

City of Hearne, Texas
For the Year Ended September 30, 2014

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FINANCIAL SECTION



**SEIDEL
SCHROEDER**

CERTIFIED PUBLIC ACCOUNTANTS/BUSINESS ADVISORS

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component units, 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, 2014, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Hearne, Texas, as of September 30, 2014, and the respective changes in financial position, where applicable, cash flows thereof, and the respective budgetary comparison for the general fund for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 9 and the Texas Municipal Retirement System analysis of funding progress on page 42 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements as a whole. The combining and individual non-major fund financial statements and budgetary comparison schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining and individual non-major fund financial statements and budgetary comparison schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining and individual non-major fund financial statements and budgetary comparison schedules are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated February 16, 2015, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

Seidel Schroeder

College Station, Texas
February 16, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of City of Hearne, Texas' annual financial report presents our discussion and analysis of the City's financial performance during the fiscal year ended September 30, 2014. Please read it in conjunction with the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

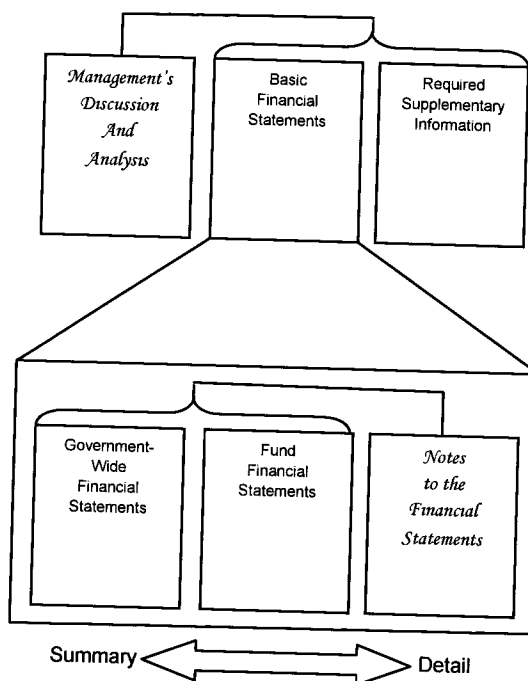
- The City's total combined Net Position was \$9,940,355 at September 30, 2014. This represents an increase of 1.8% in the Governmental Activities and 14.3% in Business Activities for an overall increase of 8.2%.
- During the year, the City's Expenses were \$817,748 less than the \$12,340,857 generated in taxes, charges for service and other revenues for Governmental and Business Activities. Comparatively, last year, the City's Expenses were \$1,266,162 less than revenues of \$12,280,978.
- In the City's Business Activities, Revenues Increased by 4.04%, to \$9,231,495. Expenditures also Increased by 6.43% to \$8,208,614.
- The Fund Balance Surplus in the General Fund remained static this year with a decrease of \$2,676 to \$905,804.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report contains the three required components of an annual financial statement—*management's discussion and analysis* (this section), the *basic financial statements*, and *required supplementary information*. The basic financial statements include two kinds of statements that present different views of the City:

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the City's overall financial status
- The remaining statements are *fund financial statements* that focus on *individual parts* of the government, reporting the City's operations in more detail than the government-wide statements.
- The *governmental funds* statements tell how *general government* services were financed in the *short term* as well as what remains for future spending.
- *Proprietary fund* statements offer *short- and long-term* financial information about the activities the government operates *like businesses*.
- *Fiduciary fund* statements provide information about the financial relationships in which the City acts solely as a trustee or agent for the benefit of others, to whom the resources in question belong.

Figure A-1, Required Components of the City of Hearne's Annual Financial Report



The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that further explains and supports the information in the financial statements. Figure A-1 shows how the required parts of this annual report are arranged and related to one another.

Figure A-2 summarizes the major features of the City's financial statements, including the portion of the City government they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis explains the structure and contents of each of the statements.

Figure A-2

Type of Statements	Fund Statements			
	Government-Wide	Governmental Funds	Proprietary Funds	Fiduciary Funds
Scope	Entire Agency's government (except fiduciary funds) and the Agency's component units	The activities of the city that are not proprietary or fiduciary	Activities the city operates similar to private businesses self insurance	Instances in which the city is the trustee or agent for someone else's resources
Required Financial Statements	*Statement of Net Position	*Balance Sheet	*Statement of Net Assets	*Statement of Fiduciary Net Position
	*Statement of activities	*Statement of Revenues, Expenditures & Changes in Fund Balance	*Statement of Revenues, Expenditures & Changes in Fund Balance	*Statement of Changes in Fiduciary Net Position
			*Statement of Cash Flows	
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of Asset / Liability Information	All assets and liabilities, both financial and capital, short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter, no capital assets included	All assets and liabilities, both financial and capital, short-term and long-term	All assets and liabilities, both short-term and long-term, the Agency's funds do not currently contain capital assets, although they can
Type of Inflow / Outflow Information	All revenues and expenses during the year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid	All revenues and expenses during the year, regardless of when cash is received or paid

Government-wide Statements

The government-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The statement of net position includes all of the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the City's net position and how they have changed. Net position, (the difference between the City's assets and liabilities), is one way to measure the City's financial health or *position*.

- Over time, increases or decreases in the City's net position are an indicator of whether its financial health is improving or deteriorating, respectively.
- To assess the overall health of the City, one needs to consider additional nonfinancial factors such as changes in the City's tax base.

The government-wide statements of the City include the Governmental activities. Most of the City's basic services are included here, such as general administration, public safety, streets and bridges, buildings and grounds, and financial and professional. Property, sales and franchise taxes finance most of these activities.

Fund Financial Statements

The fund financial statements provide more detailed information about the City's most significant funds – not the City as a whole. Funds are accounting devices that the City uses to keep track of specific sources of funding and spending for particular purposes.

- Some funds are required by state law and by bond covenants.
- The City Council establishes other funds to control and manage money for particular purposes or to show that it is properly using certain taxes and grants.

The City has the following types of funds:

- **Governmental funds** – most of the City's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental fund statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explain the relationship) or differences) between them.
- **Proprietary funds** – Services for which the City charges customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both long-term and short-term financial information

THE CITY AS A WHOLE

Table A-1
City's Net Position
(In thousands of dollars)

	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
Current Assets						
Cash and Cash Equivalents	27.1	41.3	1,011.8	798.5	1,038.9	839.8
Receivables	488.5	477.3	1,410.6	1,476.5	1,899.1	1,953.8
Internal Balances	788.0	709.3	(788.0)	(709.3)	-	-
Inventories	-	-	154.3	124.9	154.3	124.9
Other Assets	63.8	17.5	35.8	16.3	99.6	33.8
Restricted Assets	172.5	251.2	586.0	375.6	758.5	626.8
Total Current Assets:	1,539.9	1,496.6	2,410.5	2,082.5	3,950.4	3,579.1
Noncurrent Assets						
Capital Assets	9,221.7	9,140.3	25,865.4	25,031.4	35,087.1	34,171.7
Less Accumulated Depreciation	(5,128.1)	(4,998.4)	(14,382.9)	(13,673.9)	(19,511.0)	(18,672.3)
Total Noncurrent Assets	4,093.6	4,141.9	11,482.5	11,357.5	15,576.1	15,499.4
Total Assets	5,633.5	5,638.5	13,893.0	13,440.0	19,526.5	19,078.5
Deferred Outflows of Revenue						
Deferred Loss on Bond Refunding	-	-	192.0	206.3	192.0	206.3
Total Deferred Outflows of	-	-	192.0	206.3	192.0	206.3
Liabilities Due in Less Than One Year						
Accounts Payable	300.4	342.1	728.60	735.9	1,029.0	1,078.0
Accrued Liabilities	20.7	18.9	41.1	26.1	61.8	45.0
Deferred revenues	-	-	-	-	-	-
Customer Deposits	0.6	1.2	344.1	323.9	344.7	325.1
Due to component unit	-	-	600.3	504.5	600.3	504.5
Current Long-Term Debt	148.4	200.8	646.3	652.5	794.7	853.3
Total Current Liabilities	470.1	563.0	2,360.4	2,242.9	2,830.5	2,805.9
Liabilities Due in More Than One Year						
Compensated Absences	140.9	103.1	64.9	42.9	205.8	146.0
Bonds	-	-	-	-	-	-
Notes Payable	-	-	-	-	-	-
Capital Leases	413.9	445.4	1,548.0	1,694.9	1,961.9	2,140.3
Certificates of Obligation	-	-	4,780.0	5,070.0	4,780.0	5,070.0
Total Long-Term Liabilities	554.8	548.5	6,392.9	6,807.8	6,947.7	7,356.3
Total Liabilities	1,024.9	1,111.5	8,753.3	9,050.7	9,970.2	10,368.5
Net Position						
Invested in Capital Assets	3,531.3	3,495.7	4,508.2	4,146.5	8,039.5	7,642.2
Restricted	3.1	3.4	-	-	3.1	3.4
Unrestricted	1,074.2	1,027.9	823.5	449.1	1,897.7	1,477.0
Total Net Position	4,608.6	4,527.0	5,331.7	4,595.6	9,940.3	9,122.6

The City's combined Net Position increased by \$817,748, or 9.0%, to \$9,940,355 at September 30, 2014. Comparatively, last year, the City's combined Net Position increased by \$1,266,162, or 16.1%. (See Table A-1)

The City's Net Position for Government Activities increased by 1.8% to \$4.6 million, up from \$4.5 million last year. Unrestricted net position (the part of net position that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements) increased from \$1,027,887 to \$1,074,217 at September 30, 2014, up 4.5%.

The City's Net Position for Business Activities increased by 16.0% (up to \$5.3 million from \$4.6 million).

Table A-2
Changes in City's Net Position
(In thousands of dollars)

	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
Program Revenues						
Charges for Services	416.3	307.8	8,449.2	8,255.1	8,865.5	8,562.9
Operating grants	71.1	62.8	-	-	71.1	62.8
Capital grants	29.6	33.3	462.3	317.5	491.9	350.8
General Revenues						
Ad Valorem Taxes	1,621.0	1,601.5	-	-	1,621.0	1,601.5
Sales Tax	534.8	431.9	-	-	534.8	431.9
Franchise Taxes	94.1	88.6	-	-	94.1	88.6
Hotel/Motel Occupancy Tax	189.9	162.8	-	-	189.9	162.8
Rentals	-	-	3.2	13.3	3.2	13.3
Interest Income	0.2	0.5	1.1	1.6	1.3	2.1
Gain/(loss) on Sale of Assets	40.5	203.0	-	(16.7)	40.5	186.3
Other	34.1	93.3	315.7	301.9	349.8	395.2
Total Revenues	<u>3,031.6</u>	<u>2,985.5</u>	<u>9,231.5</u>	<u>8,872.7</u>	<u>12,263.1</u>	<u>11,858.2</u>
Program Expenses:						
General Government	717.3	715.0	-	-	717.3	715.0
Public Safety	1,240.9	1,331.7	-	-	1,240.9	1,331.7
Highways & Streets	430.7	448.6	-	-	430.7	448.6
Health & Welfare	73.1	64.6	-	-	73.1	64.6
Culture & Recreational	828.0	735.7	-	-	828.0	735.7
Interest on LT Debt	24.5	11.0	-	-	24.5	11.0
Enterprise Activities	-	-	8,208.6	7,708.3	8,208.6	7,708.3
Total Expenses	<u>3,314.5</u>	<u>3,306.5</u>	<u>8,208.6</u>	<u>7,708.3</u>	<u>11,523.1</u>	<u>11,014.9</u>
Increase (Decrease) in Net Position Before Transfers	(282.9)	(321.0)	1,022.9	1,164.4	740.0	843.3
Contributions Between Primary Government and Component Unit Transfers In (Out)	11.7	353.4	66.0	69.3	77.7	422.7
	<u>352.8</u>	<u>804.6</u>	<u>(352.8)</u>	<u>(804.6)</u>	<u>-</u>	<u>-</u>
Change in Net Position	<u>81.6</u>	<u>837.1</u>	<u>736.1</u>	<u>429.1</u>	<u>817.7</u>	<u>1,266.2</u>
Net Position - Beginning	<u>4,527.0</u>	<u>3,689.9</u>	<u>4,595.6</u>	<u>4,166.5</u>	<u>9,122.5</u>	<u>7,856.4</u>
Net Position - Ending	<u><u>4,608.6</u></u>	<u><u>4,527.0</u></u>	<u><u>5,331.7</u></u>	<u><u>4,595.6</u></u>	<u><u>9,940.3</u></u>	<u><u>9,122.6</u></u>

Total Revenues for the City of Hearne were \$12,263,110, an increase of 3.41%. The total cost of all programs and services increased by \$508,293, or 4.61% to \$11,523,109, over last year's total of \$11,014,816. Overall, Net Position increased by \$817,748, or 9.0% to \$9,940,355.

Governmental Activities

Revenues for the City's Governmental Activities increased modestly by 1.54%, or \$46,066, remaining basically static. The cost of all Governmental Activities also remained static with an increase of only \$7,979 to \$3,314,495, up from last year's total of \$3,306,516.

Business Activities

Revenues for the City's business activities increased by 3.89% this year (\$9,231,495 compared to \$8,872,729 for last year). Expenses increased by 6.09% this year (\$8,208,614 compared to \$7,708,300 last year).

The City's management has been taking proactive steps to help with budgetary shortfalls. This is the 5th year that they have collected \$0.003 per kilowatt on electric sales, \$2.00 per water meter, and a sanitation administrative fee equal to approximately 16.9% (the fee varies based upon the size of garbage cart or dumpster) to strengthen the net position. They have also been collecting \$0.47 per 1,000 gallons of water sold to defray the cost of the annual water storage tank maintenance and inspections.

THE CITY'S FUNDS

As the City completed the year, its governmental funds (as presented in the balance sheet within this audit report) reported a Governmental Fund Balance of \$949,387 which increased from last year's total of \$854,901.

General Fund Budgetary Highlights

During the course of the year, the City revised its budget several times. These budget amendments fall into three categories. The first category includes amendments and supplemental appropriations which the 4A and the 4B Sales Tax Boards approved and agreed to pay for special projects. The second category involves unexpected revenue such as asset sales that management decided to use to cover a specific project or insurance proceeds that was used to repair the damages covered by the insurance proceeds. The third type includes amendments at the end of the year to cover any unforeseeable budget overruns.

Actual revenues were less than the final budgeted amounts by \$22,483, with expenditures coming in \$52,265 less than expectations. Other financing sources (uses) fell short of budget by \$62,090.

Sales tax revenues exceeded the original budget amount by \$183,259. Revenues from fines exceeded the original budget amount by \$102,777.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Table A-3
City's Capital Assets
(In thousands of dollars)

	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
Capital Assets						
Land	393.1	363.4	61.6	61.6	454.7	425.0
Construction in Progress	164.7	159.9	664.8	45.7	829.5	205.6
Buildings and Improvements	5,184.1	5,301.9	1,328.9	1,318.0	6,513.0	6,619.9
Improvements Other than Buildings	1,124.3	1,040.1	-	-	1,124.3	1,040.1
Equipment	886.9	878.2	200.6	178.1	1,087.5	1,056.3
Vehicles	1,388.7	1,391.7	364.4	325.7	1,753.1	1,717.4
Furniture and Office Equipment	80.0	5.2	308.7	308.7	388.7	313.9
Airport	-	-	-	-	-	-
Distribution and Collection Systems	-	-	22,936.4	22,793.7	22,936.4	22,793.7
Totals at Historical Cost	9,221.8	9,140.4	25,865.4	25,031.5	35,087.2	34,171.9
Total Accumulated Depreciation	(5,128.1)	(4,998.4)	(14,382.9)	(13,673.9)	(19,511.0)	(18,672.3)
Net Capital Assets	4,093.7	4,142.0	11,482.5	11,357.6	15,576.2	15,499.6

At the end of 2014, the City had invested \$35,087,059 in a broad range of capital assets, including land, buildings, park facilities, roads, bridges, equipment and vehicles, electric lines, water lines, sewer lines, and waste water treatment facilities. (See Table A-3) This amount represents an increase of \$915,322, a 2.68% increase from last year.

This year's major additions included (in thousands):

Governmental

Expenses for Downtown Education / Civic Center	4A & 4B	4.8
CopSync Computers for Police Cars	4B & City Budget	64.2
New Server for Police Department	City Budget	10.6
7.409 acres Hwy 485	Land Donated From Hearne Industrial Park	29.6
Telephone Audio Recorder for Police Department	City Budget	8.7
Grappler Truck from City of Bryan	Equipment Loan From First Star Bank	32.5

New Eastside Pavilion	4B & City Budget	40.3
New Northside Pavilion	4B & City Budget	40.3
Replace Roof on Fire Station	City Budget	5.2
Pave Norwood Cemetery to Oak	City Budget	31.1
Pave Railroad Street / Milam Street	City Budget	31.0
Pave Apt St/Colorado	City Budget	22.2
Eastside Playground Equipment	City Budget	11.0
Northside Playground Equipment	City Budget	11.0
Little League Playground	City Budget	13.5
Irrigation System for Softball Field	City Budget	7.0

Business-Type Activities

Pressure Tanks for Humble Water System	City Budget	7.0
Install 3,300 LF Line for Explorer Pipeline	4A, 4B, Customer Contribution	59.5
Final Engineering Expenses for 12" Water Line	TX Capital Funds Grant	26.2
200 Radio Read Water Meter Heads-Bethany	City Budget	17.0
500 kva Pad Mount Transformer-Nursing Home	TX Capital Funds Grant, 4A, & 4B	8.1
3 Phase Pad Mount Tranformer - ECMD	TX Capital Funds Grant, 4A, & 4B	26.0
Airport Fuel Tank Installation - Final Grant Expenses	TXDOT Airport Development Grant & City Budget	5.7
Infrastructure for New Nursing Home	TX Capital Funds Grant, 4A, & 4B	122.1
Infrastructure for ECMD	TX Capital Funds Grant, 4A, & 4B	27.8
DPS Building	Bank Loan, 4A, & 4B	60.9
Airport Perimeter Fence	TXDOT Airport Development Grant & City Budget	408.3
Airport - Refurbish 3 Hangers	City Budget	8.1
Airport - Upgrade Cellometer Part of AWOS	City Budget	22.6
New Engine in International Bucket Truck	City Budget	14.6
New Chevrolet Pickup for Public Works Director	Equipment Loan From First Star Bank	24.1

Table A-4
City's Long-Term Debt
(In thousands of dollars)

	Governmental Activities		Business-type Activities		Total		Change 2013 - 2014
	2014	2013	2014	2013	2014	2013	
Long Term-Debt							
Bonds	-	-	5,070.0	5,355.0	5,070.0	5,355.0	(285.0)
Notes Payable	117.0	137.4	209.4	236.8	326.4	374.2	(47.8)
Leases Payable	445.3	508.8	1,694.8	1,825.6	2,140.1	2,334.4	(194.3)
Total Long-Term Debt	562.3	646.2	6,974.2	7,417.4	7,536.5	8,063.6	(527.1)

Long-Term Debt

At year end, the City had \$7,536,538 in Long Term Debt outstanding. This included \$5.07 million in bonds payable. This compares to \$5.36 million in bonds outstanding last year and is a 5.32% reduction in these debt instruments. (See Table A-4)

Standard & Poor's upgraded the City's bond rating of bbb- to A- on March 12, 2010 and again upgraded the rating again from A- to A on November 5, 2010. These actions were taken due to significant improvement in the City's financial condition. It is unusual for a bond rating to be raised twice in such a short time. The City is proud of this accomplishment. There has been no change in the bond rating since this recent upgrade. The Bonds were reissued in March 2011 with a total savings of approximately \$355,000 and present value savings of approximately \$275,000.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's elected and appointed officials considered many factors when setting the fiscal-year 2014-2015 budget, tax rates, and fees that will be charged for the business-type activities. One of those factors is the economy. The City of Hearne has experienced notable commercial growth for a city with a population of less than 5,000.

Over the past five years, two hotels, an upscale restaurant, a large truck stop, and a new bank have been built. A new medical facility has been built and placed in operation. Two related truss manufacturing plants have purchased an existing, dormant facility and have completed two full year of operations. The two truss concerns have employed around 45-50 employees.

In addition to the Humble Water System which was given to the City of Hearne in 2012, the City began operating the Bethany Water System during 2013 and is in the process of transferring ownership. This adds a few new customers to our ETJ.

A new Nursing Home purchased land from the City during Fiscal Year 2013-2014 and has almost completed construction on their new facility in the City which will house an Assisted Living Unit as well as a Skilled Nursing Unit. They expect to employ between 60 and 80 people.

A molding and trim manufacturer purchased an abandoned Door Manufacturing Plant, renovating it to transform the facility into a trim manufacturing facility and warehouse. They have the warehouse operation up and running at full capacity. They will be moving at least part of their manufacturing operations here in the near future.

A propane distributor has completed their new storage facility and has been operating for several months. This is the second propane company to place a facility here in Hearne.

The Texas Department of Public Safety arranged for the City to build a facility to be leased to the DPS for a Commercial Driver License Testing Facility to Hearne. This facility is expected to be complete around February to March of 2015.

These new businesses broaden not only the tax base for property taxes, but also provide many new jobs for the citizens, but also provide a reason for people to move to Hearne and become citizens. Other businesses continue to show interest in relocating to Hearne. This growth is also evident with small, locally owned businesses as well.

In 2013, the City of Hearne was awarded a \$750,000 TDRA "Capital Funds" Grant to upgrade the infrastructure, i.e., water lines, electric lines, sewer, city streets, and drainage to accommodate the new Nursing Home and Assisted Living Facility. The City also was awarded another Texas Capital Funds Grant in the amount of \$325,000 to assist in upgrading the infrastructure for the molding and trim warehouse. The work on both of these grants are nearing completion.

Also, the City received a \$577,000 Airport Development grant was obtained through TX DOT to build a game-proof perimeter fence around the airport. The work on this project is also nearing completion.

After taking all factors into consideration, the City adopted a \$12.8 million budget for Fiscal Year 2014-2015. Broken down, this is \$3.9 million for the General Fund and \$9.0 million for the Enterprise Fund. This compares to the final budget of \$3.9 million and \$8.3 million respectively for fiscal year 2013-2014. This new budget is a 0.0% increase for the General Fund and 8.5% increase for the Enterprise Fund.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the City's Finance Department.

City of Hearne, Texas
Statement of Net Position
September 30, 2014

	Primary Government			Component Units	
	Governmental Activities	Business-Type Activities	Total	Hearne Economic Development Corporation	Hearne Infrastructure/Improvement Corporation
Assets					
Cash and equivalents	\$ 27,124	\$ 1,011,831	\$ 1,038,955	\$ -	\$ -
Receivables (net of allowance for uncollectibles)					
Taxes	419,228	-	419,228	51,089	51,089
Accounts	69,262	1,364,715	1,433,977	-	-
Grant	-	45,913	45,913	-	-
Internal balances	788,016	(788,016)	-	-	-
Due from primary government	-	-	-	321,575	278,768
Inventory	-	154,293	154,293	-	-
Other assets	63,798	35,817	99,615	5,299	-
Restricted assets					
Cash and equivalents	172,549	585,988	758,537	378,611	402,109
Investments	-	-	-	141,868	-
Capital assets					
Non-depreciable	557,744	726,402	1,284,146	-	-
Depreciable, net	3,535,818	10,756,068	14,291,886	-	-
Total assets	5,633,539	13,893,011	19,526,550	898,442	731,966
Deferred outflows of resources					
Deferred loss on bond refunding	-	192,045	192,045	-	-
Total deferred outflows of resources	-	192,045	192,045	-	-
Liabilities					
Bank overdraft	-	81,062	81,062	-	-
Accounts payable	224,305	581,459	805,764	-	7,750
Salaries payable	76,142	41,785	117,927	-	-
State tax payable	-	24,349	24,349	-	-
Due to component unit	-	600,343	600,343	-	-
Accrued liabilities	20,685	41,070	61,755	-	-
Deposits	600	344,060	344,660	-	-
Liability for compensated absences					
Due in more than one year	140,906	64,936	205,842	-	-
Non-current liabilities					
Due within one year	148,368	646,277	794,645	-	-
Due in more than one year	413,900	6,327,993	6,741,893	-	-
Total liabilities	1,024,906	8,753,334	9,778,240	-	7,750
Net Position					
Net investment in capital assets	3,531,294	4,508,200	8,039,494	-	-
Restricted for					
Police department	3,122	-	3,122	-	-
Economic development	-	-	-	898,442	724,216
Unrestricted	1,074,217	823,522	1,897,739	-	-
Total net position	\$ 4,608,633	\$ 5,331,722	\$ 9,940,355	\$ 898,442	\$ 724,216

The notes to the financial statements are an integral part of this statement.

City of Hearne, Texas
Statement of Activities
For the Year Ended September 30, 2014

Program Activities	Program Revenues					Net (Expenses) Revenues and Changes in Net Position			
	Expenses	Fees, Fines and Charges for Services			Capital Grants and Contributions	Primary Government		Component Units	
		Operating Grants and Contributions	Operating Grants and Contributions	Capital Grants and Contributions		Governmental Activities	Business-type Activities	Hearne Economic Development Corporation	Hearne Infrastructure/Improvement Corporation
Primary government									
General government									
Public safety	\$ 717,282	\$ 19,116	\$ 65,670	\$ 29,636	\$ -	\$ (602,860)	\$ -	\$ -	\$ -
Highways and streets	1,240,917	357,027	3,032	-	-	(880,858)	-	-	-
Health and welfare	430,665	-	-	-	-	(430,665)	-	-	-
Culture and recreation	73,086	-	2,427	-	-	(70,659)	-	-	-
Interest on long-term debt	828,037	40,191	-	-	-	(787,846)	-	-	-
Total governmental activities	24,508	-	-	-	-	(24,508)	-	-	-
	3,314,495	416,334	71,129	29,636	-	(2,797,396)	-	-	-
Business-type activities									
Water	754,655	1,220,094	-	-	-	-	465,439	-	-
Electric	5,868,021	5,779,020	-	-	-	-	(89,001)	-	-
Sewer	785,109	735,861	-	89,362	-	-	40,114	-	-
Sanitation	659,850	611,752	-	-	-	-	(48,098)	-	-
Municipal airport	140,979	102,519	-	372,908	-	-	334,448	-	-
Total business-type activities	8,208,614	8,449,246	-	462,270	-	-	702,902	-	-
Total primary government	11,523,109	8,865,580	71,129	491,906	-	(2,797,396)	702,902	-	-
Component units									
Hearne Economic Development Corporation	112,901	-	-	-	-	-	-	(112,901)	-
Hearne Infrastructure/Improvement Corporation	76,930	-	-	-	-	-	-	-	(76,930)
	\$ 189,831	\$ -	\$ -	\$ -	\$ -	-	-	(112,901)	(76,930)
General revenues									
Taxes									
Property taxes						1,620,964	-	-	-
Sales taxes						534,759	-	265,940	265,939
Gross receipts						94,112	-	-	-
Hotel/motel occupancy						189,898	-	-	-
Rentals						-	3,233	-	-
Investment earnings						194	1,073	-	-
Gain (loss) on disposal of capital assets						40,500	20	1,118	542
Miscellaneous						34,089	315,653	-	-
Contributions between primary government and component unit						11,747	66,000	(94,770)	17,023
Transfers						352,812	(352,812)	-	-
Total general revenues and transfers						2,879,075	33,167	172,288	283,504
Change in net position						81,679	736,069	817,748	206,574
Net position at beginning of the year before restatement						4,526,954	4,663,888	9,190,842	517,642
Cumulative effect of change in accounting principle, Note 1P						-	(68,235)	839,055	-
Net position at end of year						\$ 4,608,633	\$ 5,331,722	\$ 898,442	\$ 724,216

The notes to the financial statements are an integral part of this statement

City of Hearne, Texas
Balance Sheet
Governmental Funds
September 30, 2014

	General	Total Nonmajor Funds	Total Governmental Funds
Assets			
Cash and equivalents	\$ 27,124	\$ -	\$ 27,124
Receivables:			
Taxes	401,585	17,643	419,228
Accounts	69,262	-	69,262
Due from other funds	756,125	32,226	788,351
Other assets	63,798	-	63,798
Restricted assets			
Cash	124,376	48,173	172,549
Total assets	<u>\$ 1,442,270</u>	<u>\$ 98,042</u>	<u>\$ 1,540,312</u>
Liabilities			
Accounts payable	\$ 170,181	\$ 54,124	\$ 224,305
Salaries payable	76,142	-	76,142
Accrued liabilities	20,685	-	20,685
Deposits	600	-	600
Due to other funds	-	335	335
Total liabilities	<u>267,608</u>	<u>54,459</u>	<u>322,067</u>
Deferred Inflows of Resources			
Unavailable revenue-property taxes	268,858	-	268,858
Fund Balances			
Nonspendable			
Prepaid expenses	63,798	-	63,798
Restricted for:			
Debt service	2,167	-	2,167
Court security	83,809	-	83,809
Court technology	13,286	-	13,286
Fire truck	25,114	-	25,114
Child safety fund	32,479	-	32,479
Police	-	3,122	3,122
Unassigned reported in:			
General fund	685,151	-	685,151
Hotel/Motel Tax Fund	-	40,461	40,461
Total fund balances	<u>905,804</u>	<u>43,583</u>	<u>949,387</u>
Total liabilities, deferred inflows of resources, and fund balances	<u>\$ 1,442,270</u>	<u>\$ 98,042</u>	<u>\$ 1,540,312</u>

The notes to the financial statements are an integral part of this statement

City of Hearne, Texas
Reconciliation of the Balance Sheet to the Statement of Net Position
Governmental Funds
September 30, 2014

Fund balances - total governmental funds		\$ 949,387
Amounts reported for governmental activities in the Statement of Net Position are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds:		
Governmental capital assets	9,221,650	
Less accumulated depreciation	<u>(5,128,088)</u>	4,093,562
Deferred tax revenues reported in the governmental funds are recognized as revenues for the governmental activities.		268,858
Long-term liabilities are not due and payable in the current year and therefore are not reported in the governmental funds.		(703,174)
Net position of governmental activities		<u><u>\$ 4,608,633</u></u>

The notes to the financial statements are an integral part of this statement.

City of Hearne, Texas
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended September 30, 2014

	General	Total Nonmajor Funds	Total Governmental Funds
Revenues			
Taxes			
Property	\$ 1,631,580	\$ -	\$ 1,631,580
Sales	534,759	-	534,759
Gross receipts	94,112	-	94,112
Hotel/motel occupancy	-	189,898	189,898
Intergovernmental	-	5,459	5,459
Licenses and permits	19,116	-	19,116
Property rentals	40,191	-	40,191
Fines	357,027	-	357,027
Investment income	170	25	195
Private contributions	65,670	-	65,670
Miscellaneous	23,965	10,000	33,965
Total revenues	<u>2,766,590</u>	<u>205,382</u>	<u>2,971,972</u>
Expenditures			
Current			
General government	653,993	-	653,993
Public safety	1,113,408	3,689	1,117,097
Highways and streets	329,231	-	329,231
Health and welfare	73,086	-	73,086
Culture and recreation	562,651	104,931	667,582
Capital outlay	333,215	-	333,215
Debt service			
Principal	136,080	-	136,080
Interest and fiscal charges	24,508	-	24,508
Total expenditures	<u>3,226,172</u>	<u>108,620</u>	<u>3,334,792</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(459,582)</u>	<u>96,762</u>	<u>(362,820)</u>
Other financing sources (uses)			
Proceeds from sale of capital assets	40,500	-	40,500
Proceeds from long term debt	52,247	-	52,247
Contributions from component unit	73,337	-	73,337
Contributions to component unit	(61,590)	-	(61,590)
Transfers in	1,316,036	400	1,316,436
Transfers out	(963,624)	-	(963,624)
Total other financing sources (uses)	<u>456,906</u>	<u>400</u>	<u>457,306</u>
Net change in fund balances	(2,676)	97,162	94,486
Fund balances at beginning of year	<u>908,480</u>	<u>(53,579)</u>	<u>854,901</u>
Fund balances at end of year	<u>\$ 905,804</u>	<u>\$ 43,583</u>	<u>\$ 949,387</u>

The notes to the financial statements are an integral part of this statement

City of Hearne, Texas
Reconciliation of the Statement of Revenues, Expenditures, and Changes in
Fund Balances of Governmental Funds to the Statement of Activities
For the Year Ended September 30, 2014

Net changes in fund balances - total governmental funds \$ 94,486

Amounts reported for governmental activities in the Statement of Activities
are different because:

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the costs of these assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period:

Expenditures for capital assets	\$ 333,215	
Depreciation of capital assets	<u>(411,201)</u>	(77,986)

The net effect of various miscellaneous transactions involving capital assets (i.e., sales, trade-ins, and donations) is to increase net position. 29,636

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds and are instead deferred. This amount represents the net change in unavailable tax revenue. (10,616)

The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of the governmental funds. This amount is the net effect of these differences in the treatment of long-term debt and related items. 83,957

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not included as expenditures in governmental funds. (37,798)

Change in net position of governmental activities	<u><u>\$ 81,679</u></u>
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The notes to the financial statements are an integral part of this statement.

City of Hearne, Texas
General Fund
Statement of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual
For the Year Ended September 30, 2014

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Over (Under)
Revenues				
Taxes				
Property	\$ 1,648,366	\$ 1,635,341	\$ 1,631,580	\$ (3,761)
Sales	351,500	534,759	534,759	-
Gross receipts	63,500	94,113	94,112	(1)
Licenses and permits	6,000	19,116	19,116	-
Property rentals	41,000	41,600	40,191	(1,409)
Fines	254,250	343,200	357,027	13,827
Investment income	425	425	170	(255)
Private contributions	3,000	95,306	65,670	(29,636)
Miscellaneous	15,100	25,213	23,965	(1,248)
Total revenues	<u>2,383,141</u>	<u>2,789,073</u>	<u>2,766,590</u>	<u>(22,483)</u>
Expenditures				
Current				
General government				
Legislative	49,479	52,467	54,575	2,108
Executive	221,476	219,771	222,316	2,545
Finance	274,219	236,805	230,179	(6,626)
Court	156,465	145,993	146,923	930
Total general government	<u>701,639</u>	<u>655,036</u>	<u>653,993</u>	<u>(1,043)</u>
Public safety				
Police	1,045,817	1,004,094	1,012,479	8,385
Fire	147,532	101,084	100,929	(155)
Total public safety	<u>1,193,349</u>	<u>1,105,178</u>	<u>1,113,408</u>	<u>8,230</u>
Highways and streets	<u>346,888</u>	<u>329,961</u>	<u>329,231</u>	<u>(730)</u>
Health and welfare				
Code enforcement	25,773	20,455	20,048	(407)
Animal control	57,582	53,143	53,038	(105)
Total health and welfare	<u>83,355</u>	<u>73,598</u>	<u>73,086</u>	<u>(512)</u>
Culture and recreation				
Library	158,303	148,624	148,242	(382)
Parks and recreation	412,667	413,654	414,409	755
Total culture and recreation	<u>570,970</u>	<u>562,278</u>	<u>562,651</u>	<u>373</u>
Capital outlay	<u>144,550</u>	<u>391,795</u>	<u>333,215</u>	<u>(58,580)</u>
Debt service				
Principal	103,496	136,081	136,080	(1)
Interest	6,212	24,510	24,508	(2)
Total debt service	<u>109,708</u>	<u>160,591</u>	<u>160,588</u>	<u>(3)</u>
Total expenditures	<u>3,150,459</u>	<u>3,278,437</u>	<u>3,226,172</u>	<u>(52,265)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(767,318)</u>	<u>(489,364)</u>	<u>(459,582)</u>	<u>29,782</u>
Other financing sources (uses)				
Proceeds from sale of capital assets	-	40,500	40,500	-
Proceeds from long term debt	-	52,247	52,247	-
Contributions from component unit	-	-	73,337	73,337
Contributions to component unit	-	-	(61,590)	(61,590)
Transfers in	1,476,272	1,389,874	1,316,036	(73,838)
Transfers out	<u>(708,954)</u>	<u>(963,625)</u>	<u>(963,624)</u>	<u>1</u>
Total other financing sources (uses)	<u>767,318</u>	<u>518,996</u>	<u>456,906</u>	<u>(62,090)</u>
Net change in fund balances	-	29,632	(2,676)	(32,308)
Fund balances at beginning of year	<u>908,480</u>	<u>908,480</u>	<u>908,480</u>	<u>-</u>
Fund balances at end of year	<u>\$ 908,480</u>	<u>\$ 938,112</u>	<u>\$ 905,804</u>	<u>\$ (32,308)</u>

The notes to the financial statements are an integral part of this statement.

City of Hearne, Texas
Statement of Net Position
Proprietary Funds
September 30, 2014

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Assets			
Current assets			
Cash and equivalents	\$ 1,011,831	\$ -	\$ 1,011,831
Accounts receivable (net of allowance for uncollectibles)	1,364,715	-	1,364,715
Grants receivable	33,400	12,513	45,913
Inventory	127,928	26,365	154,293
Due from other funds	94,735	6,457	101,192
Other assets	30,348	5,469	35,817
Restricted cash	585,988	-	585,988
Total current assets	3,248,945	50,804	3,299,749
Capital assets			
Land	61,634	-	61,634
Buildings and other improvements	286,985	1,041,931	1,328,916
Distribution and collection systems	22,936,410	-	22,936,410
Equipment	840,405	33,276	873,681
Construction in progress	213,242	451,526	664,768
	24,338,676	1,526,733	25,865,409
Less: accumulated depreciation	(13,996,635)	(386,304)	(14,382,939)
Capital assets, net of accumulated depreciation	10,342,041	1,140,429	11,482,470
Total non-current assets	10,342,041	1,140,429	11,482,470
Total assets	13,590,986	1,191,233	14,782,219
Deferred outflows of resources			
Deferred loss on bond refunding	192,045	-	192,045
Total deferred outflows of resources	192,045	-	192,045
Liabilities			
Current liabilities:			
Bank overdraft	81,062	-	81,062
Accounts payable	578,662	2,797	581,459
Salaries payable	41,785	-	41,785
Sales tax payable	24,349	-	24,349
Accrued liabilities	41,070	-	41,070
Due to other funds	889,208	-	889,208
Due to component units	600,343	-	600,343
Customer deposits payable	344,060	-	344,060
Long-term debt, current	646,277	-	646,277
Total current liabilities	3,246,816	2,797	3,249,613
Long-term liabilities:			
Long-term debt, net	6,327,993	-	6,327,993
Liability for compensated absences	64,936	-	64,936
Total long-term liabilities	6,392,929	-	6,392,929
Total liabilities	9,639,745	2,797	9,642,542
Net Position			
Net investment in capital assets	3,367,771	1,140,429	4,508,200
Unrestricted	775,515	48,007	823,522
Total net position	\$ 4,143,286	\$ 1,188,436	\$ 5,331,722

The notes to the financial statements are an integral part of this statement.

City of Hearne, Texas
Statement of Revenues, Expenses and Changes in Net Position
Proprietary Funds
For the Year Ended September 30, 2014

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Operating revenues:			
Charges for sales and services:			
Water sales	\$ 1,220,094	\$ -	\$ 1,220,094
Electric sales	5,779,020	-	5,779,020
Sewer charges	734,061	-	734,061
Sanitation	611,752	-	611,752
Tap fees	1,800	-	1,800
Rental fees	3,233	29,315	32,548
Penalties	113,548	-	113,548
Miscellaneous revenue	202,105	73,204	275,309
Total operating revenues	8,665,613	102,519	8,768,132
Operating expenses:			
Wholesale utilities	4,957,186	-	4,957,186
Water department	555,442	-	555,442
Electric department	421,191	-	421,191
Sewer department	386,976	-	386,976
Sanitation department	52,057	-	52,057
Administrative and billing	665,383	-	665,383
Airport	-	91,446	91,446
Depreciation and amortization	673,780	49,533	723,313
Total operating expenses	7,712,015	140,979	7,852,994
Operating income (loss)	953,598	(38,460)	915,138
Nonoperating revenues (expense)			
Intergovernmental	89,362	372,908	462,270
Contributions from component unit	-	66,000	66,000
Investment income	1,073	-	1,073
Gain on disposal of capital assets	20	-	20
Interest expense	(355,620)	-	(355,620)
Total nonoperating revenues (expense)	(265,165)	438,908	173,743
Income before transfers	688,433	400,448	1,088,881
Transfers in	963,224	-	963,224
Transfers out	(1,316,036)	-	(1,316,036)
Total other financing sources (uses)	(352,812)	-	(352,812)
Change in net position	335,621	400,448	736,069
Net position, beginning of year, as previously reported	3,875,900	787,988	4,663,888
Cumulative effect of change in accounting principle, Note 1P	(68,235)	-	(68,235)
Net position, end of year	\$ 4,143,286	\$ 1,188,436	\$ 5,331,722

The notes to the financial statements are an integral part of this statement.

City of Hearne, Texas
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2014

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Cash flows from operating activities:			
Cash received from customers	\$ 8,695,052	\$ 102,519	\$ 8,797,571
Cash payments to suppliers for goods and services	(4,861,226)	(91,501)	(4,952,727)
Cash payments to employees for services	(2,105,111)	-	(2,105,111)
Net cash provided by operating activities	<u>1,728,715</u>	<u>11,018</u>	<u>1,739,733</u>
Cash flows from non-capital financing activities			
Increase in bank overdraft	81,062	-	81,062
Transfers in	963,224	-	963,224
Transfers out	(1,316,036)	-	(1,316,036)
Net cash provided by (used in) non-capital financing activities	<u>(271,750)</u>	<u>-</u>	<u>(271,750)</u>
Cash flows from capital and related financing activities			
Acquisition of capital assets	(392,195)	(441,783)	(833,978)
Capital grants	154,137	364,765	518,902
Contributions from component unit	-	66,000	66,000
Interest paid	(353,180)	-	(353,180)
Principal payments	(465,861)	-	(465,861)
Proceeds of long term debt issuance	22,817	-	22,817
Net cash provided by (used in) capital and related financing activities	<u>(1,034,282)</u>	<u>(11,018)</u>	<u>(1,045,300)</u>
Cash flows from investing activities:			
Interest on cash and investments	1,073	-	1,073
Net increase in cash and equivalents	423,756	-	423,756
Cash and equivalents, beginning of year	1,174,063	-	1,174,063
Cash and equivalents, end of year	<u>\$ 1,597,819</u>	<u>\$ -</u>	<u>\$ 1,597,819</u>
Reconciliation of cash and equivalents:			
Unrestricted cash and equivalents	\$ 1,011,831	\$ -	\$ 1,011,831
Restricted cash and investments	585,988	-	585,988
Total cash and equivalents	<u>\$ 1,597,819</u>	<u>\$ -</u>	<u>\$ 1,597,819</u>

(continued)

The notes to the financial statements are an integral part of this statement

City of Hearne, Texas
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2014

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Reconciliation of operating income (loss) to net cash provided by operating activities			
Operating income (loss)	\$ 953,598	\$ (38,460)	\$ 915,138
Adjustments to reconcile to net cash provided by operating activities			
Depreciation and amortization	673,780	49,533	723,313
Bad debt expense	72,968	-	72,968
Increase (decrease) in cash resulting from changes in assets and liabilities.			
Accounts receivable	(63,684)	-	(63,684)
Inventory	(10,867)	(18,534)	(29,401)
Due from other funds	(57,200)	22,562	(34,638)
Other assets	(14,809)	(4,754)	(19,563)
Accounts payable	(99,995)	671	(99,324)
Salaries payable	10,364	-	10,364
Sales tax payable	639	-	639
Accrued liabilities	12,518	-	12,518
Due to other funds	113,375	-	113,375
Due to component units	95,830	-	95,830
Customer deposits	20,155	-	20,155
Liability for compensated absences	22,043	-	22,043
Net cash provided by operating activities	<u>\$ 1,728,715</u>	<u>\$ 11,018</u>	<u>\$ 1,739,733</u>

The notes to the financial statements are an integral part of this statement

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

Note 1. Summary of Significant Accounting Policies

The financial statements of the City of Hearne, Texas (the City) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The City's more significant accounting policies are described below.

A. Reporting Entity

The City is a home-rule city governed by an elected mayor and a five-member council. The City operates under a Council-Manager form of government, established by City charter. As required by generally accepted accounting principles, these financial statements present the City (the primary government) and its component units, entities for which the government is considered to be financially accountable. Each discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the government.

Discretely Presented Component Units

The Hearne Economic Development Corporation is a non-profit corporation created under Section 4A of the Development Corporation Act of 1979. The Corporation receives one-half of one percent of local sales tax collected, which is used to promote economic development within the City. The Corporation is governed by a Board of Directors that is appointed by the City Council.

The Hearne Infrastructure/Improvement Corporation is a non-profit corporation created under Section 4B of the Development Corporation Act of 1979. The Corporation receives one-half of one percent of local sales tax collected, which is used to promote economic development within the City. The Corporation is governed by a Board of Directors that is appointed by the City Council.

B. Basis of Presentation

Government-wide financial statements

The Statement of Net Position and Statement of Activities display information about the reporting government as a whole. They include all funds of the reporting entity. The effect of interfund activity, other than interfund services provided and used within the governmental and business-type activities, has been removed from these statements. The statements distinguish between governmental and business-type activities. Governmental activities are generally financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

The government-wide statement of activities demonstrates the degree to which the direct expenses of a functional category (General Government, Public Safety, etc.) are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment; grants and contributions that are restricted to meeting the operational requirements of a particular function or segment; and grants and contributions that are restricted to meeting the capital requirements of a particular function or segment.

Fund financial statements

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be separate accounting entities. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into two major categories: governmental and proprietary. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operating fund of the City or meets the following criteria:

- a. Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type; and
- b. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental fund or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.

The funds of the financial reporting entity are described below:

Governmental Funds

General Fund

The General Fund is the primary operating fund of the city and is always classified as a major fund. It is used to account for all activities except those legally or administratively required to be accounted for in other funds.

Other Governmental Funds

Other Governmental Funds is a summation of all of the non-major governmental funds.

Proprietary Funds

Enterprise Fund

This fund is used to account for the operations of the City's utility systems, which include water, electric, sewer, and sanitation services.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

Municipal Airport Enterprise Fund

This fund is a non-major enterprise fund, used to account for the operations of the City's municipal airport.

C. Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus applied.

Measurement Focus

In the government-wide Statement of Net Position and the Statement of Activities, both governmental and business-like activities are presented using the economic resources measurement focus as defined in item b below.

In the fund financial statements, the *current financial resources* measurement focus or the *economic resources* measurement focus is used as appropriate:

- a. All governmental funds utilize a *current financial resources* measurement focus. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of the period.
- b. The proprietary funds utilize an *economic resources* measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported. Proprietary fund equity is classified as net position.

Basis of Accounting

In the government-wide Statement of Net Position and Statement of Activities, both governmental and business-like activities are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

In the fund financial statements, governmental funds are presented on the modified accrual basis of accounting. Under this modified accrual basis of accounting, revenues are recognized when *measurable and available*. Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or within sixty days after year end. Property, sales, and gross receipt tax revenues of governmental funds are recognized under the susceptible to accrual concept. Licenses and permits, charges for services, fines, contributions and miscellaneous revenues are

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

recorded when received in cash, as these revenues are not measurable and available until cash is received. Investment income is recorded as earned since it is measurable and available. Expenditures (including capital outlay) are recorded when the related fund liability is incurred, except for general obligation bond principal and interest which are reported when due.

The proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used. Operating revenues and expenses for proprietary funds include activities related to providing services and producing and delivering goods in connection with a proprietary fund's principle ongoing operations. Revenues and expenses that do not meet this definition are reported as non-operating revenues and expenses.

D. Budgets

Annual appropriated budgets are adopted for the general fund, special revenue funds, except Police Special fund, and proprietary funds. The budgets for all funds are prepared and adopted on a basis consistent with generally accepted accounting principles, which is the same basis of accounting used for financial reporting in these financial statements. Budgets are adopted by passage of a budget ordinance. All annual budget appropriations lapse at fiscal year-end.

Encumbrance accounting is a system under which purchase orders, contracts, and other commitments for the expenditure of funds are recorded to reserve that portion of the applicable appropriation. Encumbrances are reported as reservations of fund balances since they do not constitute expenditures or liabilities. The City does not employ encumbrance accounting as it feels its current system is adequate to assure effective budgetary control and accountability and to facilitate effective cash planning and control.

E. Cash and Investments

For the purpose of the Statement of Net Position and the Statement of Cash Flows, "Cash and cash equivalents" consists of cash on hand, amounts in demand deposit accounts and interest-bearing checking accounts, as well as certificates of deposits and investments with maturities of three months or less.

State statutes authorize the City to invest in time deposits of its designated depositories, U.S. Government Securities, and local government investment pools. Investments are carried at fair value. Interest income and changes in fair value are reported as investment income.

Cash equivalents include investments in the local government investment pool, TexSTAR. TexSTAR is privately managed, was organized in conformity with the Interlocal Cooperation Act and is managed in compliance with the Texas Public Funds Investment Act. The fair value of the investment pools approximates cost. The fair value of the City's position in the external investment pool is the same as the value of the pool shares.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

F. Short-term Interfund Receivables/Payables

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "due from other funds" and "due to other funds," respectively, on the fund financial statements. Residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances".

G. Inventories

Inventories of enterprise funds are valued at cost using the first-in/first-out (FIFO) method. Inventories of governmental funds are recorded as expenditures when purchased.

H. Restricted Assets

Amounts in governmental funds which are legally identified for specific purposes either by City ordinance or contractual obligation are reflected as restricted assets. When both restricted and unrestricted resources are available for use, it is the government's policy to use the restricted resources first, then unrestricted resources as they are needed.

Amounts in proprietary funds restricted for Community Development Block Grant Program are also included as restricted assets.

I. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets, are reported in the applicable governmental or business-type activities columns in the government-wide financial statements and in the fund financial statements for proprietary funds.

The City defines capital assets as assets with an estimated useful life greater than one year and an initial individual cost of \$5,000 or more for land, machinery or equipment, buildings or improvements other than buildings. All capital assets are valued at historical cost or estimated historical cost if the actual historical cost is unavailable, except for donated capital assets which are recorded at their estimated fair value at the date of donation. Interest incurred during construction is not capitalized. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets, as applicable.

Infrastructure assets (such as roads, bridges, curbs and gutters, streets and sidewalks, and drainage systems) purchased before October 1, 2003 have not been capitalized and are excluded from capital assets of governmental activities.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the Statement of Activities, with accumulated depreciation reflected in the Statement of Net

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

Position. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation over the following estimated useful lives:

Buildings	10-50 years
Infrastructure	10-40 years
Improvements other than buildings	10-50 years
Machinery and equipment	5-15 years

In the fund financial statements, capital assets used in governmental operations are accounted for as capital outlay expenditures of the governmental fund at the time of acquisition. Capital assets used in proprietary fund operations are accounted for the same as in the government-wide statements.

J. Compensated Absences

Compensated absences are those absences for which employees will be paid, such as vacation and sick leave. A liability for compensated absences that are attributable to services already rendered and that are not contingent on a specific event that is outside the control of the City and its employees is accrued as employees earn the rights to the benefits. Compensated absences that relate to future services or that are contingent on a specific event that is outside the control of the City and its employees are accounted for in the period in which such services are rendered or in which such events take place.

In the governmental fund financial statements, compensated absences that are expected to be liquidated with expendable available financial resources are reported as an expenditure and fund liability in the fund that will pay for the compensated absences. Therefore, a liability for these amounts is recognized only if they have matured, for example, as a result of employee resignations and retirements. In the government-wide and proprietary fund financial statements, compensated absences are accrued as incurred.

K. Long-term Obligations

The accounting treatment for long-term debt depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

Long-term debt is recognized as a liability of a governmental fund when due. For other long-term obligations, only that portion expected to be financed from expendable available financial resources is reported as a fund liability of a governmental fund. The remaining portion of such obligations is reported in the governmental activities column of the government-wide Statement of Net Position. Long-term liabilities expected to be financed from proprietary fund operations are accounted for in those funds.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

L. Fund Equity

Government-wide statements

Equity is classified as net position and displayed in three components:

- a. Net investment in capital assets – consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- b. Restricted net position – consists of net position with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net position – all other net position that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Amounts restricted on the Statement of Net Position for Police Department and economic development are restricted by enabling legislation.

Fund statements

Proprietary fund equity is classified the same as in the government-wide statements.

Governmental fund equity is classified as fund balance. Fund balance is further classified as nonspendable, restricted, committed, assigned, and/or unassigned.

Classification of fund balances

The *nonspendable* fund balance includes the portion of net resources that cannot be spent because of their form or because they must be maintained intact. Resources not in spendable form include supplies inventories and prepaid items, long-term advances to other funds net of deferred interest revenue, long-term receivable net of deferred interest revenue, nonfinancial assets held for resale, and unrealized change in the fair value of investments.

Some resources are spendable but are legally or contractually required to be maintained intact. Such resources include the principal of an endowment.

The *restricted* fund balance includes net resources that can be spent only for the specific purposes stipulated by constitution, external resource providers (creditors, grantors, contributors), laws and regulations of other governments, or through enabling legislation. The enabling legislation authorizes the City to assess, levy, charge or otherwise mandate payment of resources from external resource providers; those resources can be used only for the specific purposes stipulated in the legislation. The City’s revenue generated through enabling legislation includes municipal court fees.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

The *committed* fund balance includes spendable net resources that can only be used for specific purposes pursuant to constraints imposed by formal Council actions, no later than the close of the fiscal year. Those constraints remain binding unless removed or changed in the same manner employed to previously commit those resources.

The *assigned* fund balance includes amounts that are constrained by the City's intent to be used for specific purposes, but are neither restricted nor committed. Such intent should be expressed by the City Council or its designated officials to assign amounts to be used for specific purposes, but are neither restricted nor committed. Constraints imposed on the use of assigned amounts can be removed with no formal Council actions. The assigned fund balance is only reported in the General Fund.

The *unassigned* fund balance represents spendable net resources that have not been restricted, committed, or assigned to specific purposes.

Spending Prioritization in Using Available Resources

When both restricted resources and other resources (i.e., committed, assigned, and unassigned) can be used for the same purpose, the City budget considers restricted resources to be spent first.

When committed, assigned, and unassigned resources can be used for the same purpose, the flow assumption in the City budget is to spend in the sequence of committed resources first, assigned second, and unassigned last.

M. Bond Issuance Costs

Bond issuance costs are recognized as an expense in the period incurred.

N. Interfund Transfers

Interfund services provided and used are accounted for as revenues, expenditures, or expenses. Transactions that constitute reimbursements to a fund for expenditures/expenses initially made from it that are properly applicable to another fund are recorded as expenditures/expenses in the reimbursing fund and as reductions in expenditures/expenses in the fund that is reimbursed.

All other interfund transactions, except interfund services provided and used and reimbursements, are reported as transfers.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

O. Post-employment Benefits

The City 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.

P. New Accounting Pronouncements Adopted

GASB Statement Number 65- Items Previously Reported as Assets and Liabilities

During the year ended September 30, 2013, the City implemented Governmental Accounting Standards Board Statement No. 65, "Items Previously Reported as Assets and Liabilities." GASB 65 requires debt issuance costs to be recognized as an expense in the period incurred. Previously, these costs were amortized over the life of the related debt issuance. The implementation of GASB 65 resulted in the write-off of bond issuance costs resulting in a reduction of beginning net position of \$68,235.

Note 2. Legal Compliance – Budgets

In June of each year, all departments of the City submit requests for appropriations to the City Manager so that a budget may be prepared. The City Manager has ultimate responsibility for the budget and formulates the budget goals for the City under the direction of the City Council. The budget is prepared by fund, function, activity, and object, and includes information on the past year, current year estimates, and requested appropriations for the next fiscal year.

In compliance with the state's uniform budget law, the City Manager files the proposed budget with the City Secretary and City Council before the 30th day prior to the date the City adopts its tax levy for the fiscal year. Once filed, the proposed budget is available for inspection by the public. The City is required to hold a public hearing on the proposed budget not less than 15 days after the budget is filed with the City Secretary and prior to the date the Council makes the tax levy. The City publishes notice of the public hearing in the official newspaper not more than 30 days nor less than 10 days before the hearing. Once the hearing 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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

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.

Expenditures/Expenses in Excess of Appropriations

Expenditures/expenses exceeded appropriations at the legal level of budgetary control by \$2,108 for the Legislative department, \$2,545 for Executive, \$930 for Court, \$8,385 for Police, and \$755 for Parks, totaling \$14,723 for the General Fund. Additionally, expenditure/expenses exceeded appropriations at the legal level of budgetary control by \$109 for the Electric department in the Enterprise Fund.

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, First Star Bank.

As of September 30, 2014, the City had investments in TexSTAR with maturities less than 60 days with a fair value of \$972,637. Additionally, the Hearne Economic Development Corporation held a certificate of deposit totaling \$141,868.

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, 2014, 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, 2014.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

Note 4. Restricted Assets

At September 30, 2014, 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	\$ 44,716	\$ -	\$ -	\$ -
Police Special	3,457	-	-	-
Interest and sinking	2,167	556,423	-	-
Fire trucks	25,114	-	-	-
Court security	83,809	-	-	-
Court technology	13,286	-	-	-
Community Development				
Block Grant Program	-	510	-	-
Meter Sinking	-	29,055	-	-
Economic development	-	-	520,479	402,109
	<u>\$ 172,549</u>	<u>\$ 585,988</u>	<u>\$ 520,479</u>	<u>\$ 402,109</u>

Note 5. Receivables

Receivables at September 30, 2014, consist of the following:

	Governmental Funds	Proprietary Funds
Receivables:		
Taxes:		
Property	\$ 298,791	\$ -
Sales	102,794	-
Hotel/motel occupancy	17,643	-
Accounts	69,262	1,958,068
Grants	-	45,913
Less:		
Allowance for uncollectibles	-	(593,353)
Net total receivables	<u>\$ 488,490</u>	<u>\$ 1,410,628</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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

Note 6. Capital Assets

The following is a summary of capital asset activity during the year ended September 30, 2014:

	Beginning Balance	Additions/ Completions	Retirements/ Adjustments	Ending Balance
<u>Governmental activities</u>				
Capital assets not being depreciated				
Land	\$ 363,446	\$ 29,636	\$ -	\$ 393,082
Construction in progress	159,862	4,800	-	164,662
Total capital assets not being depreciated	523,308	34,436	-	557,744
Capital assets being depreciated				
Buildings	5,301,895	128,166	246,000	5,184,061
Improvements other than buildings	1,040,057	84,224	-	1,124,281
Furniture and fixtures	5,171	74,790	-	79,961
Vehicles	1,391,724	32,500	35,508	1,388,716
Machinery and equipment	878,152	8,735	-	886,887
Total at historical cost	8,616,999	328,415	281,508	8,663,906
Less: accumulated depreciation for:				
Buildings	3,584,741	127,076	246,000	3,465,817
Improvements other than buildings	198,423	93,610	-	292,033
Furniture and fixtures	5,171	7,479	-	12,650
Vehicles	660,454	122,807	35,508	747,753
Machinery and equipment	549,605	60,230	-	609,835
Total accumulated depreciation	4,998,394	411,202	281,508	5,128,088
Total capital assets being depreciated, net	3,618,605	(82,787)	-	3,535,818
Governmental activities capital assets, net	\$ 4,141,913	\$ (48,351)	\$ -	\$ 4,093,562
<u>Business-type activities</u>				
Capital assets not being depreciated				
Land	\$ 61,634	\$ -	\$ -	\$ 61,634
Construction in progress	45,718	619,050	-	664,768
Total capital assets not being depreciated	107,352	619,050	-	726,402
Capital assets being depreciated				
Buildings and improvements	1,317,986	10,930	-	1,328,916
Furniture and fixtures	308,691	-	-	308,691
Vehicles	325,659	38,698	-	364,357
Distribution and collection systems	22,793,679	142,731	-	22,936,410
Machinery and equipment	178,064	22,569	-	200,633
Total at historical cost	24,924,079	214,928	-	25,139,007
Less: accumulated depreciation for:				
Buildings and improvements	517,001	60,883	-	577,884
Furniture and fixtures	248,937	15,196	-	264,133
Vehicles	142,482	29,741	-	172,223
Distribution and collection systems	12,633,140	595,337	-	13,228,477
Machinery and equipment	132,291	7,931	-	140,222
Total accumulated depreciation	13,673,851	709,088	-	14,382,939
Total capital assets being depreciated, net	11,250,228	(494,160)	-	10,756,068
Business-type activities capital assets, net	\$ 11,357,580	\$ 124,890	\$ -	\$ 11,482,470

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

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

General government	\$ 25,493
Public safety	123,820
Highways and streets	101,434
Culture and recreation	160,455
Total depreciation expense - Governmental activities	<u>\$ 411,202</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, 2014:

	Balance 9/30/13	Additions	Retirements	Balance 9/30/14	Due Within One Year	Long Term
<u>Governmental activities</u>						
Lease payable - TYMCO	\$ 33,236	\$ -	\$ (33,236)	\$ -	\$ -	\$ -
Lease payable - Oshkosh	475,595	-	(30,317)	445,278	31,378	413,900
Subtotal of leases payable	508,831	-	(63,553)	445,278	31,378	413,900
First Star Bank - Equipment	137,394	52,247	(72,651)	116,990	116,990	-
Subtotal of notes payable	137,394	52,247	(72,651)	116,990	116,990	-
	<u>\$ 646,225</u>	<u>\$ 52,247</u>	<u>\$ (136,204)</u>	<u>\$ 562,268</u>	<u>\$ 148,368</u>	<u>\$ 413,900</u>
<u>Business type activities</u>						
Lease payable - Southside	\$ 1,391,677	\$ -	\$ (98,175)	\$ 1,293,502	\$ 103,812	\$ 1,189,690
Lease payable - AEP	432,836	-	(31,501)	401,335	43,032	358,303
Lease payable - Western	1,050	-	(1,050)	-	-	-
Subtotal of leases payable	1,825,563	-	(130,726)	1,694,837	146,844	1,547,993
2011 General obligation refunding	5,355,000	-	(285,000)	5,070,000	290,000	4,780,000
Subtotal of bonds payable	5,355,000	-	(285,000)	5,070,000	290,000	4,780,000
First Star Bank - Equipment	236,772	22,817	(50,156)	209,433	209,433	-
Subtotal of notes payable	236,772	22,817	(50,156)	209,433	209,433	-
	<u>\$ 7,417,335</u>	<u>\$ 22,817</u>	<u>\$ (465,882)</u>	<u>\$ 6,974,270</u>	<u>\$ 646,277</u>	<u>\$ 6,327,993</u>

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

The annual aggregate maturities for each debt type for the years subsequent to September 30, 2014 are as follows:

Year ending September 30	Business-type Activities				Governmental Activities	
	Bonds Payable		Notes Payable		Notes Payable	
	Principal	Interest	Principal	Interest	Principal	Interest
2015	\$ 290,000	\$ 158,843	\$ 209,433	\$ 12,566	\$ 116,990	\$ 7,019
2016	300,000	151,213	-	-	-	-
2017	305,000	145,310	-	-	-	-
2018	310,000	138,465	-	-	-	-
2019	325,000	130,598	-	-	-	-
2020-2024	1,805,000	495,059	-	-	-	-
2025-2029	1,735,000	139,213	-	-	-	-
	<u>\$ 5,070,000</u>	<u>\$ 1,358,701</u>	<u>\$ 209,433</u>	<u>\$ 12,566</u>	<u>\$ 116,990</u>	<u>\$ 7,019</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, 2014, the following changes occurred in other long-term liabilities:

	Balance 9/30/13	Additions (Reductions)	Balance 9/30/14	Due Within One Year
<u>Governmental activities</u>				
Compensated absences	<u>\$ 103,109</u>	<u>\$ 37,797</u>	<u>\$ 140,906</u>	<u>\$ -</u>
<u>Business type activities</u>				
Compensated absences	<u>\$ 42,893</u>	<u>\$ 22,043</u>	<u>\$ 64,936</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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

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	<u>507,985</u>	<u>2,453,435</u>
Less: Accumulated depreciation	(50,798)	(854,104)
Total net asset	<u><u>\$ 457,187</u></u>	<u><u>\$ 1,599,331</u></u>

The total future minimum lease payments and the net present value of these minimum payments as of September 30, 2014 were as follows:

<u>Year ending September 30</u>	<u>Governmental Activities</u>	<u>Business-type Activities</u>
2015	\$ 48,000	\$ 307,069
2016	48,000	307,069
2017	48,000	307,069
2018	48,000	438,378
2019	48,000	173,545
2020-2024	240,000	807,484
2025-2029	72,000	-
Total minimum lease payments	<u>552,000</u>	<u>2,340,614</u>
Less: Amount representing interest	(106,722)	(645,777)
Present value of minimum payments	<u><u>\$ 445,278</u></u>	<u><u>\$ 1,694,837</u></u>

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

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

Note 10. Interfund Receivables and Payables

Interfund receivables and payables, all of which are considered short-term, at September 30, 2014, were as follows:

Name of Fund	Due from other funds	Due to other funds
Governmental:		
General	\$ 756,125	\$ -
Non-Major Governmental	32,226	335
Business-Type:		
Enterprise Fund	94,735	889,208
Non-Major Business-Type	6,457	-
	<u>\$ 889,543</u>	<u>\$ 889,543</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.

Note 11. Interfund Transfers

Interfund transfers during the year ended September 30, 2014, were as follows:

	Transfers In		
	General Fund	Non-Major Governmental	Enterprise
<u>Transfers out</u>			
General	\$ -	\$ 400	\$ 963,224
Enterprise	1,316,036	-	-
	<u>\$1,316,036</u>	<u>\$ 400</u>	<u>\$ 963,224</u>
			<u>\$2,279,660</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 \$4,436,081 to this company during the year ended September 30, 2014.

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, 2014. The City paid \$521,105 to this company during the year ended September 30, 2014.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

Note 13. Pension Plans

Plan Description. The City provides pension benefits for all of its full-time employees through a non-traditional, joint contributory, hybrid defined benefit plan in the state-wide Texas Municipal Retirement System (TMRS), an agent multiple-employer public employee retirement system. The plan provisions that have been adopted by the City are within the options available in the governing state statutes of TMRS.

TMRS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information (RSI) for TMRS; the report also provides detailed explanations of the contributions, benefits and actuarial methods and assumptions used by the System. This report may be obtained from TMRS' website at www.TMRS.com.

The plan provisions are adopted by the governing body of the City, within the options available in the governing state statutes of TMRS. Plan provisions for the City were as follows:

	For Plan Year ended December 31,		
	2011	2012	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

Contributions. Under the state law governing TMRS, the contribution rate for each city is determined annually by the actuary, using the Entry Age Normal (EAN) cost method (EAN was first used in the December 31, 2013 valuation; previously, the Projected Unit Credit actuarial cost method was used). This rate consists of the normal cost contribution rate and the prior service contribution rate, which is calculated to be a level percent of payroll from year to year. The normal cost contribution rate for an employee is the contribution rate which, if applied to a member's compensation throughout their period of anticipated covered service with the municipality, would be sufficient to meet all benefits payable on their behalf. The salary-weighted average of the individual rates is the total normal cost rate. The prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the applicable period for that city. Both the normal cost and prior service contribution rates include recognition of the projected impact of annually repeating benefits, such as Updated Service Credits and Annuity Increases.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

The City contributes to the TMRS Plan at an actuarially determined rate. Both the employees and the City make contributions monthly. Since the City needs to know its contribution rate in advance for budgetary purposes, there is a one-year delay between the actuarial valuation that serves as the basis for the rate and the calendar year when the rate goes into effect. The annual pension cost and net pension obligation/(asset) are as follows:

	For the year ended September 30,		
	2012	2013	2014
Annual required contribution (ARC)	\$ 231,038	\$ 235,349	\$ 277,637
Interest on Net Pension Obligation (NPO)	-	-	-
Adjustment to ARC	-	-	-
Annual pension cost	231,038	235,349	277,637
Contributions made	231,038	235,349	277,637
Increase in NPO	-	-	-
NPO at beginning of the year	-	-	-
NPO at end of the year	\$ -	\$ -	\$ -

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

The required contribution rates for fiscal year 2014 were determined as part of the December 31, 2011 and 2012 actuarial valuations. Additional information as of the latest actuarial valuation, December 31, 2013, also follows:

Valuation Date	For the year ended December 31,		
	2011	2012	2013
Actuarial cost method	Projected Unit Credit	Projected Unit Credit	Entry Age Normal
Amortization method	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll
GASB 25 equivalent single amortization period	26.8 Years; closed period	25.7 Years; closed period	27.0 Years; closed period
Amortization period for new gain/loss	30 Years	30 Years	30 Years
Asset valuation method	10-year Smoothed Market	10-year Smoothed Market	10-year Smoothed Market
Actuarial assumptions:			
Investment rate of return *	7.0%	7.0%	7.0%
Projected salary increase *	Varies by age and service	Varies by age and service	Varies by age and service
* Includes inflation at	3.00%	3.00%	3.00%
Cost-of-living adjustments	2.10%	2.10%	2.10%

Funded Status and Funding Progress – In October 2013, the TMRS Board approved actuarial changes in (a) the funding method from Projected Unit Credit to Entry Age Normal, (b) the post-retirement mortality assumptions used in calculating liabilities and contribution rates and in the development of the Annuity Purchase Rate factors, and (c) the amortization policy. These actuarial changes were effective with the December 31, 2013 actuarial valuation. For a complete description of the new actuarial cost method and assumptions, please see the December 31, 2013 TMRS Comprehensive Annual Financial Report (CAFR).

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2014

The funded status as of December 31, 2013, the most recent actuarial valuation date, is presented as follows:

Actuarial Valuation Date	Actuarial Value of Assets (1)	Actuarial Accrued Liability (AAL) (2)	Funded Ratio (3) (1)/(2)	Unfunded AAL (UAAL) (4) (2)-(1)	Covered Payroll (5)	UAAL as a Percentage of Covered Payroll (6) (4)/(5)
12/31/2013	\$ 4,627,656	\$ 7,001,976	66.1%	\$ 2,374,320	\$ 1,889,517	125.7%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

Actuarial calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation, and reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. The schedule of funding progress, presented as Required Supplementary Information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability of benefits.

Note 14. 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.

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 Funding Progress Texas Municipal Retirement System

City of Hearne, Texas
Schedule of Funding Progress
Texas Municipal Retirement System
For the Year Ended September 30, 2014

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability</u>	<u>Funded Ratio</u>	<u>Unfunded AAL (UAAL)</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
12/31/2011	\$ 3,920,275	\$ 5,637,863	69.5%	\$ 1,717,588	\$ 1,910,745	89.9%
12/31/2012	4,224,521	5,936,288	71.2%	1,711,767	1,812,173	94.5%
12/31/2013	4,627,656	7,001,976	66.1%	2,374,320	1,889,517	125.7%

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, 2014

	Special Revenue		Total Non-major Governmental Funds
	Hotel/Motel Tax	Police Special Fund	
Assets			
Taxes receivable	\$ 17,643	\$ -	\$ 17,643
Due from other funds	32,226	-	32,226
Cash, restricted	44,716	3,457	48,173
Total assets	<u>\$ 94,585</u>	<u>\$ 3,457</u>	<u>\$ 98,042</u>
Liabilities and fund balances			
Liabilities:			
Accounts payable	\$ 54,124	\$ -	\$ 54,124
Due to other funds	-	335	335
Total liabilities	<u>54,124</u>	<u>335</u>	<u>54,459</u>
Fund balances:			
Restricted for police	-	3,122	3,122
Unassigned	40,461	-	40,461
Total fund balances	<u>40,461</u>	<u>3,122</u>	<u>43,583</u>
Total liabilities and fund balances	<u>\$ 94,585</u>	<u>\$ 3,457</u>	<u>\$ 98,042</u>

City of Hearne, Texas
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Non-major Governmental Funds
For the Year Ended September 30, 2014

	Special Revenue		Total Non-major Governmental Funds
	Hotel/Motel Tax	Police Special Fund	
Revenues:			
Hotel/motel occupancy taxes	\$ 189,898	\$ -	\$ 189,898
Investment income	25	-	25
Intergovernmental	2,427	3,032	5,459
Miscellaneous	10,000	-	10,000
Total revenues	202,350	3,032	205,382
Expenditures:			
Current:			
Public safety	-	3,689	3,689
Culture and recreation	104,931	-	104,931
Total expenditures	104,931	3,689	108,620
Excess (deficiency) of revenues over (under) expenditures	97,419	(657)	96,762
Other financing sources:			
Transfers in	-	400	400
Total other financing sources	-	400	400
Net change in fund balances	97,419	(257)	97,162
Fund balances (deficit) at beginning of year	(56,958)	3,379	(53,579)
Fund balances at end of year	\$ 40,461	\$ 3,122	\$ 43,583

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, 2014

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Over (Under)
Revenues:				
Hotel/motel occupancy taxes	\$ 155,000	\$ 189,899	\$ 189,898	\$ (1)
Investment income	75	75	25	(50)
Intergovernmental	-	2,427	2,427	-
Miscellaneous	-	10,000	10,000	-
Total revenues	<u>155,075</u>	<u>202,401</u>	<u>202,350</u>	<u>(51)</u>
Expenditures:				
Current:				
Culture and recreation:				
Economic development	105,075	152,401	104,931	(47,470)
Capital outlay	<u>50,000</u>	<u>50,000</u>	<u>-</u>	<u>(50,000)</u>
Total expenditures	<u>155,075</u>	<u>202,401</u>	<u>104,931</u>	<u>(97,470)</u>
Net change in fund balance	-	-	97,419	97,419
Fund balance (deficit) at beginning of year	<u>(56,958)</u>	<u>(56,958)</u>	<u>(56,958)</u>	<u>-</u>
Fund balance (deficit) at end of year	<u>\$ (56,958)</u>	<u>\$ (56,958)</u>	<u>\$ 40,461</u>	<u>\$ 97,419</u>