

City of Hearne, Texas
Reconciliation of the Balance Sheet to the Statement of Net Assets
Governmental Funds
September 30, 2012

Fund balances - total governmental funds		\$ 2,927,959
Amounts reported for governmental activities in the Statement of Net Assets 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	7,647,968	
Less accumulated depreciation	<u>(4,739,375)</u>	2,908,593
Deferred tax revenues reported in the governmental funds are recognized as revenues for the governmental activities.		261,365
Other long term assets are not available to pay for current period expenditures and therefore are deferred in the governmental funds.		14,501
Long-term liabilities are not due and payable in the current year and therefore are not reported in the governmental funds.		(393,090)
Net assets of governmental activities		<u><u>\$ 5,719,328</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 fiscal year ended September 30, 2012

	General	4A Sales Tax Fund	4B Sales Tax Fund	Other Governmental Funds	Total Governmental Funds
Revenues:					
Taxes:					
Property	\$ 1,090,809	\$ -	\$ -	\$ -	\$ 1,090,809
Sales	388,813	193,266	193,266	-	775,345
Gross receipts	81,243	-	-	-	81,243
Hotel/motel occupancy	-	-	-	-	-
Intergovernmental	40,004	-	-	141,042	141,042
Licenses and permits	6,590	-	-	10,021	50,025
Property rentals	52,354	-	-	-	6,590
Fines	288,343	-	-	-	52,354
Investment income	639	3,532	3,489	-	288,343
Private contributions	33,076	-	-	70	7,730
Miscellaneous	12,559	-	-	-	33,076
Total revenues	1,994,430	196,798	196,755	151,133	2,539,116
Expenditures:					
Current:					
General government	639,599	-	-	-	639,599
Public safety	1,133,684	-	-	5,030	1,138,714
Highways and streets	330,668	-	-	-	330,668
Health and welfare	53,287	-	-	-	53,287
Culture and recreation	483,352	74,442	12,775	71,359	641,928
Capital outlay	267,426	-	-	8,158	275,584
Debt service:					
Principal	173,732	-	-	55,770	229,502
Interest and fiscal charges	16,684	-	-	5,149	21,833
Total expenditures	3,098,432	74,442	12,775	145,466	3,331,115
Excess (deficiency) of revenues over (under) expenditures	(1,104,002)	122,356	183,980	5,667	(791,999)
Other financing sources (uses):					
Proceeds from sale of capital assets	115,091	-	-	-	115,091
Transfers in	1,484,280	-	10,000	-	1,494,280
Transfers out	(598,119)	(156,556)	(55,111)	-	(809,786)
Total other financing sources (uses)	1,001,252	(156,556)	(45,111)	-	799,585
Net change in fund balances	(102,750)	(34,200)	138,869	5,667	7,586
Fund balances at beginning of year	1,009,313	938,888	985,871	(13,699)	2,920,373
Fund balances at end of year	\$ 906,563	\$ 904,688	\$ 1,124,740	\$ (8,032)	\$ 2,927,959

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, 2012

Net changes in fund balances - total governmental funds \$ 7,586

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	\$ 275,584	
Depreciation of capital assets	<u>(300,220)</u>	(24,636)

The net effect of various miscellaneous transactions involving capital assets (i.e., sales, trade-ins, and donations) is to increase net assets. (15,090)

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 deferred tax revenue. 38,331

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. 222,021

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. 4,892

Change in net assets of governmental activities	<div style="border-top: 1px solid black; border-bottom: 3px double black; padding: 2px 0;"> \$ 233,104 </div>
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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 fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Revenues:				
Taxes:				
Property				
Sales	\$ 1,195,070	\$ 1,199,096	\$ 1,090,809	\$ (108,287)
Gross receipts	342,000	388,813	388,813	-
Licenses and permits	97,000	97,000	81,243	(15,757)
Property rentals	15,000	15,000	6,590	(8,410)
Fines	41,500	53,855	52,354	(1,501)
Intergovernmental	256,200	294,035	288,343	(5,692)
Investment income	-	40,004	40,004	-
Private contributions	2,800	2,800	639	(2,161)
Miscellaneous	22,100	33,182	33,076	(106)
Total revenues	<u>1,985,170</u>	<u>2,140,575</u>	<u>1,994,430</u>	<u>(146,145)</u>
Expenditures:				
Current:				
General government:				
Legislative	39,734	34,260	34,254	(6)
Executive	187,264	200,519	200,602	83
Finance	280,753	260,233	260,258	25
Court	146,275	144,487	144,485	(2)
Total general government	<u>654,026</u>	<u>639,499</u>	<u>639,599</u>	<u>100</u>
Public safety:				
Police	911,099	1,017,258	1,012,882	(4,376)
Fire	141,798	122,151	120,802	(1,349)
Total public safety	<u>1,052,897</u>	<u>1,139,409</u>	<u>1,133,684</u>	<u>(5,725)</u>
Highways and streets	<u>283,540</u>	<u>328,811</u>	<u>330,668</u>	<u>1,857</u>
Health and welfare:				
Code enforcement	1,425	580	580	-
Animal control	50,834	52,713	52,707	(6)
Total health and welfare	<u>52,259</u>	<u>53,293</u>	<u>53,287</u>	<u>(6)</u>
Culture and recreation:				
Library	124,857	137,767	137,731	(36)
Parks and recreation	338,107	347,839	345,621	(2,218)
Total culture and recreation	<u>462,964</u>	<u>485,606</u>	<u>483,352</u>	<u>(2,254)</u>
Capital outlay	<u>197,500</u>	<u>181,878</u>	<u>267,426</u>	<u>85,548</u>
Debt service:				
Principal	144,589	173,734	173,732	(2)
Interest	19,902	16,686	16,684	(2)
Total debt service	<u>164,491</u>	<u>190,420</u>	<u>190,416</u>	<u>(4)</u>
Total expenditures	<u>2,867,677</u>	<u>3,018,916</u>	<u>3,098,432</u>	<u>79,516</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(882,507)</u>	<u>(878,341)</u>	<u>(1,104,002)</u>	<u>(225,661)</u>
Other financing sources (uses):				
Proceeds from sale of capital assets	22,000	70,092	115,091	44,999
Transfers in	1,316,016	1,531,645	1,484,280	(47,365)
Transfers out	(455,209)	(723,393)	(598,119)	125,274
Total other financing sources (uses)	<u>882,807</u>	<u>878,344</u>	<u>1,001,252</u>	<u>122,908</u>
Net change in fund balances	<u>300</u>	<u>3</u>	<u>(102,750)</u>	<u>(102,753)</u>
Fund balances at beginning of year	<u>1,009,313</u>	<u>1,009,313</u>	<u>1,009,313</u>	<u>-</u>
Fund balances at end of year	<u>\$ 1,009,613</u>	<u>\$ 1,009,316</u>	<u>\$ 906,563</u>	<u>\$ (102,753)</u>

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

City of Hearne, Texas
Statement of Net Assets
Proprietary Funds
September 30, 2012

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Assets			
Current assets:			
Cash and equivalents	\$ 540,972	\$ -	\$ 540,972
Accounts receivable (net of allowance for uncollectible)	1,271,905	2,817	1,274,722
Inventory	109,656	-	109,656
Due from other funds	68,033	23,472	91,505
Other assets	10,505	-	10,505
Restricted cash	239,057	-	239,057
Total current assets	2,240,128	26,289	2,266,417
Unamortized bond issuance cost	72,941	-	72,941
Capital assets:			
Land	61,634	-	61,634
Buildings and other improvements	286,985	788,038	1,075,023
Distribution and collection systems	22,415,837	-	22,415,837
Equipment	700,338	10,706	711,044
Construction in progress	47,178	87,906	135,084
	23,511,972	886,650	24,398,622
Less: accumulated depreciation	(12,732,843)	(303,749)	(13,036,592)
Capital assets, net of accumulated depreciation	10,779,129	582,901	11,362,030
Total non-current assets	10,852,070	582,901	11,434,971
Total assets	\$ 13,092,198	\$ 609,190	\$ 13,701,388
Liabilities			
Current liabilities:			
Accounts payable	\$ 582,299	\$ 1,982	\$ 584,281
Salaries payable	22,900	-	22,900
Sales tax payable	21,992	-	21,992
Accrued liabilities	31,116	-	31,116
Due to other funds	1,062,209	-	1,062,209
Customer deposits payable	303,668	-	303,668
Long-term debt, current	427,723	-	427,723
Total current liabilities	2,451,907	1,982	2,453,889
Long-term liabilities:			
Long-term debt, net	6,976,854	-	6,976,854
Liability for compensated absences	31,260	-	31,260
Total long-term liabilities	7,008,114	1,982	7,010,096
Total liabilities	9,460,021	1,982	9,462,003
Net Assets			
Invested in capital assets, net of related debt	3,374,552	582,901	3,957,453
Unrestricted	257,625	24,307	281,932
Total net assets	\$ 3,632,177	\$ 607,208	\$ 4,239,385

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

City of Hearne, Texas
Statement of Revenues, Expenses and Changes in Fund Net Assets
Proprietary Funds
For the fiscal year ended September 30, 2012

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Operating revenues:			
Charges for sales and services:			
Water sales	\$ 1,251,516	\$ -	\$ 1,251,516
Electric sales	5,777,137	-	5,777,137
Sewer charges	608,078	-	608,078
Sanitation	617,351	-	617,351
Tap fees	1,333	-	1,333
Rental fees	2,569	19,605	22,174
Intergovernmental	245,880	48,536	294,416
Penalties	77,807	-	77,807
Miscellaneous revenue	112,631	485	113,116
Total operating revenues	8,694,302	68,626	8,762,928
Operating expenses:			
Wholesale utilities	4,917,625	-	4,917,625
Water department	443,457	-	443,457
Electric department	285,949	-	285,949
Sewer department	323,369	-	323,369
Sanitation department	53,252	-	53,252
Administrative and billing	600,429	-	600,429
Airport	-	22,381	22,381
Depreciation and amortization	621,230	31,522	652,752
Total operating expenses	7,245,311	53,903	7,299,214
Operating income	1,448,991	14,723	1,463,714
Nonoperating revenues (expense):			
Investment income	1,329	-	1,329
Interest expense	(389,052)	-	(389,052)
Total nonoperating revenues (expense)	(387,723)	-	(387,723)
Income before transfers	1,061,268	14,723	1,075,991
Transfers in	610,141	21,381	631,522
Transfers out	(1,316,016)	-	(1,316,016)
Total other financing sources (uses)	(705,875)	21,381	(684,494)
Change in net assets	355,393	36,104	391,497
Net assets, beginning of the year	3,276,784	571,104	3,847,888
Net assets, end of the year	\$ 3,632,177	\$ 607,208	\$ 4,239,385

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 fiscal year ended September 30, 2012

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Cash flows from operating activities:			
Cash received from customers	\$ 9,136,953	\$ 71,022	\$ 9,207,975
Cash payments to suppliers for goods and services	(6,340,542)	(46,557)	(6,387,099)
Cash payments to employees for services	(576,232)	-	(576,232)
Net cash provided by operating activities	<u>2,220,179</u>	<u>24,465</u>	<u>2,244,644</u>
Cash flows from non-capital financing activities:			
Transfers in	610,141	21,381	631,522
Transfers out	(1,316,016)	-	(1,316,016)
Net cash provided by (used in) non-capital financing activities	<u>(705,875)</u>	<u>21,381</u>	<u>(684,494)</u>
Cash flows from capital and related financing activities:			
Acquisition of capital assets	(484,493)	(86,988)	(571,481)
Interest paid	(389,052)	-	(389,052)
Principal payments	(432,130)	-	(432,130)
Net cash provided by (used in) capital and related financing activities	<u>(1,305,675)</u>	<u>(86,988)</u>	<u>(1,392,663)</u>
Cash flows from investing activities:			
Interest on cash and investments	1,329	-	1,329
Net increase (decrease) in cash and equivalents	209,958	(41,142)	168,816
Cash and equivalents, beginning of year	570,071	41,142	611,213
Cash and equivalents, end of year	<u>\$ 780,029</u>	<u>\$ -</u>	<u>\$ 780,029</u>
Reconciliation of cash and equivalents:			
Unrestricted cash and equivalents	\$ 540,972	\$ -	\$ 540,972
Restricted cash and investments	239,057	-	239,057
Total cash and equivalents	<u>\$ 780,029</u>	<u>\$ -</u>	<u>\$ 780,029</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 fiscal year ended September 30, 2012

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	\$ 1,448,991	\$ 14,723	\$ 1,463,714
Adjustments to reconcile to net cash provided by operating activities:			
Depreciation and amortization	621,230	31,522	652,752
Bad debt expense	42,070	-	42,070
Increase (decrease) in cash resulting from changes in assets and liabilities:			
Accounts receivable	367,993	2,396	370,389
Inventory	33,425	-	33,425
Due from other funds	(68,033)	(23,472)	(91,505)
Prepays	(896)	-	(896)
Due to other funds	(5,496)	-	(5,496)
Accounts payable	(208,785)	(704)	(209,489)
Salaries payable	(5,034)	-	(5,034)
Sales tax payable	(5,233)	-	(5,233)
Liability for compensated absences	(10,730)	-	(10,730)
Customer deposits	32,588	-	32,588
Other payables	(21,911)	-	(21,911)
Net cash provided by operating activities	<u>\$ 2,220,179</u>	<u>\$ 24,465</u>	<u>\$ 2,244,644</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, 2012

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).

In determining the financial reporting entity, the City complies with the provisions of GASB Statement No. 14, "The Financial Reporting Entity," and has determined that the City has no component units. Additionally, the City is not a component unit of any other reporting entity as defined by the GASB Statement.

B. Basis of Presentation

Government-wide financial statements

The Statement of Net Assets 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.

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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2012

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.

4A Sales Tax Fund

The 4A Sales Tax fund is used to account for the one-half of one percent of local sales tax collected, which is used to promote economic development.

4B Sales Tax Fund

The 4B Sales Tax fund is used to account for the one-half of one percent of local sales tax collected, which is used to promote economic development.

Other Governmental Funds

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

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2012

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.

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 Assets 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 assets (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 assets.

Basis of Accounting

In the government-wide Statement of Net Assets 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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2012

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 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 Assets 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 with maturities of three months or less.

Cash consists of cash on hand and amounts in demand deposit accounts, interest-bearing checking accounts and certificates of deposit.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2012

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.

The City invests its idle funds 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.

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

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2012

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

Buildings	50 years
Infrastructure	30 years
Improvements other than buildings	20 years
Machinery and equipment	2-15 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

City of Hearne, Texas
Notes to Basic Financial Statements
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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 assets. Long-term liabilities expected to be financed from proprietary fund operations are accounted for in those funds.

L. Fund Equity

Government-wide statements

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

- a. Invested in capital assets, net of related debt – 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 assets – consists of net assets 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 assets – all other net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Amounts restricted on the Statement of Net Assets 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,

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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 and debt service property taxes.

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. Such intent should be expressed by the City Council or its designated officials to assign amounts to be used. 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.

Deficit fund balance or net asset balances

The Hotel/Motel Tax Fund had a deficit fund balance of \$17,507 at September 30, 2012.

M. Bond Issuance Costs

In the fund financial statements of governmental fund types, bond issuance costs are recognized in the current period. Bond issuance costs in the government-wide financial statements and fund financial statements of proprietary fund types are deferred and amortized over the term of the bonds using the straight-line method.

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

City of Hearne, Texas
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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.

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.

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.

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.

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Expenditures/Expenses in Excess of Appropriations

Expenditures/expenses exceeded appropriations at the legal level of budgetary control by \$83 for the Executive department, \$25 for the Finance department, \$1,857 for Highways and Streets, totaling \$1,965 for the General Fund. Additionally, expenditure/expenses exceeded appropriations at the legal level of budgetary control by \$539 for Water, and \$79 for Sanitation, totaling \$618 for 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. During the current fiscal year, the City transitioned primary depository banks from First Victoria National Bank to First Star Bank. A Pooled Cash account is still maintained with First Victoria National Bank.

As of September 30, 2012, the City had investments in TexSTAR with maturities less than 60 days with a fair value of \$539,079. Additionally, the City held a certificate of deposit totaling \$139,898.

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, 2012, 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, 2012.

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Notes to Basic Financial Statements
September 30, 2012

Note 4. Restricted Assets

At September 30, 2012, restrictions on cash and investments were as follows:

<u>Cash and Investments</u>	<u>Governmental Funds</u>	<u>Proprietary Funds</u>
Restricted for:		
Hotel/motel expenditures	\$ 15,049	\$ -
4A Sales Tax	715,563	-
4B Sales Tax	938,192	-
Police Special	9,475	-
Interest and sinking	10,372	209,579
Fire trucks	1,096	-
Court security	65,343	-
Court technology	47,250	-
Child Safety Fund	19,550	-
Community Development		
Block Grant Program	-	510
Meter Sinking	-	28,968
	<u>\$ 1,821,890</u>	<u>\$ 239,057</u>

Note 5. Receivables

Receivables at September 30, 2012, consist of the following:

<u>Receivables:</u>	<u>Governmental Funds</u>	<u>Proprietary Funds</u>
Taxes:		
Property	\$ 298,979	\$ -
Sales	138,120	-
Hotel/motel occupancy	25,682	-
Accounts	18,740	2,637,990
Grants	-	10,175
Less:		
Allowance for uncollectibles	-	(1,373,443)
Net total receivables	<u>\$ 481,521</u>	<u>\$ 1,274,722</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, 2012

Note 6. Capital Assets

The following is a summary of capital asset activity during the year ended September 30, 2012:

	Beginning Balance	Additions/ Completions	Retirements/ Adjustments	Ending Balance
<u>Governmental activities</u>				
Capital assets not being depreciated				
Land	\$ 142,319	\$ -	\$ -	\$ 142,319
Construction in progress	-	15,048	-	15,048
Total capital assets not being depreciated	142,319	15,048	-	157,367
Capital assets being depreciated				
Buildings	4,921,222	65,114	-	4,986,336
Improvements other than buildings	678,447	107,461	-	785,908
Furniture and fixtures	5,171	-	-	5,171
Vehicles	888,993	34,207	35,508	887,692
Machinery and equipment	908,210	53,754	136,470	825,494
Total at historical cost	7,402,043	260,536	171,978	7,490,601
Less: accumulated depreciation for:				
Buildings	3,374,409	99,708	-	3,474,117
Improvements other than buildings	54,697	62,822	-	117,519
Furniture and fixtures	3,792	1,034	-	4,826
Vehicles	585,462	83,351	20,418	648,395
Machinery and equipment	577,683	53,305	136,470	494,518
Total accumulated depreciation	4,596,043	300,220	156,888	4,739,375
Total capital assets being depreciated, net	2,806,000	(39,684)	15,090	2,751,226
Governmental activities capital assets, net	\$ 2,948,319	\$ (24,636)	\$ 15,090	\$ 2,908,593
<u>Business-type activities</u>				
Capital assets not being depreciated				
Land	\$ 61,634	\$ -	\$ -	\$ 61,634
Construction in progress	277,776	(142,692)	-	135,084
Total capital assets not being depreciated	339,410	(142,692)	-	196,718
Capital assets being depreciated				
Buildings and improvements	1,058,147	16,876	-	1,075,023
Furniture and fixtures	281,880	18,500	-	300,380
Vehicles	218,292	14,308	-	232,600
Distribution and collection systems	21,769,847	645,990	-	22,415,837
Machinery and equipment	159,564	18,500	-	178,064
Total at historical cost	23,487,730	714,174	-	24,201,904
Less: accumulated depreciation for:				
Buildings and improvements	430,094	42,535	-	472,629
Furniture and fixtures	221,708	12,274	-	233,982
Vehicles	118,009	28,774	-	146,783
Distribution and collection systems	11,515,604	543,232	-	12,058,836
Machinery and equipment	117,357	7,005	-	124,362
Total accumulated depreciation	12,402,772	633,820	-	13,036,592
Total capital assets being depreciated, net	11,084,958	80,354	-	11,165,312
Business-type activities capital assets, net	\$ 11,424,368	\$ (62,338)	\$ -	\$ 11,362,030

City of Hearne, Texas
Notes to Basic Financial Statements
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Depreciation expense was charged as direct expense to programs of the primary government as follows:

General government	\$ 22,054
Public safety	84,906
Highways and streets	70,209
Culture and recreation	123,051
Total depreciation expense - Governmental activities	<u>\$ 300,220</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, 2012:

	Balance 9/30/11	Additions	Retirements	Balance 9/30/12	Due Within One Year	Long Term
<u>Governmental activities</u>						
Lease payable - National City	\$ 46,450	\$ -	\$ (36,950)	\$ 9,500	\$ 9,500	\$ -
Lease payable - TYMCO	96,557	-	(31,147)	65,410	32,174	33,236
Subtotal of leases payable	143,007	-	(68,097)	74,910	41,674	33,236
First Victoria Bank - Library	40,367	-	(20,952)	19,415	11,627	7,788
First Star Bank - Depot	111,828	-	(55,770)	56,058	56,058	-
First Star Bank - Equipment	215,708	-	(85,453)	130,255	130,255	-
Subtotal of other debt	367,903	-	(162,175)	205,728	197,940	7,788
	<u>\$ 510,910</u>	<u>\$ -</u>	<u>\$ (230,272)</u>	<u>\$ 280,638</u>	<u>\$ 239,614</u>	<u>\$ 41,024</u>
<u>Business type activities</u>						
Lease payable - National City	\$ 36,535	\$ -	\$ (29,062)	\$ 7,473	\$ 7,473	\$ -
Lease payable - Southside	1,572,334	-	(87,876)	1,484,458	92,762	1,391,696
Lease payable - AEP	483,618	-	(21,307)	462,311	26,932	435,379
Lease payable - Western	8,739	-	(3,691)	5,048	3,998	1,050
Subtotal of leases payable	2,101,226	-	(141,936)	1,959,290	131,165	1,828,125
2011 General obligation refunding	5,905,000	-	(270,000)	5,635,000	280,000	5,355,000
Subtotal of bonds payable	5,905,000	-	(270,000)	5,635,000	280,000	5,355,000
First Star Bank - Equipment	50,979	-	(20,195)	30,784	30,784	-
Subtotal of other debt	50,979	-	(20,195)	30,784	30,784	-
Deferred charges on bonds	(234,724)	-	14,227	(220,497)	(14,226)	(206,271)
	<u>\$ 7,822,481</u>	<u>\$ -</u>	<u>\$ (417,904)</u>	<u>\$ 7,404,577</u>	<u>\$ 427,723</u>	<u>\$ 6,976,854</u>

City of Hearne, Texas
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The annual aggregate maturities for each debt type for the years subsequent to September 30, 2012 are as follows:

Year ending September 30	Business-type Activities				Governmental Activities	
	Bonds Payable		Notes Payable		Notes Payable	
	Principal	Interest	Principal	Interest	Principal	Interest
2013	\$ 280,000	\$ 178,223	\$ 30,784	\$ 1,009	\$ 197,940	\$ 6,702
2014	285,000	168,618	-	-	7,788	115
2015	290,000	158,843	-	-	-	-
2016	300,000	151,213	-	-	-	-
2017	305,000	145,310	-	-	-	-
2018-2022	1,675,000	602,329	-	-	-	-
2023-2027	2,040,000	291,805	-	-	-	-
2028-2029	460,000	9,200	-	-	-	-
	<u>\$ 5,635,000</u>	<u>\$ 1,705,541</u>	<u>\$ 30,784</u>	<u>\$ 1,009</u>	<u>\$ 205,728</u>	<u>\$ 6,817</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 Assets.

During the year ended September 30, 2012, the following changes occurred in other long-term liabilities:

	Balance 9/30/11	Additions (Reductions)	Balance 9/30/12	Due Within One Year
<u>Governmental activities</u>				
Compensated absences	<u>\$ 109,707</u>	<u>\$ 2,745</u>	<u>\$ 112,452</u>	<u>\$ -</u>
<u>Business type activities</u>				
Compensated absences	<u>\$ 41,990</u>	<u>\$ (10,730)</u>	<u>\$ 31,260</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
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The assets acquired through the capital leases are as follows:

Asset Class	Governmental Activities	Business type Activities
Vehicles	\$ 66,749	\$ 96,861
Machinery and equipment	44,128	39,410
Distribution and collection system	-	2,453,435
Cost basis	110,877	2,589,706
Less: Accumulated depreciation	(67,844)	(696,292)
Total net asset	<u>\$ 43,033</u>	<u>\$ 1,893,414</u>

The total future minimum lease payments and the net present value of these minimum payments as of September 30, 2012 were as follows:

Year ending September 30	Governmental Activities	Business-type Activities
2013	\$ 43,394	\$ 318,852
2014	33,826	308,132
2015	-	307,069
2016	-	307,069
2017	-	307,069
2018-2022	-	1,132,557
2023-2027	-	289,241
Total minimum lease payments	77,220	2,969,989
Less: Amount representing interest	(2,310)	(1,010,699)
Present value of minimum payments	<u>\$ 74,910</u>	<u>\$ 1,959,290</u>

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

City of Hearne, Texas
Notes to Basic Financial Statements
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Note 10. Interfund Receivables and Payables

Interfund receivables and payables, all of which are considered short-term, at September 30, 2012, were as follows:

Name of Fund	Due from other funds	Due to other funds
Governmental:		
General	\$ 693,647	\$ -
4A Sales Tax	146,682	-
4B Sales Tax	151,999	-
Non-Major Governmental	-	21,624
Business-Type:		
Enterprise Fund	68,033	1,062,209
Non-Major Business-Type	23,472	-
	<u>\$ 1,083,833</u>	<u>\$ 1,083,833</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, 2012, were as follows:

	Transfers In				Total
	General Fund	4B Sales Tax	Enterprise	Non-Major Enterprise	
<u>Transfers out</u>					
General	\$ -	\$ 10,000	\$ 588,119	\$ -	\$ 598,119
4A Sales Tax	133,279	-	18,277	5,000	156,556
4B Sales Tax	34,985	-	3,745	16,381	55,111
Enterprise	1,316,016	-	-	-	1,316,016
	<u>\$ 1,484,280</u>	<u>\$ 10,000</u>	<u>\$ 610,141</u>	<u>\$ 21,381</u>	<u>\$ 2,125,802</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 \$4,426,753 to this company during the year ended September 30, 2012.

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 \$490,872 to this company during the year ended September 30, 2012.

City of Hearne, Texas
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The 4A and 4B Sales Tax Boards have the following incentive commitments as of September 30, 2012:

Incentive commitment	4A	4B
Love's Truck Stop	\$ 75,000	\$ 75,000
Miscellaneous entities	-	3,125
	<u>\$ 75,000</u>	<u>\$ 78,125</u>

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 (CAFR) 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 by writing to P.O. Box 149153, Austin, Texas 78714-9153 or by calling 800-924-8677. In addition, the report is available on 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,		
	2009	2010	2011
Employee deposit rate	7%	7%	7%
Matching ratio (city to employee)	1.5 to 1	1.5 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 Projected Unit Credit actuarial method. This rate consists of the normal cost contribution rate and the prior service contribution

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rate, which is calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the portion of an active member's projected benefit allocated annually; 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.

The City contributes to the TMRS Plan at an actuarially determined rate. Both the employee 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 December 31,			
	2010			2011
	2009	Prior to restructuring	Restructured	
Actuarial value of assets	\$ 2,437,029	\$ 2,624,466	\$ 3,573,552	\$ 3,920,275
Actuarial accrued liability	3,982,620	4,448,247	5,377,066	5,637,863
Percentage funded ratio	61.2%	59.0%	66.5%	69.5%
Unfunded (over-funded) actuarial accrued liability (UAAL)	1,545,591	1,823,781	1,803,514	1,717,588
Annual covered payroll	1,623,227	1,830,685	1,830,685	1,910,745
UAAL as a percentage of covered payroll	95.2%	99.6%	98.5%	89.9%
Net pension obligation (NPO), beginning of period	-	-	-	-
Annual pension cost:				
Annual required contribution (ARC)	140,247	142,793	142,793	205,022
Interest on NPO	-	-	-	-
Adjustment to ARC	-	-	-	-
	140,247	142,793	142,793	205,022
Contributions made	140,247	142,793	142,793	205,022
Increase in NPO	-	-	-	-
NPO at end of the period	\$ -	\$ -	\$ -	\$ -

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The required contribution rates for fiscal year 2012 were determined as part of the December 31, 2009 and 2010 actuarial valuations. Additional information as of the latest actuarial valuation, December 31, 2011, also follows:

Valuation Date	For the year ended December 31,			
	2009	2010 Prior to restructuring	2010 Restructured	2011
Actuarial cost method	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit
Amortization method	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll
GASB 25 equivalent single amortization period	28.1 Years; closed period	27.6 Years; closed period	27.7 Years; closed period	26.8 Years; closed period
Amortization period for new gain/loss	30 Years	30 Years	30 Years	30 Years
Asset valuation method	10-year Smoothed Market	10-year Smoothed Market	10-year Smoothed Market	10-year Smoothed Market
Actuarial assumptions:				
Investment rate of return *	7.5%	7.5%	7.0%	7.0%
Projected salary increase *	Varies by age and service	Varies by age and service	Varies by age and service	Varies by age and service
* Includes inflation at	3.00%	3.00%	3.00%	3.00%
Cost-of-living adjustments	2.10%	2.10%	2.10%	2.10%

In June, 2011, SB 350 was enacted by the Texas Legislature, resulting in a restructure of the TMRS funds. This legislation provided for the actuarial valuation to be completed as if restructuring had occurred on December 31, 2010. In addition, the actuarial assumptions were updated for the new fund structure, based on an actuarial experience study that was adopted by the TMRS Board at their May, 2011 meeting (the review compared actual to expected experience for the four-year period of January 1, 2006 through December 31, 2009). For a complete description of the combined impact of the legislation and new actuarial assumptions, including the effects on TMRS city rates and funding ratios, please see the December 31, 2010 TMRS Comprehensive Annual Financial Report (CAFR).

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2012

The schedule of funding progress, presented as Required Supplementary Information following the notes to the financial statements, presents multiple-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.

Note 15. Subsequent events

During 2013, the City has entered into various incentive projects for 4A and 4B Sales Tax Funds totaling \$569,000.

The City obtained a promissory note from a Bank subsequent to year end in the amount of \$400,000. However, no advances were made on this note as of the report date.

The City entered into a construction subsequent to year end for a total of \$216,810 for water system improvements. The improvements will be funded with a \$150,000 grant, \$54,000 matching funds from 4B Sales Tax Funds and \$12,810 from the City's general fund.

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
- Schedule of Revenues, Expenditures and Changes in Fund Balance
 - Budget to Actual - 4A Sales Tax Special Revenue Fund
- Schedule of Revenues, Expenditures and Changes in Fund Balance
 - Budget to Actual – 4B Sales Tax Special Revenue Fund

City of Hearne, Texas
Schedule of Funding Progress
Texas Municipal Retirement System
For the Year Ended September 30, 2012

<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>
12/31/2009	2,437,029	3,772,943	64.60%	1,335,914	1,623,227	82.30%
12/31/2010 ⁽¹⁾	2,624,466	4,448,247	59.00%	1,823,781	1,830,685	99.60%
12/31/2010 ⁽²⁾	3,573,552	5,377,066	66.50%	1,803,514	1,830,685	98.50%
12/31/2011	3,920,275	5,637,863	69.50%	1,717,588	1,910,745	89.90%

⁽¹⁾ Actuarial valuation performed under the original fund structure.

⁽²⁾ Actuarial valuation performed under the new fund structure.

City of Hearne, Texas
4A Sales Tax Special Revenue Fund
Schedule of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Revenues:				
Sales taxes	\$ 160,000	\$ 160,000	\$ 193,266	\$ 33,266
Investment income	5,000	5,000	3,532	(1,468)
Total revenues	<u>165,000</u>	<u>165,000</u>	<u>196,798</u>	<u>31,798</u>
Expenditures:				
Current:				
Culture and recreation:				
Economic development	70,000	83,441	74,442	(8,999)
Capital outlay	95,000	23,278	-	(23,278)
Total expenditures	<u>165,000</u>	<u>106,719</u>	<u>74,442</u>	<u>(32,277)</u>
Excess of revenues over expenditures	<u>-</u>	<u>58,281</u>	<u>122,356</u>	<u>64,075</u>
Other financing uses:				
Transfers out	<u>-</u>	<u>(58,281)</u>	<u>(156,556)</u>	<u>(98,275)</u>
Net change in fund balances	<u>-</u>	<u>-</u>	<u>(34,200)</u>	<u>(34,200)</u>
Fund balances at beginning of year	<u>938,888</u>	<u>938,888</u>	<u>938,888</u>	<u>-</u>
Fund balances at end of year	<u>\$ 938,888</u>	<u>\$ 938,888</u>	<u>\$ 904,688</u>	<u>\$ (34,200)</u>

City of Hearne, Texas
4B Sales Tax Special Revenue Fund
Schedule of Revenues, Expenditures and Changes in Fund Balances
Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Revenues:				
Sales taxes	\$ 160,000	\$ 160,000	\$ 193,266	\$ 33,266
Investment income	5,000	5,000	3,489	(1,511)
Total revenues	<u>165,000</u>	<u>165,000</u>	<u>196,755</u>	<u>31,755</u>
Expenditures:				
Current:				
Culture and recreation:				
Economic development	105,000	70,176	12,775	(57,401)
Capital outlay	20,000	20,800	-	(20,800)
Total expenditures	<u>125,000</u>	<u>90,976</u>	<u>12,775</u>	<u>(78,201)</u>
Excess of revenues over expenditures	<u>40,000</u>	<u>74,024</u>	<u>183,980</u>	<u>109,956</u>
Other financing sources (uses):				
Transfers in	-	-	10,000	10,000
Transfers out	(40,000)	(74,024)	(55,111)	18,913
Total other financing sources (uses)	<u>(40,000)</u>	<u>(74,024)</u>	<u>(45,111)</u>	<u>28,913</u>
Net change in fund balances	-	-	138,869	138,869
Fund balances at beginning of year	<u>985,871</u>	<u>985,871</u>	<u>985,871</u>	-
Fund balances at end of year	<u>\$ 985,871</u>	<u>\$ 985,871</u>	<u>\$ 1,124,740</u>	<u>\$ 138,869</u>

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, 2012

	Special Revenue		Total
	Hotel/Motel Tax	Police Special Fund	Non-major Governmental Funds
Assets			
Taxes receivable	\$ 25,682	\$ -	\$ 25,682
Cash, restricted	15,049	9,475	24,524
Total assets	<u>\$ 40,731</u>	<u>\$ 9,475</u>	<u>\$ 50,206</u>
Liabilities and fund balances			
Liabilities:			
Accounts payable	36,614	-	36,614
Due to other funds	21,624	-	21,624
Total liabilities	<u>58,238</u>	<u>-</u>	<u>58,238</u>
Fund balances:			
Restricted for police	-	9,475	9,475
Unassigned (deficit)	(17,507)	-	(17,507)
Total fund balances (deficit)	<u>(17,507)</u>	<u>9,475</u>	<u>(8,032)</u>
Total liabilities and fund balances	<u>\$ 40,731</u>	<u>\$ 9,475</u>	<u>\$ 50,206</u>

City of Hearne, Texas
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Non-major Governmental Funds
For the fiscal year ended September 30, 2012

	Special Revenue		Total Non-major Governmental Funds
	Hotel/Motel Tax	Police Special Fund	
Revenues:			
Hotel/motel occupancy taxes	\$ 141,042	\$ -	\$ 141,042
Investment income	70	-	70
Intergovernmental	8,159	1,862	10,021
Total revenues	<u>149,271</u>	<u>1,862</u>	<u>151,133</u>
Expenditures:			
Current:			
Public safety	-	5,030	5,030
Culture and recreation	71,359	-	71,359
Capital outlay	8,158	-	8,158
Debt service:			
Principal	55,770	-	55,770
Interest	5,149	-	5,149
Total expenditures	<u>140,436</u>	<u>5,030</u>	<u>145,466</u>
Net change in fund balances	8,835	(3,168)	5,667
Fund balances (deficit) at beginning of year	<u>(26,342)</u>	<u>12,643</u>	<u>(13,699)</u>
Fund balances (deficit) at end of year	<u>\$ (17,507)</u>	<u>\$ 9,475</u>	<u>\$ (8,032)</u>

**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 fiscal year ended September 30, 2012

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Over (Under)
Revenues:				
Hotel/motel occupancy taxes	\$ 121,575	\$ 122,572	\$ 141,042	\$ 18,470
Investment income	500	500	70	(430)
Intergovernmental	-	-	8,159	8,159
Total revenues	<u>122,075</u>	<u>123,072</u>	<u>149,271</u>	<u>26,199</u>
Expenditures:				
Current:				
Culture and recreation:				
Economic development	50,000	53,994	71,359	17,365
Capital outlay	-	8,158	8,158	-
Debt service:				
Principal	55,050	55,770	55,770	-
Interest	17,025	5,150	5,149	(1)
Total expenditures	<u>122,075</u>	<u>123,072</u>	<u>140,436</u>	<u>17,364</u>
Net change in fund balance	<u>-</u>	<u>-</u>	<u>8,835</u>	<u>8,835</u>
Fund balance (deficit) at beginning of year	<u>(26,342)</u>	<u>(26,342)</u>	<u>(26,342)</u>	<u>-</u>
Fund balance (deficit) at end of year	<u>\$ (26,342)</u>	<u>\$ (26,342)</u>	<u>\$ (17,507)</u>	<u>\$ 8,835</u>

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

Enterprise Funds

City of Hearne, Texas
Enterprise Fund
Schedule of Revenues, Expenses, and Changes in Fund Net Assets
Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Over (Under)
Operating revenues:				
Charges for sales and services:				
Water sales	\$ 944,000	\$ 1,259,964	\$ 1,251,516	\$ (8,448)
Electric sales	6,300,000	6,428,983	5,777,137	(651,846)
Sewer charges	625,000	625,000	608,078	(16,922)
Sanitation	572,400	657,856	617,351	(40,505)
Tap fees	200	1,335	1,333	(2)
Rental fees	-	2,575	2,569	(6)
Intergovernmental	-	245,880	245,880	-
Penalties	-	-	77,807	77,807
Miscellaneous revenue	222,251	247,864	112,631	(135,233)
Total operating revenues	8,663,851	9,469,457	8,694,302	(775,155)
Operating expenses:				
Wholesale utilities	4,477,600	4,917,627	4,917,625	(2)
Water department	461,514	442,918	443,457	539
Electric department	330,959	300,266	285,949	(14,317)
Sewer department	385,181	323,378	323,369	(9)
Sanitation department	80,975	53,173	53,252	79
Administrative and billing	690,537	611,031	600,429	(10,602)
Depreciation and amortization	-	619,169	621,230	2,061
Capital outlay	71,250	-	-	-
Total operating expenses	6,498,016	7,267,562	7,245,311	(22,251)
Operating income	2,165,835	2,201,895	1,448,991	(752,904)
Nonoperating revenues (expenses):				
Gain on sale of assets	1,000	1,000	-	(1,000)
Investment income	1,500	1,500	1,329	(171)
Debt service:				
Principal retirement	(172,362)	-	-	-
Interest expense	(276,427)	(389,056)	(389,052)	4
Total nonoperating revenues (expenses)	(446,289)	(386,556)	(387,723)	(1,167)
Income before transfers	1,719,546	1,815,339	1,061,268	(754,071)
Transfers in	-	1,023,935	610,141	(413,794)
Transfers out	(1,719,546)	(2,592,526)	(1,316,016)	1,276,510
Total other financing sources (uses)	(1,719,546)	(1,568,591)	(705,875)	862,716
Change in net assets	-	246,748	355,393	108,645
Net assets, beginning of the year	3,276,784	3,276,784	3,276,784	-
Net assets, end of the year	\$ 3,276,784	\$ 3,523,532	\$ 3,632,177	\$ 108,645

City of Hearne, Texas
Non-major Municipal Airport Enterprise Fund
Schedule of Revenues, Expenses, and Changes in Fund Net Assets
Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	GAAP	Final Budget
			Basis	Over (Under)
Operating revenues:				
Rental fees	\$ 22,000	\$ 22,000	\$ 19,605	\$ (2,395)
Intergovernmental	-	35,000	48,536	13,536
Miscellaneous revenue	-	-	485	485
Total operating revenues	22,000	57,000	68,626	11,626
Operating expenses:				
Airport	22,000	22,000	22,381	381
Depreciation	-	31,522	31,522	-
Total operating expenses	22,000	53,522	53,903	381
Change in net assets before transfers	-	3,478	14,723	11,245
Transfers in	-	15,267	21,381	6,114
Change in net assets	-	18,745	36,104	17,359
Net assets, beginning of the year	571,104	571,104	571,104	-
Net assets, end of the year	\$ 571,104	\$ 589,849	\$ 607,208	\$ 17,359

**SUPPLEMENTARY INDIVIDUAL
FUND SCHEDULES**

General Fund

City of Hearne, Texas
General Fund
Schedule of General Government Expenditures - Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Legislative:				
Personnel	\$ 28,234	\$ 25,711	\$ 25,710	\$ (1)
Maintenance	2,200	2,233	2,232	(1)
Supplies	1,900	384	383	(1)
Other	7,400	5,932	5,929	(3)
Total City Council	39,734	34,260	34,254	(6)
Executive:				
Personnel	182,564	194,659	194,656	(3)
Maintenance	2,400	2,233	2,232	(1)
Supplies	700	851	938	87
Other	1,600	2,776	2,776	-
Total executive	187,264	200,519	200,602	83
Finance:				
Personnel	85,391	94,065	94,061	(4)
Maintenance	78,900	98,679	98,758	79
Supplies	10,700	7,134	7,087	(47)
Contract services	27,672	18,479	18,479	-
Other	78,090	41,876	41,873	(3)
Total finance	280,753	260,233	260,258	25
Court:				
Personnel	85,935	83,606	83,605	(1)
Maintenance	5,600	6,983	6,982	(1)
Supplies	4,200	3,734	3,734	-
Contract services	49,440	49,445	49,445	-
Other	1,100	719	719	-
Total court	146,275	144,487	144,485	(2)
Total general government	\$ 654,026	\$ 639,499	\$ 639,599	\$ 100

City of Hearne, Texas
General Fund
Schedule of Public Safety Expenditures - Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Police:				
Personnel	\$ 830,499	\$ 867,928	\$ 871,303	\$ 3,375
Maintenance	43,300	78,595	71,181	(7,414)
Supplies	29,700	63,226	62,891	(335)
Other	7,600	7,509	7,507	(2)
Total police	911,099	1,017,258	1,012,882	(4,376)
Fire:				
Personnel	31,748	25,907	25,903	(4)
Maintenance	27,000	23,575	23,315	(260)
Supplies	31,500	19,014	17,930	(1,084)
Volunteer Fire Department	48,000	52,584	52,583	(1)
Other	3,550	1,071	1,071	-
Total fire	141,798	122,151	120,802	(1,349)
Total public safety	\$ 1,052,897	\$ 1,139,409	\$ 1,133,684	\$ (5,725)

City of Hearne, Texas
General Fund
Schedule of Highways and Streets Expenditures - Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Streets:				
Personnel	\$ 202,868	\$ 223,604	\$ 223,600	\$ (4)
Maintenance	44,500	44,632	45,806	1,174
Supplies	35,672	60,575	61,262	687
Other	500	-	-	-
Total highways and streets	<u>\$ 283,540</u>	<u>\$ 328,811</u>	<u>\$ 330,668</u>	<u>\$ 1,857</u>

City of Hearne, Texas
General Fund
Schedule of Health and Welfare Expenditures - Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Code enforcement:				
Personnel	\$ -	\$ 580	\$ 580	\$ -
Maintenance	850	-	-	-
Supplies	425	-	-	-
Other	150	-	-	-
Total code enforcement	1,425	580	580	-
Animal control:				
Personnel	38,924	40,629	40,625	(4)
Maintenance	7,500	6,906	6,906	-
Supplies	4,160	5,178	5,177	(1)
Other	250	-	(1)	(1)
Total animal control	50,834	52,713	52,707	(6)
Total health and welfare	\$ 52,259	\$ 53,293	\$ 53,287	\$ (6)

City of Hearne, Texas
General Fund
Schedule of Culture and Recreation Expenditures - Budget and Actual
For the fiscal year ended September 30, 2012

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Library:				
Personnel	\$ 107,107	\$ 109,964	\$ 109,960	\$ (4)
Maintenance	9,300	6,508	6,507	(1)
Supplies	7,400	20,410	20,380	(30)
Other	1,050	885	884	(1)
Total library	124,857	137,767	137,731	(36)
Parks and recreation:				
Personnel	216,065	213,794	213,789	(5)
Maintenance	103,432	100,646	98,437	(2,209)
Supplies	17,660	31,224	31,221	(3)
Other	950	2,175	2,174	(1)
Total parks and recreation	338,107	347,839	345,621	(2,218)
Total culture and recreation	\$ 462,964	\$ 485,606	\$ 483,352	\$ (2,254)

AUDIT SECTION



SEIDEL, SCHROEDER & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS / BUSINESS ADVISORS

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hearne, Texas, (the "City") as of and for the year ended September 30, 2012, which collectively comprise the City's basic financial statements and have issued our report thereon dated March 27, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

schedule of findings and responses at 11-1 through 11-7 to be significant deficiencies. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the City, in a separate letter dated March 27, 2013.

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

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

March 27, 2013

Sindel, Schuster & Caring

CITY OF HEARNE
SCHEDULE OF FINDINGS AND RESPONSES
SEPTEMBER 30, 2012

Significant deficiencies

11-1 Segregation of duties for accounts payable

Condition and Criteria: Accounts payable invoices are received, coded, and posted by the Finance Assistant. She is also responsible for processing and mailing payments. Exposure is limited as other persons review invoices for approval and she has no signature authority.

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

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

11-2 Segregation of duties for general ledger

Condition and Criteria: The City does not maintain proper segregation of duties related to journal entry posting. The majority of preparation and approval is performed by the CFO.

Recommendation: The City Manager should continue to review journal entries posted by the CFO. In addition, the City Manager should review all entries prepared by the CFO and posted by other personnel.

Response: The City Manager will review all journal entries prepared and/or posted by the CFO.

11-3 Payroll

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

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

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