:

	Beginning Balance	Additions/ Completions	Retirements/ Adjustments	Ending Balance
<u>Governmental activities</u>				
Capital assets not being depreciated				
Land	\$ 393,082	\$ -	\$ -	\$ 393,082
Construction in progress	164,662	34,746	199,408	-
Total capital assets not being depreciated	<u>557,744</u>	<u>34,746</u>	<u>199,408</u>	<u>393,082</u>
Capital assets being depreciated				
Buildings	5,184,061	237,905	-	5,421,966
Improvements other than buildings	1,124,281	85,815	-	1,210,096
Furniture and fixtures	79,961	5,700	-	85,661
Vehicles	1,388,716	36,114	-	1,424,830
Machinery and equipment	886,887	41,260	-	928,147
Total at historical cost	<u>8,663,906</u>	<u>406,794</u>	<u>-</u>	<u>9,070,700</u>
Less: accumulated depreciation for:				
Buildings	3,465,817	(103,435)	-	3,362,382
Improvements other than buildings	292,033	333,439	-	625,472
Furniture and fixtures	12,650	15,242	-	27,892
Vehicles	747,753	202,167	-	949,920
Machinery and equipment	609,835	(24,203)	-	585,632
Total accumulated depreciation	<u>5,128,088</u>	<u>423,210</u>	<u>-</u>	<u>5,551,298</u>
Total capital assets being depreciated, net	<u>3,535,818</u>	<u>(16,416)</u>	<u>-</u>	<u>3,519,402</u>
Governmental activities capital assets, net	<u>\$ 4,093,562</u>	<u>\$ 18,330</u>	<u>\$ 199,408</u>	<u>\$ 3,912,484</u>
<u>Business-type activities</u>				
Capital assets not being depreciated				
Land	\$ 61,634	\$ -	\$ -	\$ 61,634
Construction in progress	664,768	725,729	455,517	934,980
Total capital assets not being depreciated	<u>726,402</u>	<u>725,729</u>	<u>455,517</u>	<u>996,614</u>
Capital assets being depreciated				
Buildings and improvements	1,328,916	947,478	-	2,276,394
Furniture and fixtures	308,691	6,501	-	315,192
Vehicles	364,357	-	12,072	352,285
Distribution and collection systems	22,936,410	31,762	-	22,968,172
Machinery and equipment	200,633	-	-	200,633
Total at historical cost	<u>25,139,007</u>	<u>985,741</u>	<u>12,072</u>	<u>26,112,676</u>
Less: accumulated depreciation for:				
Buildings and improvements	577,884	94,871	-	672,755
Furniture and fixtures	264,133	14,605	-	278,738
Vehicles	172,223	31,921	12,072	192,072
Distribution and collection systems	13,228,477	601,215	-	13,829,692
Machinery and equipment	140,222	9,356	-	149,578
Total accumulated depreciation	<u>14,382,939</u>	<u>751,968</u>	<u>12,072</u>	<u>15,122,835</u>
Total capital assets being depreciated, net	<u>10,756,068</u>	<u>233,773</u>	<u>-</u>	<u>10,989,841</u>
Business-type activities capital assets, net	<u>\$ 11,482,470</u>	<u>\$ 959,502</u>	<u>\$ 455,517</u>	<u>\$ 11,986,455</u>

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Depreciation expense was charged as direct expense to programs of the primary government as follows:

General government	\$ 26,955
Public safety	203,440
Highways and streets	113,534
Culture and recreation	79,281
Total depreciation expense - Governmental activities	<u>\$ 423,210</u>

Note 7. Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City participates in the Texas Municipal League Intergovernmental Risk Pool for its insurance and pays a quarterly premium to the Pool. The Pool is intended to be self-sustaining through member premiums and reinsures through commercial companies for excessive claims. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note 8. Long-term Debt

The following is a summary of long-term debt transactions of the City for the year ended September 30, 2015:

	Balance 9/30/14	Additions	Retirements	Balance 9/30/15	Due Within One Year	Long Term
<u>Governmental activities</u>						
Lease payable - Oshkosh	\$ 445,278	\$ -	\$ (31,364)	\$ 413,914	\$ 32,610	\$ 381,304
Subtotal of leases payable	445,278	-	(31,364)	413,914	32,610	381,304
SouthStar Bank - Equipment	116,990	-	(48,788)	68,202	68,202	-
Subtotal of notes payable	116,990	-	(48,788)	68,202	68,202	-
	<u>\$ 562,268</u>	<u>\$ -</u>	<u>\$ (80,152)</u>	<u>\$ 482,116</u>	<u>\$ 100,812</u>	<u>\$ 381,304</u>
<u>Business type activities</u>						
Lease payable - Southside	\$ 1,293,502	\$ -	\$ (103,822)	\$ 1,189,680	\$ 109,760	\$ 1,079,920
Lease payable - AEP	401,335	-	(43,033)	358,302	54,395	303,907
Subtotal of leases payable	1,694,837	-	(146,855)	1,547,982	164,155	1,383,827
2011 General obligation refunding	5,070,000	-	(290,000)	4,780,000	300,000	4,480,000
Subtotal of bonds payable	5,070,000	-	(290,000)	4,780,000	300,000	4,480,000
SouthStar Bank - Equipment	209,433	148,604	(119,089)	238,948	238,948	-
Subtotal of notes payable	209,433	148,604	(119,089)	238,948	238,948	-
	<u>\$ 6,974,270</u>	<u>\$ 148,604</u>	<u>\$ (555,944)</u>	<u>\$ 6,566,930</u>	<u>\$ 703,103</u>	<u>\$ 5,863,827</u>

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The annual aggregate maturities for each debt type for the years subsequent to September 30, 2015 are as follows:

Year ending September 30	Business-type Activities				Governmental Activities	
	Bonds Payable		Notes Payable		Notes Payable	
	Principal	Interest	Principal	Interest	Principal	Interest
2016	\$ 300,000	\$ 151,213	\$ 238,948	\$ 14,337	\$ 68,202	\$ 4,092
2017	305,000	145,310	-	-	-	-
2018	310,000	138,465	-	-	-	-
2019	325,000	130,598	-	-	-	-
2020	335,000	121,599	-	-	-	-
2021-2025	1,880,000	432,858	-	-	-	-
2026-2030	1,325,000	79,625	-	-	-	-
	<u>\$ 4,780,000</u>	<u>\$ 1,199,868</u>	<u>\$ 238,948</u>	<u>\$ 14,337</u>	<u>\$ 68,202</u>	<u>\$ 4,092</u>

On March 1, 2011, the City issued \$5,905,000 of general obligation refunding bonds to provide resources to refund its Combination Tax and Waterworks and Sewer System Surplus Revenue Certificates of Obligation, Series, 2004, in advance of their maturities. As a result, the refunded bonds are considered defeased and the liability has been removed from the business-type activities columns of the Statement of Net Position.

During the year ended September 30, 2015, the following changes occurred in other long-term liabilities:

	Balance 9/30/14	Additions (Reductions)	Balance 9/30/15	Due Within One Year
<u>Governmental activities</u>				
Compensated absences	<u>\$ 140,906</u>	<u>\$ (11,958)</u>	<u>\$ 128,948</u>	<u>\$ 2,363</u>
<u>Business type activities</u>				
Compensated absences	<u>\$ 64,936</u>	<u>\$ 7,966</u>	<u>\$ 72,902</u>	<u>\$ -</u>

The general fund has typically been used to liquidate the liability for compensated absences for governmental activities, while the enterprise fund has been used to liquidate the liability for business-type activities.

Note 9. Leases

The City has entered into several lease agreements to finance the acquisition of vehicles and equipment and a lease agreement to finance the acquisition of an electric substation. These lease commitments qualify as capital leases for accounting purposes, and therefore have been recorded at the present value of their future minimum lease payments as of inception date.

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The assets acquired through the capital leases are as follows:

<u>Asset Class</u>	<u>Governmental Activities</u>	<u>Business type Activities</u>
Vehicles	\$ 507,985	\$ -
Distribution and collection system	-	2,453,435
Cost basis	507,985	2,453,435
Less: Accumulated depreciation	(50,798)	(854,104)
Total net asset	<u>\$ 457,187</u>	<u>\$ 1,599,331</u>

The total future minimum lease payments and the net present value of these minimum payments as of September 30, 2015 were as follows:

<u>Year ending September 30</u>	<u>Governmental Activities</u>	<u>Business-type Activities</u>
2016	\$ 48,000	\$ 307,069
2017	48,000	307,069
2018	48,000	438,378
2019	48,000	173,545
2020	48,000	173,545
2021-2025	240,000	633,940
2026-2030	24,000	-
Total minimum lease payments	504,000	2,033,546
Less: Amount representing interest	(90,086)	(485,564)
Present value of minimum payments	<u>\$ 413,914</u>	<u>\$ 1,547,982</u>

Amortization expense is included in depreciation expense of the Enterprise fund.

Note 10. Interfund Receivables and Payables

Interfund receivables and payables, all of which are considered short-term, at September 30, 2015, were as follows:

<u>Name of Fund</u>	<u>Due from other funds</u>	<u>Due to other funds</u>
Governmental:		
General	\$ 977,431	\$ -
Non-Major Governmental	63,692	335
Business-Type:		
Enterprise Fund	325,493	1,395,972
Non-Major Business-Type	29,691	-
	<u>\$ 1,396,307</u>	<u>\$ 1,396,307</u>

The interfund balances primarily result from the overdraft positions in the City's pooled cash account. Generally, amounts are cleared within the following year.

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Note 11. Interfund Transfers

Interfund transfers during the year ended September 30, 2015, were as follows:

	Transfers In		
	General Fund	Enterprise	Total
<u>Transfers out</u>			
General	\$ -	\$ 506,472	\$ 506,472
Enterprise	1,260,816	-	1,260,816
	<u>\$1,260,816</u>	<u>\$ 506,472</u>	<u>\$1,767,288</u>

Transfers are made between the governmental funds and the enterprise funds in lieu of franchise fees, overhead allocations, and for debt service payments.

Note 12. Commitments

The City entered into an amended contract with AEP Energy Partners, Inc., to provide wholesale electricity. The contract will expire December 31, 2015. After the expiration, the contract is renewable upon mutual agreement. The City paid \$4,579,021 to this company during the year ended September 30, 2015.

The City entered into a contract with a company to collect commercial and residential garbage within the City. The contract will expire on December 1, 2015. The City paid \$525,560 to this company during the year ended September 30, 2015.

Note 13. Pension Plans

Texas Municipal Retirement System

A. Plan Description

The City participates as one of 860 plans in the nontraditional, joint contributory, hybrid defined benefit pension plan administered by the Texas Municipal Retirement System (TMRS). TMRS is an agency created by the State of Texas and administered in accordance with the TMRS Act, Subtitle G, Title 8, Texas Government Code (the TMRS Act) as an agent multiple-employer retirement system for municipal employees in the State of Texas. The TMRS Act places the general administration and management of the System with a six-member Board of Trustees. Although the Governor, with the advice and consent of the Senate, appoints the Board, TMRS is not fiscally dependent on the State of Texas. TMRS's defined benefit pension plan is a tax-qualified plan under Section 401(a) of the Internal Revenue Code. TMRS issues a publicly available comprehensive annual financial report (CAFR) that can be obtained at www.tmrs.com.

All eligible employees of the city are required to participate in TMRS.

B. Benefits Provided

TMRS provides retirement, disability, and death benefits. Benefit provisions are adopted by the governing body of the city, within the options available in the state statutes governing TMRS.

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At retirement the benefit is calculated as if the sum of the employee's contributions, with interest, and the city-financed monetary credits with interest were used to purchase an annuity. Members may choose to receive their retirement in one of seven payment options. Members may also choose to receive a portion of their benefit as a Partial Lump Sum Distribution in an amount equal to 12, 24, or 36 monthly payments, which cannot exceed 75% of the member's deposits and interest.

Plan provisions for the City were as follows:

	Plan Year 2015	Plan Year 2014	Plan Year 2013
Employee deposit rate	7%	7%	7%
Matching ratio (city to employee)	2 to 1	2 to 1	2 to 1
Years required for vesting	5	5	5
Service retirement eligibility (expressed as age/years of service)	60/5, 0/20	60/5, 0/20	60/5, 0/20
Updated Service Credit	100% repeating, transfers	100% repeating, transfers	100% repeating, transfers
Annuity Increase (to retirees)	70% of CPI repeating	70% of CPI repeating	70% of CPI repeating

Employees covered by benefit terms.

At the December 31, 2014 valuation and measurement date, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	24
Inactive employees entitled to but not yet receiving benefits	31
Active employees	54

C. Contributions

The contribution rates for employees in the TMRS are either 5%, 6%, or 7% of employee gross earnings, and the city matching percentages are either 100%, 150%, or 200%, both as adopted by the governing body of the city. Under the state law governing TMRS, the contribution rate for each city is determined annually by the actuary, using the Entry Age Normal (EAN) actuarial cost method. The actuarially determined rate is the additional amount necessary to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability.

Employees for the City were required to contribute 7% of their annual gross earnings during the fiscal year. The contribution rates for the City were 14.19% and 15.37% in calendar years 2014 and 2015, respectively. The city's contributions to TMRS for the year ended September 30, 2015, were \$319,205, and were equal to the required contributions.

D. Net Pension Liability

The City's Net Pension Liability (NPL) was measured as of December 31, 2014, and the Total Pension Liability (TPL) used to calculate the Net Position Liability was determined by an actuarial valuation as of that date.

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Actuarial assumptions:

The Total Pension Liability in the December 31, 2014 actuarial valuation was determined using the following actuarial assumptions:

Inflation	3.0% per year
Overall payroll growth	3.0% per year
Investment Rate of Return	7.0%, net of pension plan investment expense, including inflation

Salary increases were based on a service-related table. Mortality rates for active members, retirees, and beneficiaries were based on the gender-distinct RP2000 Combined Healthy Mortality Table, with male rates multiplied by 109% and female rates multiplied by 103%. Based on the size of the City, rates are multiplied by a factor of 100.0%. The rates are projected on a fully generational basis by scale BB to account for future mortality improvements. For disabled annuitants, the gender-distinct RP2000 Disabled Retiree Mortality Table is used, with slight adjustments.

Actuarial assumptions used in the December 31, 2014, valuation were based on the results of actuarial experience studies. The experience study in TMRS was for the period January 1, 2006 through December 31, 2009, first used in the December 31, 2010 valuation. Healthy post-retirement mortality rates and annuity purchase rates were updated based on a Mortality Experience Investigation Study covering 2009 through 2011, and dated December 31, 2013. These assumptions were first used in the December 31, 2013 valuation, along with a change to the Entry Age Normal (EAN) actuarial cost method. Assumptions are reviewed annually. No additional changes were made for the 2014 valuation.

The long-term expected rate of return on pension plan investments is 7.0%. The pension plan's policy in regard to the allocation of invested assets is established and may be amended by the TMRS Board of Trustees. Plan assets are managed on a total return basis with an emphasis on both capital appreciation as well as the production of income, in order to satisfy the short-term and long-term funding needs of TMRS.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

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Asset Class	Target Allocation	Long-Term Expected Real Rate of Return (Arithmetic)
Domestic Equity	17.5%	4.80%
International Equity	17.5%	6.05%
Core Fixed Income	30.0%	1.50%
Non-Core Fixed Income	10.0%	3.50%
Real Return	5.0%	1.75%
Real Estate	10.0%	5.25%
Absolute Return	5.0%	4.25%
Private Equity	5.0%	8.50%
Total	100.0%	

Discount Rate

The discount rate used to measure the total pension liability was 7.0%. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rates specified in statute. Based on that assumption, the pension plan's Fiduciary Net Position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all period of projected benefit payments to determine the Total Pension Liability.

Changes in the Net Pension Liability

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balance at December 31, 2013	\$ 7,001,976	\$ 4,906,933	\$ 2,095,043
Changes for the year:			
Service Cost	275,274	-	275,274
Interest	489,029	-	489,029
Change of benefit terms	-	-	-
Difference between expected and actual experience	(61,274)	-	(61,274)
Changes of assumptions	-	-	-
Contributions - employer	-	287,653	(287,653)
Contributions - employee	-	142,403	(142,403)
Net investment income	-	280,731	(280,731)
Benefit payments, including refunds of employee contributions	(306,966)	(306,966)	-
Administrative expense	-	(2,931)	2,931
Other charges	-	(241)	241
Net changes	396,063	400,649	(4,586)
Balance at December 31, 2014	\$ 7,398,039	\$ 5,307,582	\$ 2,090,457

Sensitivity of the net pension liability to changes in the discount rate

The following presents the net pension liability of the City, calculated using the discount rate of 7.0%, as well as what the City's net position liability would be if it were calculated using a

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discount rate that is 1-percentage-point lower (6%) or 1-percentage-point higher (8%) than the current rate:

	1% Decrease in Discount Rate (6%)	Discount Rate (7%)	1% Increase in Discount Rate (8%)
City's net pension liability	\$ 3,237,341	\$ 2,090,457	\$ 1,164,858

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's Fiduciary Net Position is available in a separately-issued TMRS financial report. That report may be obtained on the Internet at www.tmrs.com.

E. Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended September 30, 2015, the City recognized pension expense of \$275,825.

At September 30, 2015, the city reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ -	\$ 45,422
Difference between projected and actual investment earnings	50,203	-
Contributions subsequent to the measurement date	235,003	-
Total	<u>\$ 285,206</u>	<u>\$ 45,422</u>

\$235,003 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ending September 30, 2015. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended September 30:	
2015	\$ (3,301)
2016	(3,301)
2017	(1,167)
2018	12,550
Total	<u>\$ 4,781</u>

Texas Emergency Services Retirement System

A. Plan Description

The City participates in a cost-sharing multiple employer pension plan that has a special funding situation. The plan is administered by the Texas Emergency Services Retirement System (TESRS) established and administered by the State of Texas to provide pension

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benefits for emergency services personnel who serve without significant monetary remuneration. At August 31, 2014, there were 198 contributing fire and/or emergency services department members participating in TESRS. Eligible participants include volunteer emergency services personnel who are members in good standing of a member department.

On August 31, 2014, the pension system membership consisted of:

Retirees and beneficiaries currently receiving benefits	3,073
Terminated members entitled to benefits but not yet receiving them	2,161
Active participants (vested and non-vested)	4,036

B. Pension Plan Fiduciary Net Position

Detailed information about the TESRS's fiduciary net position is available in a separately-issued Comprehensive Annual Financial Report that includes financial statements and required supplementary information. TESRS issues a publicly available Annual Financial Report, which includes financial statements, notes, and required supplementary information, which can be obtained at www.tesrs.org. The separately issued actuarial valuations which may be of interest are also available at the same link.

C. Benefits Provided

Senate Bill, 65th Legislature, Regular Session (1977), created TESRS and established the applicable benefit provisions. The 79th Legislature, Regular Session (2005), re-codified the provisions and gave the TESRS Board of Trustees authority to establish vesting requirements, contribution levels, benefit formulas and eligibility requirements by Board rule. The benefit provisions include retirement benefits as well as death and disability benefits. Members are 50% vested after the tenth year of service, with the vesting percent increasing 10% for year of the next five years of service so that a member becomes 100% vested with 15 years of service.

Upon reaching age 55, each vested member may retire and receive a monthly pension equal to his vested percent multiplied by six times the governing body's average monthly contribution over the member's years of qualified services. For years of service in excess of 15 years, this monthly benefit is increased at the rate of 6.2% compounded annually. There is no provision for automatic postretirement benefit increases.

On and off-duty death benefits and on-duty disability benefits are dependent on whether or not the member was engaged in the performance of duties at the time of death or disability. Death benefits include a lump sum amount or continuing monthly payments to a member's surviving spouse and dependent children.

D. Funding Policy

Contributions are made by governing bodies for the participating departments. No contributions are required from the individuals who are members of the System, nor are they allowed. The governing bodies of each participating department are required to make contributions for each month a member performs emergency services for a department (this minimum contribution is \$36 per member and the department may make a higher monthly

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contribution for its members). This is referred to as a Part One contribution, which is the legacy portion of the System contribution that directly impacts future retiree annuities.

The State is required to contribute an amount necessary to make the System "actuarially sound" each year, which may not exceed one-third of the total of all contributions made by participating governing bodies in a particular year.

The Board rule defining contributions was amended effective July 27, 2014 to add the potential for actuarially determined Part Two contributions that would be required only if the expected future annual contributions from the State are not enough with the Part One contributions to provide an adequate contribution arrangement as determined by the most recent actuarial valuation. This Part Two portion, which is actuarially determined as a percent of the Part One portion (not to exceed 15%), is to be actuarially adjusted near the end of each even-numbered calendar year based on the most recent actuarial valuation. Based on the actuarial valuation as of August 31, 2014, the Part Two contribution rate was 0%, since the first actuarial valuation report after adoption of the rules showed the System to have an adequate contribution arrangement without any Part Two contributions.

Additional contributions may be made by governing bodies within two years of joining the System, to rant up to ten years of credit for service per member. Prior service purchased must have occurred before the department began participation in the System.

A small subset of participating departments has a different contribution arrangement which is being phased out over time. In this arrangement, contributions made in addition to the monthly contributions for active members, are made by local governing bodies on a pay-as-you-go basis for members who were pensioners when their respective departments merged into the System. There is no actuarial impact associated with this arrangement as the pay-as-you-go contributions made by these governing bodies are always equal to benefit payments paid by the System.

E. Contributions

The contribution requirement per active emergency services personnel member per month is not actuarially determined. Rather, the minimum contribution provisions were set by board rule, and there is no maximum contribution rate. For the fiscal year ending August 31, 2014, total contributions (due, prior service, and interest on prior financing) of \$15,012 were paid by the City. The State appropriated \$1,530,343 for the fiscal year ending August 31, 2014 to the plan as a whole.

F. Actuarial Assumptions

Total pension liability in the August 31, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Actuarial valuation date	8/31/2014
Actuarial cost method	Entry age
Amortization method	Level dollar, Open
Amortization period	30 years

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2015

Asset valuation method	Market value smoothed by a 5-year deferred recognition method with a 80%/120% corridor on market value
Actuarial assumptions:	
Investment rate of return*	7.75%
Projected salary increase	N/A
*includes inflation at	3.5%
Cost of living adjustments	None

Mortality rates were based on the RP-2000 Combined Healthy Lives Mortality Tables for males and for females projected to 2018 by scale AA. The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future net real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These components are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation (3.5%). In addition, the final 7.75% assumption reflected a reduction of 0.20% for adverse deviation. The target allocation and expected arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Net Real Rate of Return
Equities		
Large Cap Domestic	32.00%	5.20%
Small Cap Domestic	10.00%	5.80%
Developed International	21.00%	5.50%
Emerging Markets	6.00%	5.40%
Master Limited Partnership	5.00%	7.10%
Fixed Income		
Domestic	21.00%	1.40%
International	5.00%	1.60%

G. Discount Rate

The discount rate used to measure the total pension liability was 7.75%. No projection of cash flows was used to determine the discount rate because the August 31, 2014 actuarial valuation showed that expected contributions would pay the normal cost and amortize the unfunded actuarial accrued liability (UAAL) in 30 years using the conservative level dollar amortization method. That UAAL was based on an actuarial value of assets that was \$7.9 million less than the plan fiduciary net position as of August 31, 2014. Because of the 30-year amortization period with the conservative amortization method and with a lower value of assets, the pension plan's fiduciary net position is expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2015

H. Sensitivity of the Net Pension Liability to changes in the discount rate

The following presents the net pension liability of the City, alculated using the discount rate of 7.75%, as well as the City's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.75%) or 1 percentage point higher(8.75%) that the current rate:

	1% Decrease in Discount Rate (6.75%)	Discount Rate (7.75%)	1% Increase in Discount Rate (8.75)
City's proportionate share of the net pension liability:	\$123,947	\$60,148	\$22,925

I. Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At August 31, 2014, the City reported a liability of \$60,148 for its proportionate share of the plan's net pension liability. This liability reflects a reduction for State pension support provided to the City. The amount recognized by the City as a proportionate share of the net pension liability, the related State support, and the total portion of the net pension liability that was associated with the City were as followed:

City's proportionate share of the collective net pension liability	\$ 60,148
States proportionate share that is associated with the City*	20,325
Total	<u>\$ 80,473</u>

**Calculated using the City's proportionate share of contributions multiplied by the State's share of the collective net pension liability.*

The net pension liability was measured as of August 31, 2014 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. GASB Statement No. 68 requires the net pension liability to be measured as of a date no earlier than the end of the employer's prior fiscal year. TESRS did not roll forward the net pension liability nor did they provide the necessary information for the participants to roll forward themselves. While the City acknowledges that the measurement date does not fall within this 12 month period, the City elected to honor the conservatism principle and report a net pension liability measured as of August 31, 2014. The City used the assumption that and differences in the net pension liability measured as of August 31, 2014 versus September 30, 2014 would be immaterial. The employer's proportion of the net pension liability was based on the employer's contributions to the pension plan relative to the contributions of all employers to the plan for the period September 1, 2013 through August 31, 2014.

At August 31, 2014 the employer's proportion of the collective net pension liability was .331%. TESRS did not provide prior year proportions measured as of August 31, 2013. The City is using the assumption that the change in proportion would have been immaterial and therefore disregarded this year.

There were no changes of assumptions or other inputs that affected measurement of the total pension liability during the measurement period.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2015

There were no changes of benefit terms that affected measurement of the total pension liability during the measurement period.

For the year ended August 31, 2014, the City recognized pension expense of \$12,772. The City recognized on-behalf revenues of \$7,662 calculated by taking the State's total contributions to TESRS multiplied by the City's proportionate share.

At August 31, 2014, the City reported its proportionate share of the TESRS deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between projected and actual investment earnings	\$ -	\$ 15,158
Contributions paid to TESRS subsequent to the measurement date	\$ 9,108	\$ -

The net amounts of the employer's balances of deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended September 30	Pension Expense
2016	\$ 3,790
2017	3,790
2018	3,790
2019	3,788
Total	<u>\$ 15,158</u>

Note 14. Other post-employment benefits

Supplementary Death Benefit

The city also participates in the cost sharing multiple-employer defined benefit group-term life insurance plan operated by the Texas Municipal Retirement System (TMRS) known as the Supplemental Death Benefits Fund (SDBF). The city elected, by ordinance, to provide group-term life insurance coverage to both current and retired employees. The city may terminate coverage under and discontinue participation in the SDBF by adopting an ordinance before November 1 of any year to be effective the following January 1.

The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary (calculated based on employee's actual earnings, for the 12-month period preceding the month of death); retired employees are insured for \$7,500; this coverage is an "other postemployment benefit," or OPEB.

The city contributes to the SDBF at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. The funding policy for the SDBF program is to assure that adequate resources are available

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2015

to meet all death benefit payments for the upcoming year; the intent is not to pre-fund retiree term life insurance during employee's entire careers.

The city's contribution to the TMRS SDBF for the year ended September 30, 2015, were \$3,917, which equaled the required contributions for the year.

Note 15. Contingent Liabilities

Amounts received or receivable from grantor agencies are subject to audit and adjustment by grantor agencies. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures which may be disallowed by the grantor cannot be determined at this time although the City expects such amounts, if any, to be immaterial.

The City is a party to various claims and legal proceedings which normally occur in governmental operations. It is not possible to estimate the ultimate outcome or liability. These contingencies are not likely to have a material adverse impact on the City.

Note 16. Restatement of Net Position and Fund Balance

During the year ended September 30, 2015, the City adopted Governmental Accounting Standard Number 68, "Accounting and Financial Reporting for Pensions." The adoption of this standard required the City to report the net pension liability on the statement of net position. Therefore, an adjustment was made to the beginning net position for the recording of the beginning net pension liability and the beginning deferred outflow for contributions made after the measurement date. Net position of the proprietary fund and the business-type activities has been reduced by \$625,517 as of September 30, 2014. Net position of the governmental activities has been reduced by \$1,338,732 as of September 30, 2014.

Also, during the year ended September 30, 2015, the City became aware that tax assessor-collector fees from prior periods dating back to 2008 had not been paid. Therefore, an adjustment was made to the beginning fund balance and net position for the recording of this liability. Fund balance of the general fund and net position of the governmental activities as of September 30, 2014 has been reduced by \$44,381.

REQUIRED SUPPLEMENTARY INFORMATION

Required supplementary information includes financial information and disclosures that are required by the GASB but are not considered a part of the basic financial statements. Required supplementary information includes:

- Schedule of Changes in Net Pension Liability and Related Ratios - TMRS
- Schedule of Contributions – TMRS
- Schedule of Changes in Net Pension Liability and Related Ratios - TESRS
- Schedule of Contributions – TESRS

City of Hearne, Texas
Required Supplementary Information
For the Year Ended September 30, 2015

Schedule of Changes in Net Pension Liability and Related Ratios
Texas Municipal Retirement System (TMRS)
Last 10 Years (will ultimately be displayed)

	<u>2014</u>
Total Pension Liability	
Service Cost	\$ 275,274
Interest (on the Total Pension Liability)	489,029
Change in benefit terms	-
Difference between expected and actual experience	(61,274)
Change of assumptions	-
Benefit payments, including refunds of employee contributions	<u>(306,966)</u>
Net Change in Total Pension Liability	396,063
Total Pension Liability - Beginning	<u>7,001,976</u>
Total Pension Liability - Ending (a)	<u><u>\$ 7,398,039</u></u>
Plan Fiduciary Net Position	
Contributions - Employer	\$ 287,653
Contributions - Employee	142,403
Net Investment Income	280,731
Benefit payments, including refunds of employee contributions	(306,966)
Administrative Expense	(2,931)
Other	<u>(241)</u>
Net Change in Plan Fiduciary Net Position	400,649
Plan Fiduciary Net Position - Beginning	<u>4,906,933</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 5,307,582</u></u>
Net Pension Liability - Ending (a) - (b)	\$ 2,090,457
Plan Fiduciary Net Position as a Percentage of Total Pension Liability	71.74%
Covered Employee Payroll	\$ 2,027,841
Net Pension Liability as a Percentage of Covered Employee Payroll	103.09%

Notes to Schedule:

GASB 68 requires 10 fiscal years of data to be provided in this schedule. As GASB 68 has been initially adopted for the 2014 plan year, historical data is not presented.

City of Hearne, Texas
Required Supplementary Information
For the Year Ended September 30, 2015

Schedule of Contributions
Texas Municipal Retirement System (TMRS)
Last 10 Years (will ultimately be displayed)

	2015
Actuarially Determined Contribution	\$ 319,205
Contributions in relation to the actuarially determined contribution	319,205
Contribution deficiency (excess)	\$ -
Covered employee payroll	\$ 2,098,713
Contributions as a percentage of covered employee payroll	15.21%

Notes to Schedule of Contributions

Valuation Date:

Notes Actuarially determined contribution rates are calculated as of December 31 and become effective in January 13 months later.

Methods and Assumptions Used to Determine Contribution Rates:

Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percentage of Payroll, Closed
Remaining Amortization Period	26 years
Asset Valuation Method	10 Year smoothed market; 15% soft corridor
Inflation	3.0%
Salary Increases	3.50% to 12.00%, including inflation
Investment Rate of Return	7.00%
Retirement Age	Experienced-based table of rates that are specific to the City's plan of benefits. Last updated for the 2010 valuation pursuant to an experience study of the period 2005-2009 RP2000 Combined Mortality Table with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% and projected on a fully generational basis with scale BB

Other Information:

Notes There were no benefit changes during the year.
GASB 68 requires 10 fiscal years of data to be provided in this schedule. As GASB 68 has been initially adopted for the 2015 fiscal year, historical data is not presented.

City of Hearne, Texas
Required Supplementary Information
For the Year Ended September 30, 2015

Schedule of City's Proportionate Share of the Net Pension Liability
Texas Emergency Services Retirement System (TESRS)
Last 10 Years (will ultimately be displayed)

	<u>8/31/2014</u>
City's proportion of the net pension liability	0.331%
City's proportionate share of the net pension liability	\$ 60,148
State's proportionate share of the net pension liability	20,325
Total	<u>\$ 80,473</u>
Number of Active Members*	21
City's Net Pension Liability per Active Member	\$ 2,864
Plan fiduciary net position as a percentage of the total pension liability	83.5%

* There is no compensation for active members. Number of active members is used instead.

Notes to Schedule:

GASB 68 requires 10 fiscal years of data to be provided in this schedule. As GASB 68 has been initially adopted for the 2014 plan year, historical data is not presented.

Changes in benefit terms - There were no changes in benefit terms that affect the measurement of the total pension liability.

Changes in assumptions - There were no changes in assumptions or other inputs that affected the measurement of the total pension liability during the measurement period.

City of Hearne, Texas
Required Supplementary Information
For the Year Ended September 30, 2015

Schedule of Contributions
Texas Emergency Services Retirement System (TESRS)
Last 10 Years (will ultimately be displayed)

	<u>2015</u>
Contractually required contribution	\$ 9,108
Contributions in relation to the contractually required contribution	<u>9,108</u>
Contribution deficiency (excess)	<u>\$ -</u>
Number of Active Members *	21
Contributions per active member	\$ 434

* There is no compensation for active members. Number of active members is used instead.

Notes to Schedule:

GASB 68 requires 10 fiscal years of data to be provided in this schedule. As GASB 68 has been initially adopted for the 2015 fiscal year, historical data is not presented.

Combining Financial Statements

Non-Major Governmental Funds

Special Revenue Funds

Special revenue funds are used to account for specific revenues that are legally restricted to expenditure for particular purposes.

Hotel/Motel Occupancy Tax Fund – This fund is used to account for the tax collected from local hotels and motels, which is used to promote tourism.

Police Special Fund – This fund is used to account for restricted grant funds from the State for officer training and crime victims benefits.

City of Hearne, Texas
Combining Balance Sheet
Non-major Governmental Funds
September 30, 2015

	Special Revenue		Total Non-major Governmental Funds
	Hotel/Motel Tax	Police Special Fund	
Assets			
Taxes receivable	\$ 12,710	\$ -	\$ 12,710
Due from other funds	63,692	-	63,692
Cash, restricted	98,453	6,087	104,540
Total assets	\$ 174,855	\$ 6,087	\$ 180,942
Liabilities and fund balances			
Liabilities:			
Accounts payable	\$ 54,177	\$ -	\$ 54,177
Due to other funds	-	335	335
Total liabilities	54,177	335	54,512
Fund balances:			
Restricted for police	-	5,752	5,752
Restricted for tourism	120,678	-	120,678
Total fund balances	120,678	5,752	126,430
Total liabilities and fund balances	\$ 174,855	\$ 6,087	\$ 180,942

City of Hearne, Texas
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Non-major Governmental Funds
For the Year Ended September 30, 2015

	Special Revenue		Total
	Hotel/Motel	Police	Non-major
	Tax	Special	Governmental
		Fund	Funds
Revenues:			
Hotel/motel occupancy taxes	\$ 160,917	\$ -	\$ 160,917
Investment income	129	-	129
Intergovernmental	2,000	2,630	4,630
Total revenues	163,046	2,630	165,676
Expenditures:			
Current:			
Culture and recreation	82,829	-	82,829
Total expenditures	82,829	-	82,829
Excess (deficiency) of revenues over (under) expenditures	80,217	2,630	82,847
Net change in fund balances	80,217	2,630	82,847
Fund balances at beginning of year	40,461	3,122	43,583
Fund balances at end of year	\$ 120,678	\$ 5,752	\$ 126,430

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**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE – BUDGET AND ACTUAL**

Special Revenue Funds

City of Hearne, Texas
Hotel/Motel Occupancy Tax Special Revenue Fund
Schedule of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Over (Under)
Revenues:				
Hotel/motel occupancy taxes	\$ 158,000	\$ 158,000	\$ 160,917	\$ 2,917
Investment income	75	75	129	54
Intergovernmental	-	-	2,000	2,000
Total revenues	<u>158,075</u>	<u>158,075</u>	<u>163,046</u>	<u>4,971</u>
Expenditures:				
Current:				
Culture and recreation:				
Economic development	99,075	99,075	82,829	(16,246)
Capital outlay	59,000	59,000	-	(59,000)
Total expenditures	<u>158,075</u>	<u>158,075</u>	<u>82,829</u>	<u>(75,246)</u>
Net change in fund balance	-	-	80,217	80,217
Fund balance at beginning of year	<u>40,461</u>	<u>40,461</u>	<u>40,461</u>	<u>-</u>
Fund balance at end of year	<u>\$ 40,461</u>	<u>\$ 40,461</u>	<u>\$ 120,678</u>	<u>\$ 80,217</u>

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**SCHEDULE OF REVENUES, EXPENSES AND CHANGES
IN NET POSITION – BUDGET AND ACTUAL**

Enterprise Funds

City of Hearne, Texas
Enterprise Fund
Schedule of Revenues, Expenses, and Changes in Net Position
Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Operating revenues:				
Charges for sales and services:				
Water sales	\$ 1,028,000	\$ 1,028,000	\$ 1,139,820	\$ 111,820
Electric sales	6,109,800	6,109,800	5,863,379	(246,421)
Sewer charges	578,000	578,000	685,048	107,048
Sanitation	631,000	631,000	612,365	(18,635)
Tap fees	1,200	1,200	1,000	(200)
Rental fees	10,000	10,000	6,804	(3,196)
Penalties	112,000	112,000	115,153	3,153
Miscellaneous revenue	113,560	113,560	113,985	425
Total operating revenues	8,583,560	8,583,560	8,537,554	(46,006)
Operating expenses:				
Wholesale utilities	4,760,000	5,104,582	5,104,581	(1)
Water department	512,555	462,762	397,157	(65,605)
Electric department	435,038	472,431	435,947	(36,484)
Sewer department	427,185	427,185	356,041	(71,144)
Sanitation department	65,800	75,846	51,776	(24,070)
Administrative and billing	844,407	896,517	831,725	(64,792)
Depreciation and amortization	-	689,627	690,255	628
Capital outlay	103,000	92,954.00	-	(92,954)
Total operating expenses	7,147,985	8,221,904	7,867,482	(354,422)
Operating income	1,435,575	361,656	670,072	308,416
Nonoperating revenues (expenses):				
Intergovernmental	1,062,500	1,062,500	795,219	(267,281)
Contribution from component unit	-	-	75,000	75,000
Investment income	-	-	1,917	1,917
Gain on disposal of capital assets	-	-	2,269	2,269
Interest expense	(327,793)	(333,340)	(330,700)	2,640
Total nonoperating revenues (expenses)	734,707	729,160	543,705	(185,455)
Change in net position before transfers	2,170,282	1,090,816	1,213,777	122,961
Transfers in	622,388	622,388	506,472	(115,916)
Transfers out	(2,792,670)	(1,713,204)	(1,260,816)	452,388
Total other financing sources (uses)	(2,170,282)	(1,090,816)	(754,344)	336,472
Change in net position	-	-	459,433	459,433
Net position, beginning of year, as previously reported	4,143,286	4,143,286	4,143,286	-
Restatement of net position, see Note 16	(625,517)	(625,517)	(625,517)	-
Net position, beginning of year, as restated	3,517,769	3,517,769	3,517,769	-
Net position, end of the year	\$ 3,517,769	\$ 3,517,769	\$ 3,977,202	\$ 459,433

City of Hearne, Texas
Non-major Municipal Airport Enterprise Fund
Schedule of Revenues, Expenses, and Changes in Net Position
Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Operating revenues:				
Rental fees	\$ 29,300	\$ 30,510	\$ 30,510	\$ -
Miscellaneous revenue	75,000	75,000	66,380	(8,620)
Total operating revenues	104,300	105,510	96,890	(8,620)
Operating expenses:				
Airport	77,900	79,110	96,879	17,769
Depreciation	33,000	33,000	75,939	42,939
Total operating expenses	110,900	112,110	172,818	60,708
Operating income (loss)	(6,600)	(6,600)	(75,928)	(69,328)
Nonoperating revenue:				
Contribution from component unit	-	6,600	-	(6,600)
Total non operating revenue	-	6,600	-	(6,600)
Change in net position	-	-	(75,928)	(75,928)
Net position, beginning of the year	1,188,436	1,188,436	1,188,436	-
Net position, end of the year	\$ 1,188,436	\$ 1,188,436	\$ 1,112,508	\$ (75,928)

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SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES

IN FUND BALANCE – BUDGET AND ACTUAL

Discretely Presented Component Units

City of Hearne, Texas
Hearne Economic Development Corporation
Schedule of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Revenues:				
Sales taxes	\$ 215,000	\$ 215,000	\$ 279,300	\$ 64,300
Investment income	1,200	1,200	1,162	(38)
Total revenues	<u>216,200</u>	<u>216,200</u>	<u>280,462</u>	<u>64,262</u>
Expenditures:				
Current:				
Culture and recreation:				
Economic development	216,200	216,200	194,855	(21,345)
Total expenditures	<u>216,200</u>	<u>216,200</u>	<u>194,855</u>	<u>(21,345)</u>
Excess of revenues over expenditures	<u>-</u>	<u>-</u>	<u>85,607</u>	<u>85,607</u>
Other financing sources:				
Contributions to primary government	<u>-</u>	<u>-</u>	<u>(83,381)</u>	<u>(83,381)</u>
Net change in fund balances	<u>-</u>	<u>-</u>	<u>2,226</u>	<u>2,226</u>
Fund balances at beginning of year	<u>898,442</u>	<u>898,442</u>	<u>898,442</u>	<u>-</u>
Fund balances at end of year	<u>\$ 898,442</u>	<u>\$ 898,442</u>	<u>\$ 900,668</u>	<u>\$ 2,226</u>

City of Hearne, Texas
Hearne Infrastructure/Improvement Corporation
Schedule of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Revenues:				
Sales taxes	\$ 215,000	\$ 215,000	\$ 279,300	\$ 64,300
Investment income	550	550	801	251
Total revenues	215,550	215,550	280,101	64,551
Expenditures:				
Current:				
Culture and recreation:				
Economic development	215,550	215,550	137,958	(77,592)
Total expenditures	215,550	215,550	137,958	(77,592)
Excess of revenues over expenditures	-	-	142,143	142,143
Other financing sources (uses):				
Contributions to primary government	-	-	(83,381)	(83,381)
Total other financing sources (uses)	-	-	(83,381)	(83,381)
Net change in fund balances	-	-	58,762	58,762
Fund balances at beginning of year	724,216	724,216	724,216	-
Fund balances at end of year	<u>\$ 724,216</u>	<u>\$ 724,216</u>	<u>\$ 782,978</u>	<u>\$ 58,762</u>

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**SUPPLEMENTARY INDIVIDUAL
FUND SCHEDULES**

General Fund

City of Hearne, Texas
General Fund
Schedule of General Government Expenditures - Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts			Variance with Final Budget Over (Under)
	Original	Final	Actual	
Legislative:				
Personnel	\$ 45,522	\$ 61,858	\$ 58,913	\$ (2,945)
Maintenance	2,200	2,690	2,690	-
Supplies	1,250	4,678	4,627	(51)
Other	8,300	18,618	18,038	(580)
Total legislative	57,272	87,844	84,268	(3,576)
Executive:				
Personnel	222,987	259,740	260,443	703
Maintenance	1,800	2,725	2,725	-
Supplies	1,800	4,278	3,878	(400)
Other	4,750	4,981	4,220	(761)
Total executive	231,337	271,724	271,266	(458)
Finance:				
Personnel	37,250	33,558	33,041	(517)
Maintenance	89,700	105,105	118,773	13,668
Supplies	8,900	8,929	3,507	(5,422)
Contract services	44,000	83,256	41,610	(41,646)
Other	97,103	90,064	81,801	(8,263)
Total finance	276,953	320,912	278,732	(42,180)
Court:				
Personnel	65,468	67,780	61,698	(6,082)
Maintenance	4,800	6,103	6,102	(1)
Supplies	1,800	4,469	3,821	(648)
Contract services	54,048	47,132	45,862	(1,270)
Other	3,600	4,232	2,571	(1,661)
Total court	129,716	129,716	120,054	(9,662)
Total general government	\$ 695,278	\$ 810,196	\$ 754,320	\$ (55,876)

City of Hearne, Texas
General Fund
Schedule of Public Safety Expenditures - Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Police:				
Personnel	\$ 978,372	\$ 979,983	\$ 968,860	\$ (11,123)
Maintenance	42,800	60,607	63,804	3,197
Supplies	67,400	69,842	57,285	(12,557)
Other	7,800	18,935	19,981	1,046
Total police	1,096,372	1,129,367	1,109,930	(19,437)
Fire:				
Personnel	34,432	28,776	30,771	1,995
Maintenance	30,500	30,899	30,736	(163)
Supplies	28,100	35,448	28,633	(6,815)
Other	4,750	7,658	6,217	(1,441)
Total fire	97,782	102,781	96,357	(6,424)
Total public safety	\$ 1,194,154	\$ 1,232,148	\$ 1,206,287	\$ (25,861)

City of Hearne, Texas
General Fund
Schedule of Highways and Streets Expenditures - Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Streets:				
Personnel	\$ 250,543	\$ 265,843	\$ 220,962	\$ (44,881)
Maintenance	69,500	90,040	64,817	(25,223)
Supplies	52,650	53,349	27,204	(26,145)
Other	800	1,383	806	(577)
Total highways and streets	<u>\$ 373,493</u>	<u>\$ 410,615</u>	<u>\$ 313,789</u>	<u>\$ (96,826)</u>

City of Hearne, Texas
General Fund
Schedule of Health and Welfare Expenditures - Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Code enforcement:				
Personnel	\$ 5,297	\$ 14,937	\$ 15,119	\$ 182
Maintenance	450	2,004	1,704	(300)
Supplies	1,700	2,666	2,056	(610)
Other	1,500	3,526	2,226	(1,300)
Total code enforcement	<u>8,947</u>	<u>23,133</u>	<u>21,105</u>	<u>(2,028)</u>
Animal control:				
Personnel	43,914	44,447	43,624	(823)
Maintenance	8,900	8,900	5,119	(3,781)
Supplies	5,900	6,243	5,229	(1,014)
Other	400	400	-	(400)
Total animal control	<u>59,114</u>	<u>59,990</u>	<u>53,972</u>	<u>(6,018)</u>
Total health and welfare	<u>\$ 68,061</u>	<u>\$ 83,123</u>	<u>\$ 75,077</u>	<u>\$ (8,046)</u>

City of Hearne, Texas
General Fund
Schedule of Culture and Recreation Expenditures - Budget and Actual
For the Year Ended September 30, 2015

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Over (Under)
Library:				
Personnel	\$ 129,092	\$ 130,092	\$ 127,323	\$ (2,769)
Maintenance	10,500	10,548	6,714	(3,834)
Supplies	17,100	29,953	29,031	(922)
Other	3,400	3,400	2,838	(562)
Total library	<u>168,092</u>	<u>173,993</u>	<u>165,906</u>	<u>(8,087)</u>
Parks and recreation:				
Personnel	293,698	286,137	248,229	(37,908)
Maintenance	117,625	119,850	94,709	(25,141)
Supplies	30,050	30,050	20,280	(9,770)
Other	2,750	2,750	165	(2,585)
Total parks and recreation	<u>444,123</u>	<u>438,787</u>	<u>363,383</u>	<u>(75,404)</u>
Total culture and recreation	<u>\$ 604,215</u>	<u>\$ 612,780</u>	<u>\$ 529,289</u>	<u>\$ (83,491)</u>

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AUDIT SECTION

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 Honorable Mayor and
Members of the City Council
City of Hearne, Texas

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hearne, Texas, (the "City") as of and for the year ended September 30, 2015, which collectively comprise the City's basic financial statements and have issued our report thereon dated March 8, 2016. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompany schedule of findings and responses that we consider to be significant deficiencies in internal control over financial reporting. We consider the deficiencies described in the accompany

schedule of findings and responses at 2015-1 through 2015-6 to be significant deficiencies. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of 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*.

We noted certain matters that we reported to management of the City, in a separate letter dated March 8, 2016.

The City's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the City's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the City Council, management, others within the organization and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

College Station, Texas
March 8, 2016

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

To the Honorable Mayor and
Members of the City Council
City of Hearne, Texas

Report on Compliance for Each Major Federal Program

We have audited the City of Hearne, Texas's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended September 30, 2015. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City of Hearne'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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 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 the City'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 the City's compliance.

Opinion on Each Major Federal Program

In our opinion, the City of Hearne, Texas 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 September 30, 2015.

Report on Internal Control Over Compliance

Management of the City 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 the City's internal control over compliance with the types of requirements that could have a direct and material effect on a major federal program to determine our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 the City'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 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 preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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 OMB Circular A-133. Accordingly, this report is not suitable for any other purposes.

March 8, 2016
College Station, Texas

CITY OF HEARNE, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
SEPTEMBER 30, 2015

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses a qualified opinion on the financial statements of the City of Hearne, Texas (the "City").
2. There were six significant deficiencies relating to the audit of the financial statements reported in the "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*."
3. No instances of noncompliance material to the financial statements of the City, which are required to be reported in accordance with *Government Auditing Standards*, were disclosed during the audit.
4. There were no deficiencies relating to the audit of the major federal award programs reported in the "Independent Auditors' Report on Compliance for Each Major Program and on Internal Control Over Compliance required by OMB Circular A-133."
5. The auditor's report on compliance for the major federal award programs for the City expresses an unqualified opinion on all major federal programs.
6. The program tested as a major program was: Department of Housing and Urban Development/Texas Department of Agriculture - CFDA No. 14.228.
7. The threshold for distinguishing Types A and B programs was \$300,000.
8. The City did not qualify as a low-risk auditee.

CITY OF HEARNE, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
SEPTEMBER 30, 2015

B. FINDINGS – FINANCIAL STATEMENT AUDIT

Significant deficiencies

2015-1 Segregation of duties for accounts payable

Condition and Criteria: Accounts payable invoices are received, coded, and posted by the Finance Assistant. The assistant is also responsible for processing and mailing payments. Exposure is limited as other persons review invoices for approval and the Finance Assistant does not have signature authority.

Recommendation: We recommend that the invoice coding continue to be reviewed by the Chief Financial Officer (CFO) to ensure accuracy.

Response: The coding of all Check Requests and Purchase Orders will continue to be reviewed by the CFO.

2015-2 Segregation of duties for general ledger

Condition and Criteria: The City does not maintain proper segregation of duties related to journal entry posting. The majority of preparation and approval is performed by the CFO. However, the City Manager reviews and signs off on all journal entries.

Recommendation: The City Manager should continue to review all journal entries.

Response: The City Manager will continue to review all journal entries.

2015-3 Payroll

Condition and Criteria: The City Secretary processes all payroll transactions. The direct deposit ACH transmittal is prepared and submitted by the City Secretary and reviewed by the City Manager.

Recommendation: The City Manager should continue to review the direct deposit ACH transmittal.

Response: The direct deposit ACH transmittal will continue to be reviewed by the City Manager.

2015-4 Inventory

Condition and Criteria: There is a lack of internal controls over the receiving and dispensing of inventory as there is no attendant at the warehouse to monitor inventory movement and ensure proper documentation is obtained for activity. To minimize the potential for theft, the City has installed secured gates and security cameras that are monitored by the Police Dispatchers.

Recommendation: The security cameras should be maintained and monitored. In addition, the level of purchases should be carefully scrutinized for large or unusual purchases.

Response: The City will continue to monitor the security cameras and scrutinize large or unusual inventory purchases.

2015-5 Accounts Receivable

Condition and Criteria: Our review of the accounts receivable subledger as of year end identified significant balances over 90 days old. The City continues transitioning into formalized disconnect policies to prevent deterioration of the accounts receivable balance and avoid the significant write offs experienced in the past due to lenient collection practices.

Recommendation: The City needs to estimate a reasonable allowance for doubtful accounts and write-off accounts that are deemed to be uncollectible.

Response: The City continues to follow its policies that keep accounts over 90 days old to a minimum. The majority of balances over 90 days old are due to inactive accounts which will be written off during the fiscal year ending September 30, 2016.

2015-6 Utility billing and receipts

Condition and Criteria: The utility billing clerk sorts the mail, processes billings, adjustments and receipts. The City has implemented a procedure to reconcile the system-generated adjustments report to the approved adjustments log. In addition, the City Manager reviews and signs the adjustment reports.

Recommendation: The City Manager should continue to review the adjustment reports.

Response: An independent review of the adjustments will continue to be made by a member of management.

CITY OF HEARNE, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
SEPTEMBER 30, 2015

**C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD
PROGRAMS AUDIT**

None

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City of Hearne, Texas
Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2015

Federal Grantor/ Pass-Through Grantor/ Program Title	Federal CFDA Number	Federal Expenditures
Department of Housing and Urban Development		
Texas Department of Agriculture		
Texas Community Development Block (Contract No. 713112)	14.228	\$ 686,434
Department of Housing and Urban Development		
Texas Department of Agriculture		
Texas Community Development Block (Contract No. 713242)	14.228	108,787
Department of Housing and Urban Development		
Economic Development Initiative (Contract No. B-08-SP-TX-0107)	14.251	2,000
Total Expenditures of Federal Awards		<u><u>\$ 797,221</u></u>

Basis of Presentation:

The schedule of expenditures of federal awards includes the federal and state grant activity of the City and is presented on the modified accrual basis of accounting.

City of Hearne, Texas
Financial Statements with
Report of Independent Auditors
For the Fiscal Year Ended
September 30, 2014