

11-4 Inventory

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

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

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

11-5 Accounts Receivable

Condition and Criteria: Our review of the accounts receivable subledger as of year end identified significant balances over 90 days old. The City continues transitioning into formalized disconnect policies to prevent deterioration of the accounts receivable balance and avoid the significant write offs experienced in the past due to lenient collection practices. In addition, other receivables include amounts that are no longer collectible. The City needs to estimate a reasonable allowance for doubtful accounts and record necessary adjustments as of year end.

Recommendation: The City should follow its new policies and procedures and also estimate and record adjustments to the allowance for doubtful accounts as deemed necessary.

Response: The City will follow its new policies and procedures.

11-6 Utility billing and receipts

Condition and Criteria: The utility billing clerk processes billings, adjustments and receipts. The City has now implemented a procedure to reconcile the system-generated adjustments report to the approved adjustments log.

Recommendation: Internal controls should be put in place to require review of adjustments posted by the utility billing clerk. This review should be documented and retained as evidence.

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

11-7 Transaction documentation

Condition and Criteria: A small grader and street paving were bartered in exchange for a City-owned grader. The City did not initially record the value of the small grader received in the exchange. Additionally, the invoice did not reflect the value of the paving performed in the exchange.

Recommendation: Transaction documents should clearly reflect the nature and amounts of such transactions. The transaction to trade the motor grader should reflect the value of the paving work performed, as well as any cash and other asset values to be exchanged for payment.

Response: In the future, documents will reflect the nature and amount of such transactions.

City of Hearne, Texas
Financial Statements with
Report of Independent Auditors
For the Fiscal Year Ended
September 30, 2011

City of Hearne, Texas
For the Fiscal Year Ended September 30, 2011

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For the Fiscal Year Ended September 30, 2011

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FINANCIAL SECTION



SEIDEL, SCHROEDER & COMPANY

CERTIFIED PUBLIC ACCOUNTANTS / BUSINESS ADVISORS

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying 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, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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, each major fund, and the aggregate remaining fund information of the City of Hearne, Texas, as of September 30, 2011, and the respective changes in financial position and, where applicable, cash flows, thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report April 12, 2012, on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grants 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 8, the Texas Municipal Retirement System analysis of funding progress on page 42, the Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget to Actual – for the 4A and 4B Sales Tax Special Revenue Funds on pages 43 and 44 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.

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 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

April 12, 2012

Seidel, Schneider & Company

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, 2011. Please read it in conjunction with the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

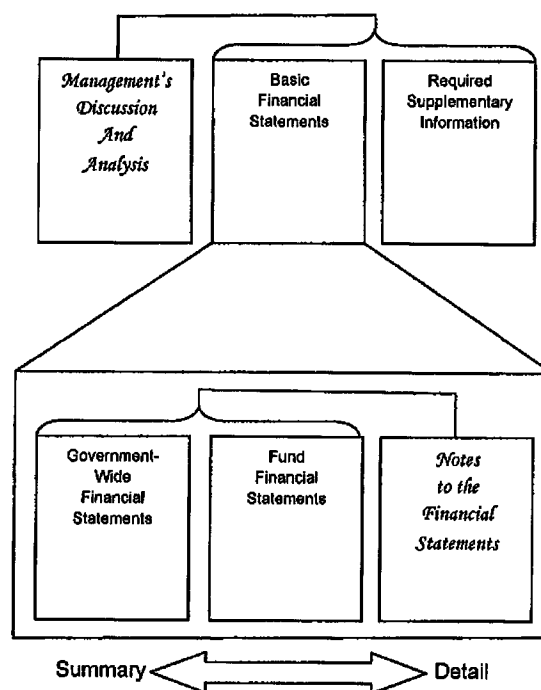
- The City's total combined net assets were \$9,334,113 at September 30, 2011. This represents an increase of 14.41% in the Governmental Activities and a decrease of 8.91% in Business Activities for an overall increase of 3.49%.
- During the year, the City's expenses were \$314,856 less than the \$11,813,837 generated in taxes, charges for service and other revenues for governmental and business-type activities. Comparatively, last year, the City's expenses were \$769,628 less than revenues of \$11,242,224.
- In the City's Business Activities, revenues increased by 6.2%, to \$9,404,139 with expenditures showing a corresponding increase of 8.59% to \$8,287,690.
- The Fund Balance surplus in the General Fund increased this year by \$276,568 to \$1,009,313.

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

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.



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 Assets	*Balance Sheet	*Statement of Net Assets	*Statement of Fiduciary Net Assets
	*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 Assets
			*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 assets 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 assets and how they have changed. Net assets, (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 assets 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 Assets
(In thousands of dollars)

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Current Assets						
Cash and Cash Equivalents	7.7	106.1	610.7	778.5	618.4	884.6
Inventories	-	-	143.1	174.9	143.1	174.9
Internal Balances	1,067.7	623.5	(1,067.7)	(623.5)	-	-
Receivables	485.3	448.5	1,687.2	1,356.6	2,172.5	1,805.1
Prepaid Items	9.8	23.3	9.6	-	19.4	23.3
Restricted Assets	1,814.9	1,844.3	0.5	0.5	1,815.4	1,844.8
Total Current Assets:	3,385.4	3,045.7	1,383.4	1,687.0	4,768.8	4,732.7
Noncurrent Assets						
Unamortized Bond Issuance Cost	-	-	77.6	266.0	77.6	266.0
Capital Assets	7,544.3	7,126.7	23,827.2	23,419.5	31,371.5	30,546.2
Less Accumulated Depreciation	(4,596.0)	(4,557.6)	(12,402.8)	(11,797.1)	(16,998.8)	(16,354.7)
Total Noncurrent Assets	2,948.3	2,569.1	11,502.0	11,888.4	14,450.3	14,457.5
Total Assets	6,333.7	5,614.8	12,885.4	13,575.4	19,219.1	19,190.2
Current Liabilities						
Accounts Payable	169.9	254.4	870.8	509.6	1,040.7	764.0
Accrued Expenses	56.4	46.7	31.1	88.4	87.5	135.1
Customer Deposits	0.6	0.3	271.1	246.9	271.7	247.2
Compensated Absences	5.7	0.8	9.0	-	14.7	0.8
Current Long-Term Debt	406.4	247.6	448.6	584.7	855.0	832.3
Total Current Liabilities	639.0	549.8	1,630.6	1,429.6	2,269.6	1,979.4
Long-Term Liabilities:						
Compensated Absences	104.0	76.2	33.0	29.2	137.0	105.4
Bonds	-	-	-	-	-	-
Notes Payable	29.6	50.6	-	-	29.6	50.6
Capital Leases	74.9	143.0	1,959.4	2,092.5	2,034.3	2,235.5
Certificates of Obligation	-	-	5,414.5	5,800.0	5,414.5	5,800.0
Total Long-Term Liabilities	208.5	269.8	7,406.9	7,921.7	7,615.4	8,191.5
Total Liabilities	847.5	819.6	9,037.5	9,351.3	9,885.0	10,170.9
Net Assets						
Invested in Capital Assets	2,437.4	2,127.9	3,601.9	3,411.2	6,039.3	5,539.1
Restricted	1,936.3	1,744.1	-	-	1,936.3	1,744.1
Unrestricted	1,112.5	923.2	246.0	812.9	1,358.5	1,736.1
Total Net Assets	5,486.2	4,795.2	3,847.9	4,224.1	9,334.1	9,019.3

The City's combined net assets increased by \$314,856, or 3.49%, to \$9,334,113 at September 30, 2011. Comparatively, last year, the City's combined net assets increased by \$769,628, or 9.33%. (See Table A-1)

The City's governmental activities net assets increased by 14.4% (almost \$5.5 million compared to \$4.8 million). Unrestricted net assets (the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements) increased from \$923,246 to \$1,112,474 at September 30, 2011.

The City's business-type activities net assets decreased by 8.91% (down to \$3.85 million from \$4.22 million).

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

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Program Revenues						
Charges for Services	289.8	299.3	8,788.1	8,354.8	9,077.9	8,654.1
Operating Grants	22.4	15.7	2.1	3.0	24.5	18.7
Capital Grants	92.8	164.1	242.7	277.1	335.5	441.2
General Revenues						
Ad Valorem Taxes	1,002.4	1,001.6	-	-	1,002.4	1,001.6
Sales Tax	747.4	649.6	-	-	747.4	649.6
Franchise Taxes	83.8	75.5	-	-	83.8	75.5
Other Taxes	121.4	139.8	-	-	121.4	139.8
Interest Income	9.9	10.6	1.2	1.6	11.1	12.2
Gain/(Loss) on Sale of Assets	16.5	9.3	2.0	-	18.5	9.3
Other	23.3	17.4	368.1	222.8	391.4	240.2
Total Revenues	2,409.7	2,382.9	9,404.2	8,859.3	11,813.9	11,242.2
Program Expenses:						
Legislature	25.7	10.6	-	-	25.7	10.6
Executive	205.1	192.7	-	-	205.1	192.7
Municipal Court	154.1	142.4	-	-	154.1	142.4
Library	154.7	143.8	-	-	154.7	143.8
Police Department	1,000.0	918.9	-	-	1,000.0	918.9
Animal Control	51.7	46.1	-	-	51.7	46.1
Fire Department	229.3	172.5	-	-	229.3	172.5
Building Inspector	9.8	11.2	-	-	9.8	11.2
Parks & Recreation	531.9	472.1	-	-	531.9	472.1
Streets Department	359.6	334.7	-	-	359.6	334.7
Finance / Administrative	314.7	274.2	-	-	314.7	274.2
Economic Development	152.3	94.5	-	-	152.3	94.5
Interest & Fiscal Charges	22.4	26.8	-	-	22.4	26.8
Enterprise Activities	-	-	8,287.7	7,632.1	8,287.7	7,632.1
Total Expenses	3,211.3	2,840.5	8,287.7	7,632.1	11,499.0	10,472.6
Increase (Decrease) in Net Assets	(801.6)	(457.6)	1,116.5	1,227.2	314.9	769.6
Transfers In (Out)	1,492.7	575.3	(1,492.7)	(575.3)	-	-
Change in Net Assets	691.1	117.7	(376.2)	651.9	314.9	769.6
Net Assets - Beginning	4,795.2	4,677.5	4,224.1	3,572.2	9,019.3	8,249.7
Net Assets - Ending	5,486.3	4,795.2	3,847.9	4,224.1	9,334.2	9,019.3

The total revenues for the City of Hearne were \$11,813,837, an increase of 5.08%. Total expenses were \$11,498,981. This resulted in an increase of net assets of \$314,856 (See Table A-2). The total cost of all programs and services, increased by \$1,026,409, or 9.8%, from last year.

Governmental Activities

Revenues for the City's governmental activities were stable, showing a slight increase of 1.12%, or \$26,779. Expenditures increased by 13.05%, or \$370,765, primarily due to increases in the following areas: Police personnel and maintenance, depreciation, 4 A & 4 B Economic Development Grants, Volunteer Fire Department payments, and Parks and Recreation activities. The cost of all governmental activities this year was \$3.21 million compared to \$2.84 million last year. This is due primarily to the General Fund activity.

Business-Type Activities

Revenues for the City's business-type activities increased by 6.15% this year (\$9,404,139 compared to \$8,859,281 last year). Expenses showed an increase of 8.59% this year (\$8,287,690 compared to \$7,632,046 last year). The City's management has been taking proactive steps to help with budgetary shortfalls. For the last two years, they have been collecting \$0.003 per kilowatt on the 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 asset position.

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 \$2,920,374, which is up from last year's total of \$2,476,619.

General Fund Budgetary Highlights

During the course of the year, the City revised its budget several times. These budget amendments fall into two 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 includes amendments at the end of the year to cover any foreseeable budget overruns.

Actual expenditures were \$137,674 less than final budget amounts, before audit adjustments. After audit adjustments, final expenses exceeded the final budget by \$20,940, with expenditures exceeding the budget in nine departments.

The most significant budget variances were as follows:

Property tax revenues exceeded the budgeted amount by \$52,303. This is primarily due to our budget being calculated based on collecting less than 100% of assessed property taxes. Collections this year, exceeded our expectations, and therefore exceeded our budget projections. However, this is variance is in our favor.

Sales tax revenues exceeded the budgeted amount by \$10,488. Sales on our local level performed close to expectations. This variance is also in our favor.

Expenditures in the Smith-Welch Library finalized \$12,484 above budget. The primary reason for this, is the upgrades to the computer hardware and operating systems that were not anticipated when the budget was prepared. The Library upgraded their operating system, had to replace their server, and added two computer literacy stations.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

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

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Capital Assets						
Land	142.3	142.3	61.6	61.6	203.9	203.9
Construction in Progress	-	462.5	277.8	-	277.8	462.5
Buildings and Improvements	4,921.2	4,587.2	888.0	888.0	5,809.2	5,475.2
Improvements Other than Buildings	678.4	176.5	-	-	678.4	176.5
Equipment	908.2	743.8	49.8	49.8	958.0	793.6
Vehicles	889.0	1,009.2	218.3	227.9	1,107.3	1,237.1
Furniture and Office Equipment	5.2	5.1	281.9	225.3	287.1	230.4
Airport	-	-	-	798.7	-	798.7
Distribution and Collection Systems	-	-	22,049.8	21,168.2	22,049.8	21,168.2
Totals at Historical Cost	7,544.3	7,126.6	23,827.2	23,419.5	31,371.5	30,546.1
Total Accumulated Depreciation	(4,596.0)	(4,557.6)	(12,402.8)	(11,797.1)	(16,998.8)	(16,354.7)
Net Capital Assets	2,948.3	2,569.0	11,424.4	11,622.4	14,372.7	14,191.4

At the end of 2011, the City had invested \$31,371,502 in a broad range of capital assets, including land, buildings, park facilities, roads, bridges, equipment and vehicles, water lines, sewer lines, waste water treatment facilities, and electric lines. (See Table A-3) This amount represents an increase of \$825,253, or 2.7%, over last year.

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

Governmental

Clubhouse Renovation	Funded By 4B Sales Tax Board	26.8
Swimming Pool Recoating and Split Drains	Funded By Equipment Loan – First Star Bank	27.9
John Deere 5083 Tractor - Parks Dept	Funded By Equipment Loan – First Star Bank	35.3
Fairway Mower for Golf Course	Funded By Equipment Loan – First Star Bank	37.0
Radio System – Police Dept	Funded By Technology Grant	42.4
Baseball Complex – Fence, Irrigation, Bleachers	Funded By 4B Sales Tax & Within Budget	74.3
4 Chevrolet Tahoe's – Police Dept	Funded By Equipment Loan – First Star Bank	130.0
Depot Improvements	Funded By FHWA Grant thru TX DOT	204.9
Street Improvements	Funded From Reserves	231.8

Business-Type Activities

Extend Water Line on 8 th Street	Funded Within Budget	23.6
Backup Generator for City Hall	Funded By Equipment Loan – First Star Bank	27.8
2010 Sewer Line Improvements	TDRA Sustainability Grant	253.7

Long-Term Debt

At year end, the City had \$8,333,391 in Long Term Debt outstanding. This included \$5.9 million in Bonds and Certificates of Obligation. This compares to \$6.26 million in Bonds and Certificates last year and is a 5.6% reduction in these debt instruments. (Table A-4)

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

	Governmental Activities		Business-type Activities		Total		Change
	2011	2010	2011	2010	2011	2010	2010 - 2011
Long Term-Debt							
Bonds	-	-	-	375.0	-	375.0	(375.0)
Certificates of Obligation	-	-	5,905.0	5,880.0	5,905.0	5,880.0	25.0
Deferred Bond Charges	-	-	(234.7)	-	(234.7)	-	(234.7)
Notes Payable	367.9	223.6	51.0	-	418.9	223.6	195.3
Leases Payable	143.0	217.5	2,101.2	2,222.2	2,244.2	2,439.7	(195.5)
Total Long-Term Debt	510.9	441.1	7,822.5	8,477.2	8,333.4	8,918.3	(584.9)

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. This is quite unusual for a bond rating to be raised twice in such a short time. The City is proud of this accomplishment. 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 2011-2012 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 four years, two hotels, an upscale restaurant, a large truck stop, and a new bank have been built. Since the close of this Fiscal Year, a new medical clinic has been started, completed and placed in operation. These new businesses increase not only the tax base for property taxes, but also provide many new jobs for the citizens, as well as a reason for new people to move to Hearne. Other businesses continue to show interest in relocating to Heane. This growth is also evident with small, locally owned businesses as well.

In 2010, the City of Hearne was awarded a \$250,000 TDRA "Sustainability" Grant to further improve the sewer system. Construction under this grant began in July 2011 and was completed in October 2011.

The City was also awarded another \$250,000 grant from TDRA, through Robertson County, for necessary improvements to the Humble Water System which was recently acquired by the City. Construction on this project began October 3, 2011 and will be completed within the Fiscal Year of 2011-2012.

After taking all factors into consideration, the City adopted a \$10.7 million budget for Fiscal Year 2011-2012. Broken down, this is \$3.3 million for the General Fund and \$7.4 million for the Enterprise Fund. This compares to \$3.5 million and \$8.2 million respectively for fiscal year 2010-2011. This new budget is a 5.7% decrease for the General Fund and 9.8% decrease 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 questions about this report or need additional financial information, contact the City's Finance Department.

City of Hearne, Texas
Statement of Net Assets
September 30, 2011

	Primary Government		
	Governmental Activities	Business-Type Activities	Total
Assets			
Cash and equivalents	\$ 7,647	\$ 610,703	\$ 618,350
Receivables (net of allowance for uncollectibles):			
Taxes	454,301	-	454,301
Accounts	30,969	1,687,181	1,718,150
Internal balances	1,067,705	(1,067,705)	-
Inventory	-	143,081	143,081
Other assets	9,843	9,609	19,452
Unamortized bond issue costs	-	77,648	77,648
Temporarily restricted assets:			
Cash	1,676,152	510	1,676,662
Investments	138,784	-	138,784
Capital assets:			
Non-depreciable	142,319	339,410	481,729
Depreciable, net	2,806,000	11,084,958	13,890,958
Total assets	6,333,720	12,885,395	19,219,115
Liabilities			
Accounts payable	169,866	793,770	963,636
Salaries payable	56,203	27,934	84,137
State tax payable	-	27,225	27,225
Other payables	-	21,911	21,911
Accrued liabilities	-	31,116	31,116
Accrued interest payable	209	-	209
Deposits	600	271,080	271,680
Liability for compensated absences:			
Due within one year	5,715	8,960	14,675
Due in more than one year	103,992	33,030	137,022
Non-current liabilities:			
Due within one year	406,406	448,628	855,034
Due in more than one year	104,504	7,373,853	7,478,357
Total liabilities	847,495	9,037,507	9,885,002
Net Assets			
Invested in capital assets, net of related debt	2,437,409	3,601,887	6,039,296
Restricted for:			
Police department	11,583	-	11,583
Economic development	1,924,759	-	1,924,759
Unrestricted (deficit)	1,112,474	246,001	1,358,475
Total net assets	\$ 5,486,225	\$ 3,847,888	\$ 9,334,113

City of Hearn, Texas
Statement of Activities
For the Year Ended September 30, 2011

Program Activities	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets		
	Expenses	Fees, Fines and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		
					Governmental Activities	Business-type Activities	Total
Primary government:							
Governmental activities:							
General government	\$ 699,599	\$ 13,790	\$ 22,414	\$ -	\$ (663,395)	\$ -	\$ (663,395)
Public safety	1,229,354	232,651	-	86,256	(910,447)	-	(910,447)
Highways and streets	359,588	-	-	-	(359,588)	-	(359,588)
Health and welfare	61,429	-	-	6,523	(54,906)	-	(54,906)
Culture and recreation	838,889	43,337	-	-	(795,552)	-	(795,552)
Interest on long-term debt	22,432	-	-	-	(22,432)	-	(22,432)
Total governmental activities	3,211,291	289,778	22,414	92,779	(2,806,320)	-	(2,806,320)
Business-type activities:							
Water	625,965	1,355,737	-	-	-	729,772	729,772
Electric	5,971,250	6,207,449	-	-	-	236,199	236,199
Sewer	956,390	554,532	-	242,708	-	(159,150)	(159,150)
Sanitation	684,665	646,838	-	-	-	(37,827)	(37,827)
Municipal airport	49,420	23,507	2,058	-	-	(23,855)	(23,855)
Total business-type activities	8,287,690	8,788,063	2,058	242,708	-	745,139	745,139
Total primary government	\$ 11,498,981	\$ 9,077,841	\$ 24,472	\$ 335,487	(2,806,320)	745,139	(2,061,181)
General revenues:							
Taxes:							
Property taxes					1,002,378	-	1,002,378
Sales taxes					747,428	-	747,428
Gross receipts					83,813	-	83,813
Hotel/motel occupancy					121,395	-	121,395
Rentals					-	148,357	148,357
Investment earnings					9,920	1,151	11,071
Gain on sale of assets					16,459	1,976	18,435
Miscellaneous					23,334	219,826	243,160
Transfers					1,492,685	(1,492,685)	-
Total general revenues and transfers					3,497,412	(1,121,375)	2,376,037
Change in net assets					691,092	(376,236)	314,856
Net assets at beginning of the year					4,795,133	4,224,124	9,019,257
Net assets at end of year					\$ 5,486,225	\$ 3,847,888	\$ 9,334,113

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

City of Hearne, Texas
Balance Sheet
Governmental Funds
September 30, 2011

	General	4A Sales Tax Fund	4B Sales Tax Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Cash	\$ 7,647	\$ -	\$ -	\$ -	\$ 7,647
Receivables:					
Taxes	362,876	34,313	34,314	22,798	454,301
Accounts	20,969	10,000	-	-	30,969
Due from other funds	831,550	294,324	175,151	-	1,301,025
Other assets	233	-	-	-	233
Restricted assets:					
Cash	170,405	586,035	864,139	55,573	1,676,152
Investments	106	138,678	-	-	138,784
Total assets	\$ 1,393,786	\$ 1,063,350	\$ 1,073,604	\$ 78,371	\$ 3,609,111
Liabilities and fund balances					
Liabilities:					
Accounts payable	\$ 98,921	\$ 49,922	\$ 3,745	\$ 17,278	\$ 169,866
Salaries payable	61,917	-	-	-	61,917
Deposits	600	-	-	-	600
Deferred revenues	223,034	-	-	-	223,034
Due to other funds	-	74,540	83,988	74,792	233,320
Total liabilities	384,472	124,462	87,733	92,070	688,737
Fund balances:					
Nonspendable					
Prepaid postage	233	-	-	-	233
Restricted for:					
Debt Service	79,781	-	-	-	79,781
Court security	55,198	-	-	-	55,198
Court technology	33,873	-	-	-	33,873
Fire truck	1,659	-	-	-	1,659
4A and 4B Sales Tax	-	938,888	985,871	-	1,924,759
Police	-	-	-	12,643	12,643
Unassigned (deficit) reported in:					
General fund	838,570	-	-	-	838,570
Hotel/Motel Tax Fund	-	-	-	(26,342)	(26,342)
Total fund balances	1,009,314	938,888	985,871	(13,699)	2,920,374
Total liabilities and fund balances	\$ 1,393,786	\$ 1,063,350	\$ 1,073,604	\$ 78,371	\$ 3,609,111

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 Assets
Governmental Funds
September 30, 2011

Fund balances - total governmental funds \$ 2,920,374

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	7,544,362	
Less accumulated depreciation	<u>(4,596,043)</u>	2,948,319

Deferred revenues reported in the governmental funds are recognized
as revenues for the governmental activities. 223,034

Other long term assets are not available to pay for current period
expenditures and therefore are deferred in the governmental funds. 9,609

Long-term liabilities are not due and payable in the current year and
therefore are not reported in the governmental funds. (615,111)

Net assets of governmental activities \$ 5,486,225

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, 2011

	General	4A Sales Tax Fund	4B Sales Tax Fund	Other Governmental Funds	Total Governmental Funds
Revenues:					
Taxes:					
Property	\$ 1,034,041	\$ -	\$ -	\$ -	\$ 1,034,041
Sales	364,888	191,270	191,270	-	747,428
Gross receipts	83,813	-	-	-	83,813
Hotel/motel occupancy	-	-	-	121,395	121,395
Intergovernmental	84,187	-	-	8,673	92,860
Licenses and permits	13,790	-	-	-	13,790
Property rentals	43,337	-	-	-	43,337
Fines	232,651	-	-	-	232,651
Investment income	1,763	4,089	3,984	84	9,920
Private contributions	22,333	-	-	-	22,333
Miscellaneous	23,283	-	-	-	23,283
Total revenues	1,904,086	195,359	195,254	130,152	2,424,851
Expenditures:					
Current:					
General government	646,968	-	-	-	646,968
Public safety	1,142,710	-	-	1,090	1,143,800
Highways and streets	324,871	-	-	-	324,871
Health and welfare	61,429	-	-	-	61,429
Culture and recreation	494,665	122,218	30,081	80,636	727,600
Capital outlay	663,751	-	-	12,523	676,274
Debt service:					
Principal	121,029	-	-	51,269	172,298
Interest and fiscal charges	12,650	-	-	9,782	22,432
Total expenditures	3,468,073	122,218	30,081	155,300	3,775,672
Excess (deficiency) of revenues over (under) expenditures	(1,563,987)	73,141	165,173	(25,148)	(1,350,821)
Other financing sources (uses):					
Proceeds from sale of capital assets	59,900	-	-	-	59,900
Proceeds from long term debt	241,991	-	-	-	241,991
Transfers in	1,538,664	-	-	-	1,538,664
Transfers out	-	(30,000)	(15,979)	-	(45,979)
Total other financing sources (uses)	1,840,555	(30,000)	(15,979)	-	1,794,576
Net change in fund balances	276,568	43,141	149,194	(25,148)	443,755
Fund balances at beginning of year	732,745	895,747	836,677	11,450	2,476,619
Fund balances at end of year	\$ 1,009,313	\$ 938,888	\$ 985,871	\$ (13,698)	\$ 2,920,374

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, 2011

Net changes in fund balances - total governmental funds \$ 443,755

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	\$ 676,274	
Depreciation of capital assets	<u>(253,615)</u>	422,659

The net effect of various miscellaneous transactions involving capital assets (i.e., sales, trade-ins, and donations) is to increase net assets. (43,441)

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 revenue. (31,663)

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. (69,642)

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. (30,576)

Change in net assets of governmental activities	<u><u>\$ 691,092</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 fiscal year ended September 30, 2011

	Budgeted Amounts			Variance with Final Budget Over (Under)
	Original	Final	Actual	
Revenues:				
Taxes:				
Property	\$ 981,738	\$ 981,738	\$ 1,034,041	\$ 52,303
Sales	354,400	354,400	364,888	10,488
Gross receipts	95,000	95,000	83,813	(11,187)
Licenses and permits	13,000	13,000	13,790	790
Property rentals	37,000	37,000	43,337	6,337
Fines	229,300	229,300	232,651	3,351
Intergovernmental	-	-	84,187	84,187
Investment income	3,000	3,000	1,763	(1,237)
Private contributions	6,800	16,834	22,333	5,499
Miscellaneous	15,200	15,200	23,283	8,083
Total revenues	1,735,438	1,745,472	1,904,086	158,614
Expenditures:				
Current:				
General government:				
Legislative	20,990	24,814	24,861	47
Executive	182,061	199,225	199,413	188
Finance	285,361	277,478	278,350	872
Court	139,065	141,920	144,344	2,424
Total general government	627,477	643,437	646,968	3,531
Public safety:				
Police	935,558	935,989	938,863	2,874
Fire	90,573	205,776	203,847	(1,929)
Total public safety	1,026,131	1,141,765	1,142,710	945
Highways and streets	484,465	324,258	324,871	613
Health and welfare:				
Code enforcement	12,766	12,766	9,756	(3,010)
Animal control	51,509	51,509	51,673	164
Total health and welfare	64,275	64,275	61,429	(2,846)
Culture and recreation:				
Library	141,027	138,185	150,669	12,484
Parks and recreation	293,004	339,436	343,996	4,560
Total culture and recreation	434,031	477,621	494,665	17,044
Capital outlay	338,500	662,095	663,751	1,656
Debt service:				
Principal	144,589	118,928	121,029	2,101
Interest	24,781	14,754	12,650	(2,104)
Total debt service	169,370	133,682	133,679	(3)
Total expenditures	3,144,249	3,447,133	3,468,073	20,940
Excess (deficiency) of revenues over (under) expenditures	(1,408,811)	(1,701,661)	(1,563,987)	137,674
Other financing sources (uses):				
Proceeds from sale of capital assets	15,000	55,000	59,900	4,900
Proceeds from long term debt	300,000	300,000	241,991	(58,009)
Transfers in	1,316,016	1,347,488	1,538,664	191,176
Transfers out	(423,000)	(201,622)	-	201,622
Total other financing sources (uses)	1,208,016	1,500,866	1,840,555	339,689
Net change in fund balances	(200,795)	(200,795)	276,568	477,363
Fund balances at beginning of year	732,745	732,745	732,745	-
Fund balances at end of year	\$ 531,950	\$ 531,950	\$ 1,009,313	\$ 477,363

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, 2011

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Assets			
Current assets:			
Cash and equivalents	\$ 569,561	\$ 41,142	\$ 610,703
Accounts receivable (net of allowance for uncollectible)	1,681,968	5,213	1,687,181
Inventory	143,081	-	143,081
Other assets	9,609	-	9,609
Restricted cash	510	-	510
Total current assets	<u>2,404,729</u>	<u>46,355</u>	<u>2,451,084</u>
Unamortized bond issuance cost	77,647	-	77,647
Capital assets:			
Land	61,634	-	61,634
Buildings and other improvements	270,109	788,038	1,058,147
Distribution and collection systems	20,749,846	-	20,749,846
Equipment	1,669,032	10,706	1,679,738
Construction in progress	276,858	918	277,776
	<u>23,027,479</u>	<u>799,662</u>	<u>23,827,141</u>
Less: accumulated depreciation	<u>(12,130,545)</u>	<u>(272,227)</u>	<u>(12,402,772)</u>
Capital assets, net of accumulated depreciation	<u>10,896,934</u>	<u>527,435</u>	<u>11,424,369</u>
Total non-current assets	<u>10,974,581</u>	<u>527,435</u>	<u>11,502,016</u>
Total assets	<u>\$ 13,379,310</u>	<u>\$ 573,790</u>	<u>\$ 13,953,100</u>
Liabilities			
Current liabilities:			
Accounts payable	\$ 791,084	\$ 2,686	\$ 793,770
Salaries payable	27,934	-	27,934
Sales tax payable	27,225	-	27,225
Other payables	21,911	-	21,911
Accrued liabilities	31,116	-	31,116
Liability for compensated absences	8,960	-	8,960
Due to other funds	1,067,705	-	1,067,705
Customer deposits payable	271,080	-	271,080
Long-term debt, current	448,628	-	448,628
Total current liabilities	<u>2,695,643</u>	<u>2,686</u>	<u>2,698,329</u>
Long-term liabilities:			
Long-term debt, net	7,373,853	-	7,373,853
Liability for compensated absences	33,030	-	33,030
Total long-term liabilities	<u>7,406,883</u>	<u>2,686</u>	<u>7,409,569</u>
Total liabilities	<u>10,102,526</u>	<u>2,686</u>	<u>10,105,212</u>
Net Assets			
Invested in capital assets, net of related debt	3,074,453	527,435	3,601,888
Unrestricted	202,331	43,669	246,000
Total net assets	<u>\$ 3,276,784</u>	<u>\$ 571,104</u>	<u>\$ 3,847,888</u>

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, 2011

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Operating revenues:			
Charges for sales and services:			
Water sales	\$ 1,355,737	\$ -	\$ 1,355,737
Electric sales	6,207,449	-	6,207,449
Sewer charges	554,532	-	554,532
Sanitation	646,838	-	646,838
Rental fees	148,357	22,025	170,382
Intergovernmental	242,708	2,058	244,766
Penalties	124,648	-	124,648
Miscellaneous revenue	95,178	1,482	96,660
Total operating revenues	<u>9,375,447</u>	<u>25,565</u>	<u>9,401,012</u>
Operating expenses:			
Wholesale utilities	5,093,174	-	5,093,174
Water department	508,137	-	508,137
Electric department	359,847	-	359,847
Sewer department	420,686	-	420,686
Sanitation department	63,551	-	63,551
Administrative and billing	729,801	-	729,801
Airport	-	17,898	17,898
Depreciation	612,514	31,522	644,036
Total operating expenses	<u>7,787,710</u>	<u>49,420</u>	<u>7,837,130</u>
Operating income (loss)	<u>1,587,737</u>	<u>(23,855)</u>	<u>1,563,882</u>
Nonoperating revenues (expense):			
Gain on sale of assets	1,976	-	1,976
Investment income	1,151	-	1,151
Interest expense	(450,560)	-	(450,560)
Total nonoperating revenues (expense)	<u>(447,433)</u>	<u>-</u>	<u>(447,433)</u>
Income (loss) before transfers	1,140,304	(23,855)	1,116,449
Transfers in	-	7,369	7,369
Transfers out	(1,500,054)	-	(1,500,054)
Total other financing sources (uses)	<u>(1,500,054)</u>	<u>7,369</u>	<u>(1,492,685)</u>
Change in net assets	(359,750)	(16,486)	(376,236)
Net assets, beginning of the year	3,636,534	587,590	4,224,124
Net assets, end of the year	<u>\$ 3,276,784</u>	<u>\$ 571,104</u>	<u>\$ 3,847,888</u>

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, 2011

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Cash flows from operating activities:			
Cash received from customers	\$ 9,069,989	\$ 24,627	\$ 9,094,616
Cash payments to suppliers for goods and services	(5,757,165)	9,146	(5,748,019)
Cash payments to employees for services	(685,655)	-	(685,655)
Net cash provided by (used in) operating activities	<u>2,627,169</u>	<u>33,773</u>	<u>2,660,942</u>
Cash flows from non-capital financing activities:			
Transfers in	-	7,369	7,369
Transfers out	(1,500,054)	-	(1,500,054)
Net cash provided by (used in) non-capital financing activities	<u>(1,500,054)</u>	<u>7,369</u>	<u>(1,492,685)</u>
Cash flows from capital and related financing activities:			
Acquisition of capital assets	(413,402)	-	(413,402)
Proceeds from sale of assets	1,976	-	1,976
Interest paid	(425,845)	-	(425,845)
Principal payments	(610,037)	-	(610,037)
Proceeds of long term debt issuance	110,091	-	110,091
Net cash provided by (used in) capital and related financing activities	<u>(1,337,217)</u>	<u>-</u>	<u>(1,337,217)</u>
Cash flows from investing activities:			
Interest on cash and investments	1,151	-	1,151
Net increase (decrease) in cash and equivalents	(208,951)	41,142	(167,809)
Cash and equivalents, beginning of year	779,022	-	779,022
Cash and equivalents, end of year	<u>\$ 570,071</u>	<u>\$ 41,142</u>	<u>\$ 611,213</u>
Reconciliation of cash and equivalents:			
Unrestricted cash and equivalents	\$ 569,561	\$ 41,142	\$ 610,703
Restricted cash and investments	510	-	510
Total cash and equivalents	<u>\$ 570,071</u>	<u>\$ 41,142</u>	<u>\$ 611,213</u>

(continued)

City of Hearne, Texas
Statement of Cash Flows
Proprietary Funds
For the fiscal year ended September 30, 2011

	Enterprise Fund	Nonmajor Fund Municipal Airport Fund	Total
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:			
Operating income (loss)	\$ 1,587,737	\$ (23,855)	\$ 1,563,882
Adjustments to reconcile to net cash provided by operating activities:			
Depreciation and amortization	580,838	30,604	611,442
Bad debt expense	59,979	-	59,979
Increase (decrease) in cash resulting from changes in assets and liabilities:			
Accounts receivable	(389,636)	(938)	(390,574)
Inventory	31,835	-	31,835
Due from other funds	36,268	27,227	63,495
Prepays	(9,609)	-	(9,609)
Due to other funds	381,100	(426)	380,674
Accounts payable	283,007	1,161	284,168
Salaries payable	4,586	-	4,586
Sales tax payable	2,204	-	2,204
Liability for compensated absences	12,750	-	12,750
Customer deposits	24,199	-	24,199
Other payables	21,911	-	21,911
Net cash provided by (used in) operating activities	<u>\$ 2,627,169</u>	<u>\$ 33,773</u>	<u>\$ 2,660,942</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, 2011

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 more significant of the City's accounting policies are described below.

A. Reporting Entity

The City is a home-rule city governed by an elected mayor and 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 generally are 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
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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, 2011

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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

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 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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

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

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.

City of Hearne, Texas
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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 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.

City of Hearne, Texas
Notes to Basic Financial Statements
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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 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

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

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 include 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 \$26,341 at year end. The government has budgeted for recovery of the deficit balance in the next fiscal year.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

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 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

City of Hearne, Texas
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September 30, 2011

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.

Compliance with Finance Related Legal and Contractual Provisions. During the fiscal year under review, the City did not document in the Council minutes the approval of all budget amendments. The City will ensure that all budget amendments are properly documented in the minutes.

Excess of Expenditures/Expenses Over Appropriations. Expenditures/expenses exceeded appropriations at the legal level of budgetary control by \$47 for the Legislative department, \$188 for the Executive department, \$872 for the Finance department, \$2,424 for Court, \$2,874 for Police, \$613 for Highways and Streets, \$164 for Animal Control, \$12,484 for Library, and \$4,560 for Parks and Recreations, totaling \$24,226 for the General Fund. Additionally, expenditure/expenses exceeded appropriations at the legal level of budgetary control by \$12,454 for Water, \$4,626 for Electric, \$42,613 for Sewer, \$3,072 for Sanitation, totaling \$62,765 for the Enterprise Fund.

Note 3. Deposits and Investments

The City maintains a cash pool that is available for use by 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 Victoria National Bank.

As of September 30, 2011, the City had investments in TexSTAR with maturities less than 60 days with a fair value of \$558,744. Additionally, the City held a certificate of deposit totaling approximately \$139,000 which had a 12 month maturity period.

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

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

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 certificate of deposit. As of September 30, 2011, 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, 2011.

Note 4. Restricted Assets

At September 30, 2011, restrictions on cash and investments were as follows:

	Governmental Funds	Proprietary Funds
<u>Cash and Investments</u>		
Restricted for:		
Hotel/motel		
expenditures	\$ 42,930	\$ -
4A Sales Tax	724,713	-
4B Sales Tax	864,139	-
Police Special	12,643	-
Interest and sinking	79,781	-
Fire trucks	1,659	-
Court security	55,198	-
Court technology	33,873	-
Community Development		
Block Grant Program	-	510
	<u>\$ 1,814,936</u>	<u>\$ 510</u>

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

Note 5. Receivables

Receivables at September 30, 2011, consist of the following:

	<u>Governmental Funds</u>	<u>Proprietary Funds</u>
Receivables:		
Taxes:		
Property	\$ 293,783	\$ -
Sales	137,720	-
Hotel/motel occupancy	22,798	-
Accounts	30,969	2,352,527
Grants	-	250,077
Less:		
Allowance for uncollectibles	-	(915,423)
Net total receivables	<u>\$ 485,270</u>	<u>\$ 1,687,181</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, 2011

Note 6. Capital Assets

The following is a summary of capital asset activity during the year ended September 30, 2011:

	Beginning Balance	Additions/ Completions	Retirements/ Adjustments	Ending Balance
Governmental activities				
Capital assets not being depreciated				
Land	\$ 142,319	\$ -	\$ -	\$ 142,319
Construction in progress	462,478	(462,478)	-	-
Total capital assets not being depreciated	604,797	(462,478)	-	142,319
Capital assets being depreciated				
Buildings	4,587,263	333,959	-	4,921,222
Improvements other than buildings	176,547	501,900	-	678,447
Furniture and fixtures	5,171	-	-	5,171
Vehicles	1,009,182	138,453	258,642	888,993
Machinery and equipment	743,772	164,438	-	908,210
Total at historical cost	6,521,935	1,138,750	258,642	7,402,043
Less: accumulated depreciation for:				
Buildings	3,289,226	85,183	-	3,374,409
Improvements other than buildings	22,344	32,353	-	54,697
Furniture and fixtures	2,758	1,034	-	3,792
Vehicles	717,164	83,499	215,201	585,462
Machinery and equipment	526,140	51,543	-	577,683
Total accumulated depreciation	4,557,632	253,612	215,201	4,596,043
Total capital assets being depreciated, net	1,964,303	885,138	43,441	2,806,000
Governmental activities capital assets, net	\$ 2,569,100	\$ 422,660	\$ 43,441	\$ 2,948,319
	Beginning Balance	Additions/ Completions	Retirements/ Adjustments	Ending Balance
Business-type activities				
Capital assets not being depreciated				
Land	\$ 61,634	\$ -	\$ -	\$ 61,634
Construction in progress	-	277,776	-	277,776
Total capital assets not being depreciated	61,634	277,776	-	339,410
Capital assets being depreciated				
Buildings and improvements	887,990	-	-	887,990
Furniture and fixtures	225,257	56,623	-	281,880
Vehicles	227,858	-	9,566	218,292
Distribution and collection systems	21,966,992	82,790	-	22,049,782
Machinery and equipment	49,786	-	-	49,786
Total at historical cost	23,357,883	139,413	9,566	23,487,730
Less: accumulated depreciation for:				
Buildings and improvements	287,388	35,520	-	322,908
Furniture and fixtures	215,266	6,442	-	221,708
Vehicles	95,449	29,256	6,696	118,009
Distribution and collection systems	11,183,512	536,404	-	11,719,916
Machinery and equipment	15,493	4,738	-	20,231
Total accumulated depreciation	11,797,108	612,360	6,696	12,402,772
Total capital assets being depreciated, net	11,560,775	(472,947)	2,870	11,084,958
Business-type activities capital assets, net	\$ 11,622,409	\$ (195,171)	\$ 2,870	\$ 11,424,368

City of Hearne, Texas
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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	85,555
Highways and streets	34,717
Culture and recreation	111,289
Total depreciation expense - Governmental activities	<u>\$ 253,615</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, 2011:

	Balance 09/30/10	Additions	Retirements	Balance 09/30/11	Due Within One Year	Long Term
Governmental activities						
Lease payable - LaSalle	\$ 9,051	\$ -	\$ (9,051)	\$ -	\$ -	\$ -
Lease payable - National City	81,787	-	(35,337)	46,450	36,950	9,500
Lease payable - TYMCO	126,709	-	(30,152)	96,557	31,147	65,410
Subtotal of leases payable	217,547	-	(74,540)	143,007	68,097	74,910
First Victoria Bank - Library	60,527	-	(20,160)	40,367	10,773	29,594
First Star Bank - Depot	163,097	-	(51,269)	111,828	111,828	-
First Star Bank - Equipment	-	241,991	(26,283)	215,708	215,708	-
Subtotal of other debt	223,624	241,991	(97,712)	367,903	338,309	29,594
Total governmental	<u>\$ 441,171</u>	<u>\$ 241,991</u>	<u>\$ (172,252)</u>	<u>\$ 510,910</u>	<u>\$ 406,406</u>	<u>\$ 104,504</u>

	Balance 09/30/10	Refunded	Additions	Retirements	Balance 09/30/11	Due Within One Year	Long Term
Business type activities							
Lease payable - LaSalle	\$ 1,981		\$ -	\$ (1,981)	\$ -	\$ -	\$ -
Lease payable - National City	64,329		-	(27,794)	36,535	29,068	7,467
Lease payable - Southside	1,655,367		-	(83,033)	1,572,334	87,805	1,484,529
Lease payable - AEP	500,474		-	(16,856)	483,618	21,307	462,311
Lease payable - Western	-		28,510	(19,771)	8,739	3,695	5,044
Subtotal of leases payable	2,222,151		28,510	(149,435)	2,101,226	141,875	1,959,351
2004 General obligation bonds	375,000	-	-	(375,000)	-	-	-
2004 Certificates of obligation	5,880,000	(5,800,000)	-	(80,000)	-	-	-
2011 General obligation refunding	-		5,905,000	-	5,905,000	270,000	5,635,000
Subtotal of bonds payable	6,255,000	(5,800,000)	5,905,000	(455,000)	5,905,000	270,000	5,635,000
First Star Bank - Equipment	-		56,405	(5,426)	50,979	50,979	-
Subtotal of other debt	-		56,405	(5,426)	50,979	50,979	-
Deferred charges on bonds	-	(241,836)	-	7,113	(234,724)	(14,226)	(220,498)
Total proprietary	<u>\$ 8,477,151</u>	<u>\$ (6,041,836)</u>	<u>\$ 5,989,915</u>	<u>\$ (602,748)</u>	<u>\$ 7,822,481</u>	<u>\$ 448,628</u>	<u>\$ 7,373,853</u>

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

The annual aggregate maturities for each debt type for the years subsequent to September 30, 2011 are as follows:

Year ending September 30	Business-type Activities				Governmental Activities	
	Bonds Payable		Notes Payable		Notes Payable	
	Principal	Interest	Principal	Interest	Principal	Interest
2012	\$ 270,000	\$ 187,033	\$ 50,979	\$ 3,059	\$ 338,309	\$ 21,071
2013	280,000	178,223	-	-	11,212	980
2014	285,000	168,618	-	-	11,668	524
2015	290,000	158,843	-	-	6,715	87
2016	300,000	151,213	-	-	-	-
2017-2021	1,620,000	647,449	-	-	-	-
2022-2026	1,960,000	365,015	-	-	-	-
2027-2028	900,000	36,180	-	-	-	-
	<u>\$ 5,905,000</u>	<u>\$ 1,892,571</u>	<u>\$ 50,979</u>	<u>\$ 3,059</u>	<u>\$ 367,903</u>	<u>\$ 22,662</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. The reacquisition price exceeded the net carrying value of the old debt by \$241,836. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt. This advance refunding was undertaken to reduce total debt service payments over the next 17 years by \$355,599 and resulted in an economic gain of \$274,763.

During the year ended September 30, 2011, the following changes occurred in other long-term liabilities:

	Balance 09/30/10	Additions (Reductions)	Balance 09/30/11	Due Within One Year
Governmental activities				
Compensated absences	<u>\$ 77,018</u>	<u>\$ 32,689</u>	<u>\$ 109,707</u>	<u>\$ 5,715</u>
Business type activities				
Compensated absences	<u>\$ 29,240</u>	<u>\$ 12,750</u>	<u>\$ 41,990</u>	<u>\$ 8,960</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.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

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.

The assets acquired through the capital leases are as follows:

<u>Asset Class</u>	<u>Governmental Activities</u>	<u>Business type Activities</u>
Vehicles	\$ 102,257	\$ 96,861
Machinery and equipment	44,128	39,410
Buildings	-	-
Distribution and collection system	-	2,453,435
Cost basis	146,385	2,589,706
Less: Accumulated depreciation	(65,945)	(575,495)
Total net asset	<u>\$ 80,440</u>	<u>\$ 2,014,211</u>

The total future minimum lease payments and the net present value of these minimum payments as of September 30, 2011 were as follows:

<u>Year ending September 30</u>	<u>Governmental Activities</u>	<u>Business-type Activities</u>
2012	\$ 72,105	\$ 341,438
2013	43,394	318,852
2014	33,824	308,132
2015	-	307,069
2016	-	307,069
2017-2021	-	1,266,081
2022-2026	-	462,782
Total minimum lease payments	149,323	3,311,421
Less: Amount representing interest	(6,316)	(1,210,196)
Present value of minimum payments	<u>\$ 143,007</u>	<u>\$ 2,101,226</u>

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

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

Note 10. Interfund Receivables and Payables

Interfund receivables and payables, all of which are considered short-term, at September 30, 2011, were as follows:

Name of Fund	Due from other funds	Due to other funds
Governmental:		
General	\$ 831,550	\$ -
4A Sales Tax	294,324	74,540
4B Sales Tax	175,151	83,988
Non-Major Governmental	-	74,792
Business-Type:		
Enterprise Fund	-	1,067,705
Non-Major Business-Type	-	-
Total	<u>\$ 1,301,025</u>	<u>\$ 1,301,025</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, 2011, were as follows:

	Transfers Out			
	General Fund	4A Sales Tax	4B Sales Tax	Enterprise Total
<u>Transfers in</u>				
General	\$ -	\$ 30,000	\$ 15,979	\$ 1,492,685
Non-Major Enterprise	-	-	-	7,369
	<u>\$ -</u>	<u>\$ 30,000</u>	<u>\$ 15,979</u>	<u>\$ 1,500,054</u>
				<u>\$ 1,546,033</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 \$4,561,543 to this company during the year ended September 30, 2011.

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 \$531,630 to this company during the year ended September 30, 2011.

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

The 4A and 4B Sales Tax Boards have the following incentive commitments as of September 30, 2011:

<u>Incentive commitment</u>	<u>4A</u>	<u>4B</u>
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 nontraditional, 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 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:

	<u>For the year ended December 31,</u>		
	<u>2008</u>	<u>2009</u>	<u>2010</u>
Employee deposit rate	7%	7%	7%
Matching ratio (city to employee)	1.5 to 1	1.5 to 1	1.5 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

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

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 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,			
	2008	2009	2010	
			Prior to restructuring	Restructured
Actuarial value of assets	\$ 2,355,763	\$ 2,437,029	\$ 2,624,466	\$ 3,573,552
Actuarial accrued liability	3,607,451	3,772,943	4,448,247	5,377,066
Percentage funded ratio	65.3%	64.6%	59.0%	66.5%
Unfunded (over-funded) actuarial accrued liability (UAAL)	1,251,688	1,335,914	1,823,781	1,803,514
Annual covered payroll	1,645,760	1,623,227	1,830,685	1,830,685
UAAL as a percentage of covered payroll	76.1%	82.3%	99.6%	98.5%
Net pension obligation (NPO), beginning of period	-	-	-	-
Annual pension cost:				
Annual required contribution (ARC)	121,299	140,247	142,793	142,793
Interest on NPO	-	-	-	-
Adjustment to ARC	-	-	-	-
	<u>121,299</u>	<u>140,247</u>	<u>142,793</u>	<u>142,793</u>
Contributions made	<u>121,299</u>	<u>140,247</u>	<u>142,793</u>	<u>142,793</u>
Increase in NPO	-	-	-	-
NPO at end of the period	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

City of Hearne, Texas
Notes to Basic Financial Statements
September 30, 2011

The required contribution rates for fiscal year 2011 were determined as part of the December 31, 2008 and 2009 actuarial valuations. Additional information as of the latest actuarial valuation, December 31, 2010, also follows:

Valuation Date	For the year ended December 31,			
	2008	2009	2010 Prior to restructuring	2010 Restructured
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	29 Years; closed period	28.1 Years; closed period	27.6 Years; closed period	27.7 Years; closed period
Amortization period for new gain/loss	30 Years	30 Years	30 Years	30 Years
Asset valuation method	Amortized Cost	10-year Smoothed Market	10-year Smoothed Market	10-year Smoothed Market
Actuarial assumptions:				
Investment rate of return *	7.5%	7.5%	7.5%	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, 2011

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.

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, 2011

	For the year ended December 31,			
	2008	2009	2010	
			Prior to restructuring	Restructured
Actuarial value of assets	\$ 2,355,763	\$ 2,437,029	\$ 2,624,466	\$ 3,573,552
Actuarial accrued liability	3,607,451	3,772,943	4,448,247	5,377,066
Percentage funded ratio	65.3%	64.6%	59.0%	66.5%
Unfunded (over-funded) actuarial accrued liability (UAAL)	1,251,688	1,335,914	1,823,781	1,803,514
Annual covered payroll	1,645,760	1,623,227	1,830,685	1,830,685
UAAL as a percentage of covered payroll	76.1%	82.3%	99.6%	98.5%
Net pension obligation (NPO), beginning of period	-	-	-	-
Annual pension cost:				
Annual required contribution (ARC)	121,299	140,247	142,793	142,793
Interest on NPO	-	-	-	-
Adjustment to ARC	-	-	-	-
	<u>121,299</u>	<u>140,247</u>	<u>142,793</u>	<u>142,793</u>
Contributions made	<u>121,299</u>	<u>140,247</u>	<u>142,793</u>	<u>142,793</u>
Increase in NPO	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
NPO at end of the period	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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, 2011

	Budgeted Amounts		Actual	Variance with Final Budget Over (Under)
	Original	Final		
Revenues:				
Sales taxes	\$ 182,000	\$ 182,000	\$ 191,270	\$ 9,270
Investment income	18,000	18,000	4,089	(13,911)
Total revenues	<u>200,000</u>	<u>200,000</u>	<u>195,359</u>	<u>(4,641)</u>
Expenditures:				
Current:				
Culture and recreation:				
Economic development	80,000	157,690	122,218	(35,472)
Capital outlay	120,000	12,310	-	(12,310)
Total expenditures	<u>200,000</u>	<u>170,000</u>	<u>122,218</u>	<u>(47,782)</u>
Excess of revenues over expenditures	<u>-</u>	<u>30,000</u>	<u>73,141</u>	<u>43,141</u>
Other financing uses:				
Transfers out	<u>-</u>	<u>(30,000)</u>	<u>(30,000)</u>	<u>-</u>
Net change in fund balances	-	-	43,141	43,141
Fund balances at beginning of year	<u>895,747</u>	<u>895,747</u>	<u>895,747</u>	<u>-</u>
Fund balances at end of year	<u>\$ 895,747</u>	<u>\$ 895,747</u>	<u>\$ 938,888</u>	<u>\$ 43,141</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, 2011

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Over (Under)
Revenues:				
Sales taxes	\$ 182,000	\$182,000	\$ 191,270	\$ 9,270
Investment income	18,000	18,000	3,984	(14,016)
Total revenues	200,000	200,000	195,254	(4,746)
Expenditures:				
Current:				
Culture and recreation:				
Economic development	118,000	118,000	30,081	(87,919)
Capital outlay	82,000	50,528	-	(50,528)
Total expenditures	200,000	168,528	30,081	(138,447)
Excess of revenues over expenditures	-	31,472	165,173	133,701
Other financing uses:				
Transfers out	-	(31,472)	(15,979)	15,493
Net change in fund balances	-	-	149,194	149,194
Fund balances at beginning of year	836,677	836,677	836,677	-
Fund balances at end of year	\$ 836,677	\$836,677	\$985,871	\$ 149,194