

CITY OF HEMPHILL, TEXAS
ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2010

CITY OF HEMPHILL, TEXAS
Annual Financial Report
For the Year Ended June 30, 2010

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FINANCIAL SECTION



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Certified Public Accountants

Independent Auditor's Report

Honorable Mayor and Members of the City Council
City of Hemphill, 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 Hemphill, Texas as of and for the year ended June 30, 2010, 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. 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hemphill, Texas as of June 30, 2010, and the respective changes in financial position and cash flows, where applicable, thereof 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 our report dated September 24, 2010, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Independent Auditor's Report

Honorable Mayor and Members of City Council
City of Hemphill, Texas
Page 2

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 10 and page 37 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of the 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 the 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 other schedules and statistical tables are presented for purposes of additional analysis and are not a required part of the financial statements. The other schedules are 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. The statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Pipes & Associates

PIPES & ASSOCIATES
Certified Public Accountants

September 24, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City of Hemphill, Texas annual financial report presents our narrative discussion and analysis of the City's financial activities for the year ended June 30, 2010. Please read it in conjunction with the City's financial statements, which immediately follow this section.

Financial Highlights

- ▶ The City's total net assets were \$5,108,032 as of June 30, 2010. Of this amount, \$1,272,583 (unrestricted net assets) may be used to meet the City's continuing obligations to citizens, customers and creditors.
- ▶ During the year ended June 30, 2010, the City's net assets **increased** by \$238,033.
- ▶ Total long-term debt of the City decreased by \$57,042 to \$1,052,433 during the current fiscal year.
- ▶ At the end of the current fiscal year, unreserved fund balance for the general fund was \$91,663 or 8.85 percent of total general fund current expenditures.

Overview of the Financial Statements

This annual financial report consists of three parts - **management's discussion and analysis** (this section), the **basic financial statements**, and **required supplementary information**. The basic financial statements include: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. The required supplementary information further explains and supports the information in the financial statements.

Government-wide Financial Statements

The City's annual financial report includes two government-wide financial statements. These statements provide both long-term and short-term information about the City's finances. Financial reporting at this level uses a perspective similar to that found in the private sector.

The first of these government-wide financial statements is the **Statement of Net Assets**. This is the City wide statement of financial position presenting information that includes all of the City's assets and liabilities, with the difference reported as **net assets**. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City as a whole is improving or deteriorating. Evaluation of the overall health of the City would extend to other non financial factors such as changes to the City's tax base.

The second government-wide financial statement is the **Statement of Activities**, which reports how the City's net assets changed during the current year. All current revenues and expenses are included regardless of when the cash is received or paid.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Both of the government-wide financial statements distinguish governmental activities of the City that are principally supported by taxes and intergovernmental revenues, from business-type activities that are intended to recover all or a significant portion of their costs through user fees and charges. Governmental activities include general government, public safety, streets, parks and recreation, health and welfare, and sanitation collection. Business-type activities include water and sewer operations, natural gas utilities, and electric services.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into two categories: governmental funds and proprietary funds.

Governmental funds - Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term cash inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the City's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the City's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and change in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains one individual governmental fund, the general fund, which is considered a major fund. The City adopts an annual budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

Proprietary funds - Proprietary funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses an enterprise fund (a type of proprietary fund) to account for its water and sewer operations, natural gas utilities, and electric services.

Notes to the financial statements - The accompanying notes to the financial statements provide essential information to a full understanding of the government-wide and fund financial statements.

Other information - In addition to the basic financial statements and accompanying notes, this

MANAGEMENT'S DISCUSSION AND ANALYSIS

report also presents other supplementary information which includes detail expenditures by fund and department. Supplementary information follows the notes to the financial statements.

Government-wide Financial Analysis

Net Assets. As noted earlier, net assets may serve over time as a useful indicator of the City's financial position. The City's assets exceed liabilities by \$5,108,032 at the close of the fiscal year.

By far the largest portion of the City's net assets (73.5 percent) reflects its investment in capital assets (land, buildings, utility systems, machinery and equipment), less any related debt used to acquire those assets that is still outstanding. The City uses these assets to provide services to the citizens, consequently, these assets are not available for future spending. Although the City investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The City's Net Assets

	Governmental Activities		Business-type activities		Total	
	2010	2009	2010	2009	2010	2009
Current and Other Assets	137,755	165,906	1,643,006	1,488,487	1,780,761	1,654,393
Capital and Non-Current Assets	635,936	570,344	4,172,312	4,179,650	4,808,248	4,749,994
Total Assets	773,691	736,250	5,815,318	5,668,137	6,589,009	6,404,387
Other Liabilities	45,622	43,947	382,453	380,966	428,075	424,913
Long Term Liabilities	-	-	1,052,433	1,109,475	1,052,433	1,109,475
Total Liabilities	45,622	43,947	1,434,886	1,490,441	1,480,508	1,534,388
Net Assets:						
Investment in Capital Assets,						
Net of Related Debt	635,936	570,344	3,119,879	3,070,175	3,755,815	3,640,519
Restricted	-	-	79,634	75,107	79,634	75,107
Unrestricted	91,663	121,959	1,180,920	1,032,414	1,272,583	1,154,373
Total Net Assets	<u>727,599</u>	<u>692,303</u>	<u>4,380,433</u>	<u>4,177,696</u>	<u>5,108,032</u>	<u>4,869,999</u>

A portion of the City's net assets (1.6 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets in the amount of \$1,272,583 may be used to meet the City's ongoing obligations to citizens and creditors.

MANAGEMENT'S DISCUSSION AND ANALYSIS

At the end of the current fiscal year, the City is able to report positive balances in all three categories of net assets, both for the City as a whole, as well as for its separate governmental and business-type activities.

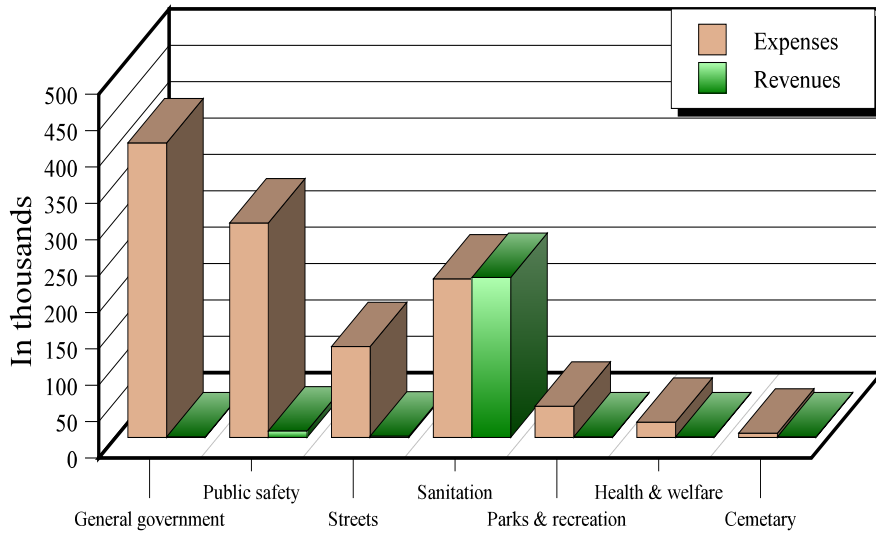
Changes in the City's Net Assets

	Governmental Activities		Business-type activities		Total	
	2010	2009	2010	2009	2010	2009
Revenues:						
Program Revenues:						
Charges for services	232,915	209,472	4,282,317	3,763,783	4,515,232	3,973,255
Operating grants	34,030	15,477	-	-	34,030	15,477
Capital grants	69,189	33,600	-	1,900	69,189	35,500
General Revenues:						
Sales taxes	371,321	490,087	-	-	371,321	490,087
Other taxes	11,959	6,491	-	-	11,959	6,491
Other	62,242	41,204	33,728	33,290	95,970	74,494
Total revenues	781,656	796,331	4,316,045	3,798,973	5,097,701	4,595,304
Expenses:						
General government	405,128	405,305	-	-	405,128	405,305
Public safety	295,820	286,803	-	-	295,820	286,803
Streets	124,553	104,300	-	-	124,553	104,300
Sanitation	218,827	185,512	-	-	218,827	185,512
Parks and recreation	42,912	19,283	-	-	42,912	19,283
Health and welfare	21,458	20,795	-	-	21,458	20,795
Cemetery	5,750	4,800	-	-	5,750	4,800
Debt service	-	-	-	-	-	-
Electric	-	-	1,721,737	1,751,309	1,721,737	1,751,309
Natural gas	-	-	249,141	308,377	249,141	308,377
Water	-	-	1,352,981	1,142,973	1,352,981	1,142,973
Sewer	-	-	421,361	364,380	421,361	364,380
Total expenses	1,114,448	1,026,798	3,745,220	3,567,039	4,859,668	4,593,837
Transfers	368,088	262,995	(368,088)	(262,995)	-	-
Increase in net assets	35,296	32,528	202,737	(31,061)	238,033	1,467
Beginning net assets	692,303	659,775	4,177,696	4,208,757	4,869,999	4,868,532
Ending net assets	<u>727,599</u>	<u>692,303</u>	<u>4,380,433</u>	<u>4,177,696</u>	<u>5,108,032</u>	<u>4,869,999</u>

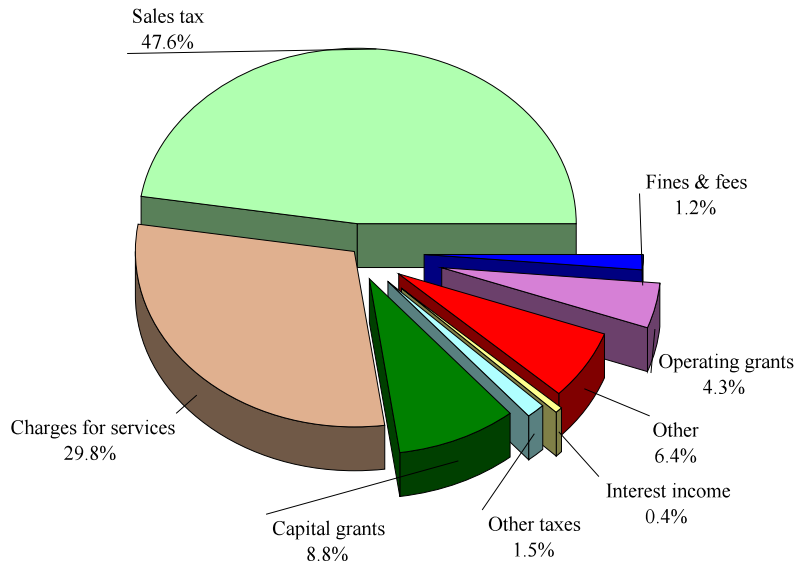
MANAGEMENT'S DISCUSSION AND ANALYSIS

Governmental Activities. Governmental activities increased the City's net assets by \$35,296 contributing to the overall increase in the City's total net assets.

Expenses and Program Revenues - Governmental Activities



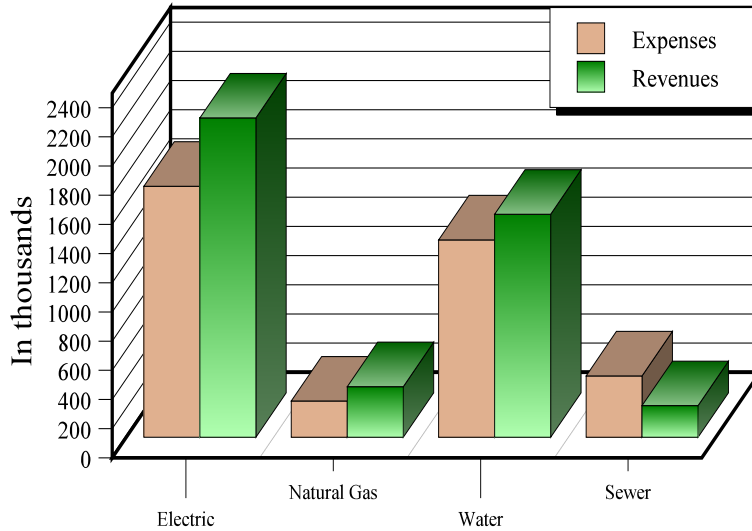
Revenues by Source - Governmental Activities



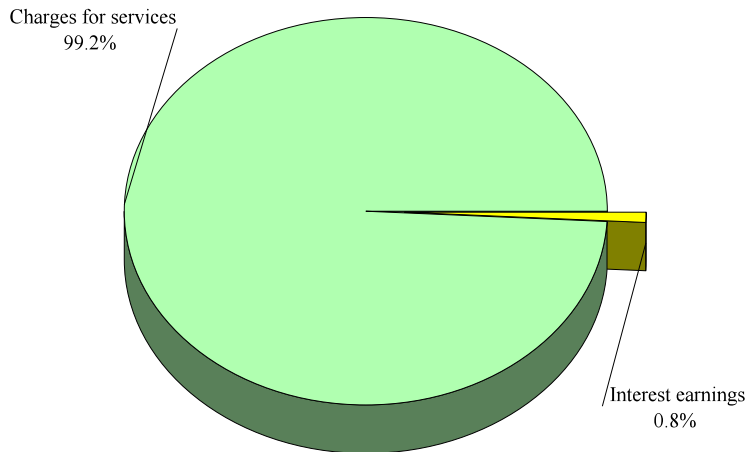
MANAGEMENT'S DISCUSSION AND ANALYSIS

Business-type Activities. Business-type activities increased the City's net assets by \$202,737, contributing to the overall increase in the City's total net assets.

Expenses and Program Revenues - Business-Type Activities



Revenues by Source - Business-Type Activities



Financial Analysis of the City's Funds

Governmental funds. The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

MANAGEMENT DISCUSSION AND ANALYSIS

As of the end of the current fiscal year, the City's governmental funds reported an ending fund balance of \$91,663, a decrease of \$30,296 compared with the prior year. This balance is unreserved, which is available for current expenditures.

Proprietary funds. The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. Unrestricted net assets of the proprietary fund at the end of the year amounted to \$1,180,920.

General Fund Budgetary Highlights

During the year, the City Council approved an increase in appropriations between the original and final amended budget. The following are components of amounts amended:

- ▶ \$50,000 increase in the Street department capital outlay.
- ▶ \$10,000 increase in the Sanitation department capital outlay.
- ▶ \$3,650 increase in the Fire department capital outlay.

These capital outlay budget increases were used to provide for street paving and equipment needs.

Capital Asset and Debt Administration

Capital Assets. At the end of the current fiscal year, the City's investment in capital assets for the governmental and business type activities amounted to \$4,808,248 (net of accumulated depreciation). This investment in capital assets included land, buildings, utility system improvements, machinery, equipment, and park facilities.

	City's Capital Assets (net of depreciation)					
	Governmental		Business-type activities		Total	
	2010	2009	2010	2009	2010	2009
Land	92,641	88,290	79,523	79,523	172,164	167,813
Buildings & improvements	374,008	307,544	-	-	374,008	307,544
Utility systems	-	-	3,897,481	3,992,576	3,897,481	3,992,576
Property - capital lease	-	-	-	-	-	-
Vehicles and equipment	169,287	174,510	195,308	107,551	364,595	282,061
Construction in progress	-	-	-	-	-	-
Net capital assets	<u>635,936</u>	<u>570,344</u>	<u>4,172,312</u>	<u>4,179,650</u>	<u>4,808,248</u>	<u>4,749,994</u>

MANAGEMENT DISCUSSION AND ANALYSIS

More detailed information about the City's capital assets is presented in the notes to the financial statements.

Long-term debt. At the end of the current fiscal year, the City had total long term debt of \$1,052,433.

	City's Outstanding Debt					
	Governmental Activities		Business-type activities		Total	
	2010	2009	2010	2009	2010	2009
Revenue bonds	-	-	656,000	692,000	656,000	692,000
Capital lease	-	-	170,090	181,973	170,090	181,973
Promissory notes	-	-	226,343	235,502	226,343	235,502
Bank loans	-	-	-	-	-	-
Net capital assets	-	-	1,052,433	1,109,475	1,052,433	1,109,475

The City's total long term debt decreased by \$57,042 during the current fiscal year. The City's revenue bonds are owned by the Texas Water Development Board and the U. S. Department of Agriculture and are not rated.

Economic Factors and Next Year's Budgets and Rates

The City considered many factors when setting the fiscal year 2010-2011 budget, including estimated sales tax receipts and fees that will be charged for business-type activities. The City estimates a net decrease in general fund revenues due to a decrease in grants. The other ongoing general fund revenue items (charges for services, etc.) should generate similar revenues as the prior year. The City's General Fund budgeted expenditures reflect a reduction in payroll costs due to eliminating a police officer position and using current staff position to serve as municipal judge. The City's business-type activities budget reflect no utility rates increases. Major capital expenditures estimated at \$180,000 are expected at the water treatment plant to comply with Texas Commission on Environmental Quality mandates.

The City anticipates spending \$236,255 in capital improvements during fiscal year 2010-2011. These include technology equipment purchases, cemetery improvements, Utility system equipment and improvements, and TCEQ mandated improvements to the water treatment plant.

If these estimates are realized, the City's budgetary general fund balance and utility reserves are expected to increase modestly by the close of 2011.

Request for Information

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the City of Hemphill's finances and to demonstrate accountability for the money it receives. If you have any questions about this report or need additional financial information contact the City Secretary, P. O. Box 788, Hemphill, Texas, 75948.

Government-Wide Financial Statements

**CITY OF HEMPHILL, TEXAS
STATEMENT OF NET ASSETS
JUNE 30, 2010**

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Cash and cash equivalents	107,755	1,093,036	1,200,791
Sales tax receivable	26,697	-	26,697
Accounts receivable	-	430,607	430,607
Inventories	-	11,970	11,970
Deferred charges	-	27,759	27,759
Restricted assets:			
Cash and cash equivalents	2,833	79,634	82,467
Capital Assets (net of accumulated depreciation):			
Land	92,641	79,523	172,164
Other capital assets, net of depreciation	543,295	4,092,789	4,636,084
Total assets	773,221	5,815,318	6,588,539
LIABILITIES			
Accounts payable	22,506	247,466	269,972
Accrued expenses	23,116	26,280	49,396
Accrued interest payable	-	9,275	9,275
Customer meter deposits	-	99,431	99,431
Long Term Liabilities:			
Due within one year	-	64,496	64,496
Due after one year	-	987,937	987,937
Total liabilities	45,622	1,434,885	1,480,507
NET ASSETS			
Invested in capital assets, net of related debt	635,936	3,119,879	3,755,815
Restricted for other purposes	-	79,634	79,634
Unrestricted net assets	91,663	1,180,920	1,272,583
Total net assets	727,599	4,380,433	5,108,032

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010**

Functions/Programs	Program Revenues		
	Expenses	Charges for Services	Operating Grants and Contributions
Governmental activities:			
General government	405,128	501	24,805
Public safety	295,820	9,319	8,450
Streets	124,553	1,570	-
Sanitation	218,827	220,082	-
Parks and recreation	42,912	-	-
Health and welfare	21,458	393	-
Cemetery	5,750	1,050	775
Interest on long term debt	-	-	-
Total governmental activities	1,114,448	232,915	34,030
Business-type activities:			
Electric	1,721,737	2,189,261	-
Natural gas	249,141	347,359	-
Water	1,352,981	1,529,073	-
Sewer	421,361	216,624	-
Total business-type activities	3,745,220	4,282,317	-
	4,859,668	4,515,232	34,030

General revenues:
 Sales taxes
 Franchise taxes
 Miscellaneous
 Net grants not restricted to specific programs
 Investment earnings
 Transfers

Total general revenues and transfers
 Change in net assets
 Net assets, beginning

Net assets, ending

See accompanying notes to the financial statements

Program Revenues	Net (Expense) Revenues and Changes in Net Assets		
	Capital Grants and Contributions	Governmental Activities	Business Activities
-	(379,822)	-	(379,822)
-	(278,051)	-	(278,051)
48,189	(74,794)	-	(74,794)
21,000	22,255	-	22,255
-	(42,912)	-	(42,912)
-	(21,065)	-	(21,065)
-	(3,925)	-	(3,925)
-	-	-	-
69,189	(778,314)	-	(778,314)
-	-	467,524	467,524
-	-	98,218	98,218
-	-	176,092	176,092
-	-	(204,737)	(204,737)
-	-	537,097	537,097
69,189	(778,314)	537,097	(241,217)
	371,321	-	371,321
	11,959	-	11,959
	20,031	-	20,031
	38,872	-	38,872
	3,339	33,728	37,067
	368,088	(368,088)	-
	813,610	(334,360)	479,250
	35,296	202,737	238,033
	692,303	4,177,696	4,869,999
	-	-	-
	727,599	4,380,433	5,108,032

See accompanying notes to the financial statements

Fund Financial Statements

**CITY OF HEMPHILL, TEXAS
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2010**

	General Fund	Other Governmental Funds	Total Governmental Funds
ASSETS			
Cash and cash equivalents	107,755	-	107,755
Sales tax receivable	26,697	-	26,697
Cash and cash equivalents - restricted	2,833	-	2,833
Total assets	<u>137,285</u>	-	<u>137,285</u>
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	22,506	-	22,506
Accrued liabilities	23,116	-	23,116
Total liabilities	<u>45,622</u>	-	<u>45,622</u>
Fund balances:			
Unreserved and undesignated	91,663	-	91,663
Total fund balances	<u>91,663</u>	-	<u>91,663</u>
Total liabilities and fund balances	<u>137,285</u>	-	<u>137,285</u>

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
JUNE 30, 2010**

Total fund balances - governmental funds	91,663
Capital assets used in governmental activities are not financial resources and therefore are not reported in governmental funds. At the beginning of the year, the cost of these assets was \$1,043,948 and the accumulated depreciation was \$473,604. The effect of including beginning balances for capital assets (net of depreciation) in the governmental activities is to increase (decrease) net assets.	570,344
Capital outlays are expenditures in the fund financial statements, but they should be shown as increases in capital assets in the government-wide financial statements. The net effect of including the current year capital outlays, less current year depreciation is to increase net assets.	65,592
Long term liabilities are not due and payable in the current period and therefore are not reported in the funds.	-
Net assets of governmental activities	<u>727,599</u>

See accompanying notes to the financial statements

CITY OF HEMPHILL, TEXAS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2010

	General Fund	Other Governmental Funds	Total Governmental Funds
REVENUES			
Taxes:			
Sales taxes	371,321	-	371,321
Franchise taxes	11,960	-	11,960
License and permits	205	-	205
Fines	9,652	-	9,652
Charges for services	220,082	-	220,082
Interest income	3,339	-	3,339
Intergovernmental	141,317	-	141,317
Contributions and donations	1,825	-	1,825
Other	21,956	-	21,956
Total revenues	781,657	-	781,657
EXPENDITURES			
Current:			
General government:			
Finance and administration	370,522	-	370,522
Municipal court	28,309	-	28,309
Public safety:			
Fire	16,056	-	16,056
Police	230,992	-	230,992
Streets	116,644	-	116,644
Sanitation	212,832	-	212,832
Parks and recreation	32,772	-	32,772
Health and welfare	21,458	-	21,458
Cemetery	5,750	-	5,750
Debt service	-	-	-
Capital outlay	144,706	-	144,706
Total expenditures	1,180,041	-	1,180,041
Excess (deficiency) of revenues over expenditures	(398,384)	-	(398,384)
OTHER FINANCING SOURCES (USES)			
Transfers in	368,088	-	368,088
Total other financing sources and uses	368,088	-	368,088
Net change in fund balance	(30,296)	-	(30,296)
Fund balance - beginning	121,959	-	121,959
Fund balance - ending	91,663	-	91,663

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010**

Net change in fund balances - governmental funds	(30,296)
Current year capital outlays are expenditures in the governmental fund financial statements but they should be shown as increases in capital assets in the government-wide financial statements. The effect of removing the current year capital outlays is to increase net assets.	144,706
Depreciation is not recognized as an expense in governmental fund financial statements since it does not require the use of current financial resources. The net effect of the current year depreciation and retiring assets not fully depreciated is to decrease net assets.	(79,114)
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. The net effect of removing principal payments is to increase net assets.	<hr style="width: 100%;"/>
Change in net assets of governmental activities	<hr style="width: 100%;"/> <u>35,296</u>

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
STATEMENT OF NET ASSETS
PROPRIETARY FUND
JUNE 30, 2010**

ASSETS

Current assets:	
Cash and cash equivalents	1,093,036
Accounts receivable	430,607
Inventories	11,970
Total current assets	1,535,613
Noncurrent assets:	
Restricted cash and cash equivalents	79,634
Deferred charges	27,759
Capital assets:	
Land	79,523
Other capital assets, net of depreciation	4,092,789
Total noncurrent assets	4,279,705
Total assets	5,815,318

LIABILITIES

Current liabilities:	
Accounts payable	247,466
Accrued expenses	26,280
Accrued interest payable	9,275
Current portion of:	
Capital leases	14,029
Promissory note	9,467
Revenue bonds payable	41,000
Total current liabilities	347,517
Noncurrent liabilities:	
Capital leases	156,061
Promissory note	216,876
Revenue bonds payable	615,000
Customer deposits	99,431
Total noncurrent liabilities	1,087,368
Total liabilities	1,434,885

NET ASSETS

Invested in capital assets, net of related debt	3,119,879
Restricted for debt service	79,634
Unrestricted	1,180,920
Total net assets	4,380,433
Total liabilities and net assets	5,815,318

See accompanying notes to the financial statements

CITY OF HEMPHILL, TEXAS
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUND
FOR THE YEAR ENDED JUNE 30, 2010

Operating revenues:	
Water sales	1,513,958
Sewer charges	214,465
Electric sales	2,167,626
Gas sales	343,930
Other services	<u>42,338</u>
Total operating revenues	<u>4,282,317</u>
Operating expenses:	
Personnel	641,240
Supplies and materials	398,880
Maintenance and repairs	61,325
Contractual services	122,897
Cost of services	2,104,980
Depreciation	316,339
Other operating	<u>42,788</u>
Total operating expenses	<u>3,688,449</u>
Operating income	593,868
Nonoperating revenues (expenses):	
Interest income	33,728
Capital grant	-
Interest expense	<u>(56,771)</u>
Total nonoperating revenue (expenses)	(23,043)
Income before transfers	570,825
Transfers to other funds	<u>(368,088)</u>
Change in net assets	202,737
Total net assets - beginning	<u>4,177,696</u>
Total net assets - ending	<u><u>4,380,433</u></u>

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
STATEMENT OF CASH FLOWS
PROPRIETARY FUND
FOR THE YEAR ENDED JUNE 30, 2010**

Cash flows from operating activities:	
Receipts from customers	4,197,938
Payments to suppliers and contractors	(2,719,411)
Payments to employees	(641,510)
Net cash provided by (used for) operating activities	<u>837,017</u>
Cash flows from noncapital financing activities:	
Operating transfers	(368,088)
Net cash provided by (used for) noncapital activities	<u>(368,088)</u>
Cash flows from capital and related financing activities:	
Capital grant received	-
Purchases of capital assets	(309,003)
Principal paid on capital debt	(57,042)
Interest paid on capital debt	(56,112)
Net cash provided by (used for) capital activities	<u>(422,157)</u>
Cash flows from investing activities:	
Interest received	33,728
Net cash provided by (used for) investing activities	<u>33,728</u>
 Net increase (decrease) in cash and cash equivalents	 80,500
 Cash and cash equivalents, beginning	 <u>1,092,170</u>
 Cash and cash equivalents, ending	 <u><u>1,172,670</u></u>
 Reconciliation of operating income to net cash used by operating activities:	
Operating income	593,868
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	316,339
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	(74,943)
(Increase) decrease in supply inventory	(406)
Increase (decrease) in accounts payable	11,865
Increase (decrease) in accrued liabilities	539
Increase (decrease) in customer meter deposits	(10,245)
Net cash provided by operating activities	<u><u>837,017</u></u>

See accompanying notes to the financial statements

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity - The City of Hemphill, Texas, (City) operates under Section 4, Article XI of the Texas constitution as a general law city. The City is governed by a Mayor and five council members. The accompanying financial statements present the City's primary government which includes all functions which the City's mayor and council exercise significant influence and are financially accountable. Significant influence or accountability is based on any budget adoption, rate setting, taxing authority, outstanding debt secured by the City to finance any deficits that may occur, and receipt of significant subsidies from the City.

Government-wide and Fund Financial Statements - The government-wide financial statements include the statement of net assets and the statement of activities. These statements report financial information for the City as a whole. Individual funds are not displayed in the government-wide financial statements. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate fund financial statements are provided for governmental funds and proprietary funds.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation - The accounting policies of the City conform to accounting principles generally accepted in the United States of America as applicable to governments. The City's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. The proprietary fund applies Financial Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which GASB prevails.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements are met.

Governmental fund financial statements are reported using the current financial resources measurement focus and modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible with the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences, are recorded only when payment is due.

Sales tax, franchise taxes and interest associated with the current fiscal year are all considered to susceptible to accrual and so have been recognized as revenues of the current fiscal year. All other revenue items are considered to be measurable and available only when cash is received by the City.

The City reports the following major governmental funds:

General Fund - The General Fund is the general operating fund of the City. It is used to account for all financial resources except for those required to be accounted for in another fund.

The City reports the following major proprietary funds:

Utility Fund - accounts for the activities of the City's electric distribution operations, water and sewer services, and natural gas utilities.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's utility functions and various other functions of the City. Elimination of these charges would distort the direct cost and program revenues reported for the various functions concerned.

Amounts reported as programs revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and operations. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

The proprietary fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

delivering goods in connection with the proprietary fund's principal operations. The principal operating revenues of the Utility Fund are charges to customers for sale and services. The Utility Fund also recognizes as operating revenues tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for the Utility Fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

Budget - Annual appropriated budgets are adopted for the general fund and utility fund. All annual appropriation lapse at fiscal year end. The budget presented includes all approved amendments.

Deposits and Investments - The City's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. The City only invests in short term certificates of deposit. Investments are stated at cost, which approximates market.

Short-term Interfund Receivables/Payables - During the course of operations, transactions occur between individual funds for advances or for goods provided or services rendered. These receivables and payables are classified as due from other funds or due to other funds on the balance sheet.

Inventory of Supplies - Inventory of supplies consist primarily of supplies held for consumption stated at cost, which approximates market. Inventory is expended at the time the individual items are used or consumed.

Restricted Assets - Certain resources set aside for repayment of utility fund revenue bonds and tax anticipation notes are classified as restricted assets on the balance sheet, since use is limited by bond covenants or City Council authorization.

Capital assets - Capital assets, which include property, utility systems, buildings, vehicles and equipment, are reported in the applicable governmental or business-types activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of five years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

Depreciation is provided on all capital assets used by the general and utility funds over the following estimated useful lives using the straight-line method. The estimated useful lives are:

<u>Assets</u>	<u>Years</u>
Buildings and improvements	10-30
Utility distribution systems	30
Vehicles and equipment	3-10
Furniture and equipment	5-10

Net Assets and Fund Balance - Net assets in the statement of net assets include components that are restricted for debt service. Unreserved fund balance in the governmental fund financial statements represents that portion of fund balance that is available for budgeting in future periods.

Compensated Absences - The City allows employees to accumulate sick leave and vacation time. Upon termination, the City pays any accumulated vacation that was not used. Accumulated sick leave is not paid upon termination. The liability for accrued vacation is recorded in the applicable funds. The amount expected to be paid from current resources is not significant.

Long-Term Obligations - In the government-wide financial statements, and proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities or proprietary fund financial statements. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

Interfund Transactions - Transactions that constitute reimbursements to a fund for expenditures initially made from it that are properly applicable to another fund, are recorded as expenditures in the reimbursing fund and as reductions of expenditures in the fund that is reimbursed. All other interfund transactions are reported as operating transfers.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles includes the use of estimates that affect the financial statements. Accordingly, actual results could differ from those estimates.

Statement of Cash Flows - For the purposes of cash flows, the City considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

DEPOSITS AND INVESTMENTS

Legal and Contractual Provisions Governing Deposits and Investments. The Public Funds Investment Act (Government Code Chapter 2256) contains specific provisions in the areas of investment practices, management reports, and establishment of appropriate policies. Among other things, it requires the City to adopt, implement, and publicize an investment policy. That policy must address the following areas: (1) safety of principal and liquidity, (2) portfolio diversification, (3) allowable investments, (4) acceptable risk levels, (5) expected rates of return, (6) maximum allowable stated maturity of portfolio investments, (7) maximum average dollar-weighted maturity allowed based on stated maturity date for the portfolio, (8) investment staff quality and capabilities, (9) and bid solicitation preferences for certificates of deposit. Statutes authorize the City to invest in (1) obligations of the U.S. Treasury, certain U.S. agencies, and the State of Texas; (2) certificates of deposit, (3) certain municipal securities, (4) money market saving accounts, (5) repurchase agreements, (6) bankers acceptances, (7) Mutual Funds, (8) Investment pools, (9) guaranteed investment contracts, and (10) common trust funds. The Act also requires the City to have independent auditors perform test procedures related to investment practices as provided by the Act. The City is in substantial compliance with the requirements of the Act and with local policies.

In compliance with the Public Funds Investment Act, the City has adopted a deposit and investment policy. The policy addresses the following risks:

Deposits

Custodial Credit Risk - Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City's policy regarding types of deposits allowed and collateral requirements is that the funds of the City must be deposited under the terms of a contract, contents of which are set out in the Depository Contract Law. The depository bank places approved pledged securities for safekeeping and trust with the City's agent bank in an amount sufficient to protect City funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance. The City's cash deposits at June 30, 2010 were entirely covered by FDIC insurance or by pledged collateral held by the City's agent bank in the City's name.

As of June 30, 2010, the bank balances of the City's deposits (demand and certificates) were \$1,380,390. The City is not exposed to custodial credit risk for its deposits as all are covered by depository insurance or by pledged collateral as of June 30, 2010 as follows:

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

FDIC Insurance	500,000
Market value of securities pledged	<u>1,672,923</u>
Total coverage	<u>2,172,923</u>

Investments

Credit Risk. - This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The ratings of securities by nationally recognized rating agencies are designed to give an indication of credit risk. The City was not exposed to credit risk at June 30, 2010.

Custodial Credit Risk - Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either the counterparty or the counterparty's trust department or agent but not in the name of the City. The City was not exposed to custodial credit risk at June 30, 2010.

Interest Rate Risk. - This is the risk that changes in interest rates will adversely affect the fair value of an investment. The City was not exposed to interest rate risk at June 30, 2010.

Concentration of Credit Risk.- This is the risk of loss attributed to the magnitude of the government's investment in a single issuer. The City was not exposed to concentration of credit risk at June 30, 2010.

Foreign Currency Risk. - This is the risk that exchange rates will adversely affect the fair value of an investment. The City was not exposed to foreign currency risk at June 30, 2010.

The City's investments as of June 30, 2010 are with the depository bank in certificates of deposit in the amount of \$959,877.

Restricted deposits - Resources set aside for repayment of revenue bonds are classified as restricted assets in the statement of net assets since their use is limited by bond covenants. At June 30, 2010, the City's business type activities restricted assets consisted of \$79,634 for debt service. The governmental activities restricted assets consisted of \$2,817 for cemetery operations and \$16 for street paving.

PROPERTY TAXES

The City did not levy property taxes in October, 2009. An allowance in the amount of \$2,224 is

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

established for the entire balance of delinquent property taxes due to the City.

DUE FROM OTHER GOVERNMENTS

Amount due from other governments as of June 30, 2010 is \$26,697 for sales tax due from the State of Texas.

CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2010 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements/ Adjustments</u>	<u>Ending Balance</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	88,290	4,351	-	92,641
Capital assets, being depreciated:				
Buildings and improvements	462,510	94,189	-	556,699
Vehicles and equipment	493,148	46,166	-	539,314
Total capital assets being depreciated	<u>955,658</u>	<u>140,355</u>	<u>0</u>	<u>1,096,013</u>
Less accumulated depreciation for:				
Buildings and improvements	154,965	27,726	-	182,691
Vehicles and equipment	318,639	51,388	-	370,027
Total accumulated depreciation	<u>473,604</u>	<u>79,114</u>	<u>0</u>	<u>552,718</u>
Total capital assets, being depreciated, net	<u>482,054</u>	<u>61,241</u>	<u>-</u>	<u>543,295</u>
Governmental activities capital assets, net	<u><u>570,344</u></u>	<u><u>65,592</u></u>	<u><u>-</u></u>	<u><u>635,936</u></u>
Business-type activities:				
Capital assets, not being depreciated:				
Land	79,523	-	-	79,523
Capital assets, being depreciated:				
Buildings and improvements	32,500	-	-	32,500

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements/ Adjustments</u>	<u>Ending Balance</u>
Utility systems	8,181,652	179,002	-	8,360,654
Vehicles and equipment	675,763	130,000	(4,239)	801,524
Property under capital lease	350,000	-	-	350,000
Totals at cost	<u>9,239,915</u>	<u>309,002</u>	<u>(4,239)</u>	<u>9,544,678</u>
Less accumulated depreciation:				
Buildings and improvements	32,500	-	-	32,500
Utility system	4,189,076	274,096	-	4,463,172
Vehicles and equipment	568,212	42,243	(4,239)	606,216
Property under capital lease	350,000	-	-	350,000
Total accumulated depreciation	<u>5,139,788</u>	<u>316,339</u>	<u>(4,239)</u>	<u>5,451,888</u>
Total capital assets, being depreciated, net	<u>4,100,127</u>	<u>(7,337)</u>	<u>0</u>	<u>4,092,790</u>
Business-type activities capital assets, net	<u>4,179,650</u>	<u>(7,337)</u>	<u>0</u>	<u>4,172,313</u>

Depreciation expense was charged to functions of the City as follows:

Governmental activities:

General government	6,297
Public safety	48,773
Streets	7,909
Sanitation	5,554
Health and welfare	441
Parks and recreation	<u>10,140</u>
Total depreciation expense - governmental activities	<u>79,114</u>

Business-type activities:

Overhead	36,342
Water	21,055
Sewer	96,343
Natural Gas	25,727
Electric	29,056
Water Plant	<u>107,816</u>

CITY OF HEMPHILL, TEXAS
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

Total depreciation expense - business-type activities	<u>316,339</u>
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CAPITAL LEASE

The City has entered into a lease agreement with the Sabine River Authority (Authority) to lease water treatment and transmission facilities that were constructed by the Authority. The lease agreement has been accounted for as capital lease in the accompanying financial statements.

The lease agreement was entered into in September, 1980 and went into effect in 1981. This contract was entered into to provide for the additional sale of water to a major purchaser. The lease is for a period of 40 years, with minimum payments ranging from \$1,683 to \$1,833 per month. The facilities are owned by the Authority, with the City having the exclusive use of the entire project throughout its useful life. Amortization is computed using the straight-line method and is included in depreciation expense. Interest expense for this lease was \$8,804 for the year ended June 30, 2010.

The following is a schedule of the future minimum lease payments under the capitalized lease together with the present value of the net minimum lease payments as of June 30, 2010:

Years ending June 30,	
2011	22,160
2012	20,658
2013	20,842
2014	20,317
2015	21,283
2016-2020	108,584
2021	<u>3,500</u>
Total minimum lease payments	217,344
Less: Amount representing interest	<u>47,254</u>
Present value of future minimum lease payments	<u><u>170,090</u></u>

LONG-TERM DEBT

Revenue Bonds

In April 1995, the City Council authorized the issuance of Waterworks and Sewer System Revenue

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

Bonds in the amount of \$495,000. The proceeds were used to make improvements and extensions to the Water and Sewer system, including water supply and treatment facilities. The revenue bonds are scheduled to mature April 1, 2015, with interest rates ranging from 6.65% to 8.25%. The revenue bonds are payable solely from the net revenues derived from the operations of the City's water and sewer system.

The revenue bond ordinance contains significant requirements for annual debt service and reserve funds, in addition to various other requirements. The City is in compliance with all significant requirements of the bond ordinance. As of June 30, 2010, the City had 698 water connections and 602 sewer connections.

The City's compliance with the balances required as of June 30, 2010 in each account is as follows:

	<u>Balance Required</u>	<u>Balance Available</u>	<u>Excess (Deficiency)</u>
Series 1995 Revenue Bonds:			
Interest & Sinking Fund	12,951	14,669	1,718
Reserve Fund	50,560	50,560	-

In March 2005, the City Council authorized the issuance of Waterworks and Sewer System Revenue Bonds in the amount of \$477,000. The proceeds were used for construction of a waste water treatment plant. The revenue bonds are scheduled to mature May 1, 2044, with an interest rate of 4.50%. The revenue bonds are payable solely from the net revenues derived from the operations of the City's water and sewer system. The City is in compliance with all significant requirements of this bond ordinance.

The City's compliance with the balances required as of June 30, 2010 in each account is as follows:

	<u>Balance Required</u>	<u>Balance Available</u>	<u>Excess (Deficiency)</u>
Series 2005 Revenue Bonds:			
Interest & Sinking Fund	6,573	6,835	262
Reserve Fund	7,500	7,570	70

Promissory Note

In May 1998, the City entered into a promissory note in the amount of \$288,062 to fund repairs and improvements to the water plant. The note is payable in monthly installments to the Sabine River Authority of Texas with an annual adjustable interest rate, currently 3.25%, maturing May 2028.

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

The City's water and sewer system will service the debt from net revenues of the system.

The annual debt service requirements to maturity, including principal and interest, for the City's business type activities long term debt is as of June 30, 2010 is as follows:

Year ending June 30,	
2011	116,943
2012	112,336
2013	114,396
2014	116,322
2015	118,261
2016-2020	324,626
2021-2025	216,417
2026-2030	180,057
2031-2035	129,830
2036-2040	122,830
2041-2045	113,500
Total principal and interest	1,665,518
Less interest	613,085
Total debt at June 30, 2010	1,052,433

Change in Long-Term Liabilities

Long term liability activity for the year ended June 30, 2010 was as follows:

	Beginning Balance	Issued	Retired	Ending Balance	Due in One Year
Business-type activities:					
Capital lease	181,972	-	11,882	170,090	14,029
Promissory Notes	235,503	-	9,160	226,343	9,466
Revenue bonds	692,000	-	36,000	656,000	41,000
Business-type activity, long-term liabilities	1,109,475	-	57,042	1,052,433	64,495

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

WATER SUPPLY AGREEMENT

On July 1, 1996, the City entered into a long term water supply agreement with the Sabine River Authority of Texas (Authority). The agreement requires the City to take and pay for a minimum monthly quantity of treated water of 18,000,000 gallons. The City will pay the Authority a monthly fee based on the unit cost for treated water. The unit cost is recalculated each year based on the total estimated annual cost for the next full contract year. The agreement expires in 2020, and the City must make minimum monthly payments whether or not it is able to take delivery of the water. For the year ended June 30, 2010, the City's cost for treated water under this agreement was \$682,292.

WATER TREATMENT AND TRANSMISSION FACILITIES OPERATING AGREEMENT

On July 1, 1996, the City entered into a long term operating agreement with the Sabine River Authority of Texas (Authority). The agreement stipulates that the City will operate and maintain the treatment and transmission facilities as an independent contractor and shall be paid a monthly fee by the Authority based on the actual quantity of water purchased times the unit cost for treated water. The unit cost for treated water is developed from an annual budget. The agreement expires in 2020. For the year ended June 30, 2010, the City earned \$697,100 under the operating agreement.

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 maintains workers' compensation and other risks of loss coverage through the Texas Municipal League Intergovernmental Risk Pool, which is a public entity risk pool. The pool is to be self-sustaining through member premiums and obtains reinsurance through commercial insurance companies for claims in excess of dollar amount. City management believes such coverage is sufficient to preclude any significant uninsured losses to the City. Settled claims did not exceed the commercial coverage during the current fiscal year.

COMMITMENTS AND CONTINGENCIES

Grants

Intergovernmental grants received by the City are subject to audit and adjustment by the funding agency or its representatives. If grant revenues are received for expenditures which are subsequently disallowed, the City may be required to repay the revenues to the funding agency. In the opinion of City management, liabilities resulting from such disallowed expenditures, if any, will not be material to the accompanying financial statements as of June 30, 2010.

CITY OF HEMPHILL, TEXAS
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

RETIREMENT PLAN

Plan Description

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

TMRS issues a publicly available comprehensive annual report that included 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 TMRS, P. O. Box 149153, Austin, TX 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 City Council, within the options available in the state statutes governing TMRS. Plan provisions for the City were as follows:

	Plan Year 2009	Plan year 2010
Employee deposit rate	5.0%	5.0%
Matching ratio (city to employee)	1 to 1	1 to 1
Years required for vesting	5	5
Service retirement eligibility (expresses as age/years of service)	60/5,0/25	60/5,0/25
Updates Service Credit	100% Repeating	100% Repeating
Annuity Increase (to retirees)	0% of CPI	0% of CPI

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 cost method. This rate consists of the normal cost contribution rate and the prior service cost 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

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

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

Annual Required Contribution (ARC)	30,395
Interest on Net Pension Obligation	0
Adjustment to the ARC	0
Annual Pension Cost (APC)	30,395
Contributions Made	30,395
Increase (decrease) in net pension obligation	0
Net Pension Obligation/(Asset) beginning of year	0
Net Pension Obligation/(Asset), end of year	0

Three-year Trend Information

Accounting Year End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/09	29,935	100%	---
6/30/08	27,619	100%	---
6/30/07	25,234	100%	---

The required contribution rates for fiscal year 2010 were determined as part of the December 31, 2007 and 2008 actuarial valuations. Additional information as of the latest actuarial valuation, December 31, 2009, also follows:

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

Valuation Date	12/31/07	12/31/08	12/31/09
Actuarial Cost Method	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit
Amortization Method	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll
GASB 25 Equivalent Single Amortization Period	25 years; closed period	24 years; closed period	22 years; closed period
Amortization Period for new Gains/Losses	25 years	25 years	25 years
Asset Valuation Method	Amortized Cost	Amortized Cost	Amortized Cost
Actuarial Assumptions			
Investment Rate of Return*	7.00%	7.50%	7.50%
Projected Salary Increases*	Varies by age and service	Varies by age and service	Varies by age and service
*Includes Inflation at	3.00%	3.00%	3.00%
Cost-of-Living Adjustment	0.00%	0.00%	0.00%

The funded status as of December 31, 2009, the most recent actuarial valuation date, is as follows

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Funded Ratio	Unfunded AAL (UAAL)	Covered Payroll	UAAL as a Percentage of Covered Payroll
12/31/09	\$1,122,589	\$1,106,120	101.5%	\$(16,469)	\$878,589	(1.9%)

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

The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary (calculated based on the employee's actual earnings, for the 12-month

CITY OF HEMPHILL, TEXAS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

period preceding the month of death); retired employees are insured for \$7,500; this coverage is an “other post employment benefit” or OPEB.

The City contributes to the SDBF at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. The funding policy for the SDBF program is to assure that adequate resources are available to meet all death benefit payments for the upcoming year; the intent is not to pre-fund retiree life insurance during employees’ entire careers.

The City’s contribution to the TMRS SDBF for the fiscal years ended 2010, 2009, and 2008 were \$2,366, \$2,521, and \$2,349, respectively, which equaled the required contributions each year.

Budgetary Comparison Reporting

CITY OF HEMPHILL, TEXAS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
FOR THE YEAR ENDED JUNE 30, 2010

	Budgeted Amounts		Actual Amounts	Variance With Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes:				
Sales taxes	480,876	480,876	371,321	(109,555)
Franchise taxes	10,950	10,950	11,960	1,010
Licenses and permits	4,643	4,643	205	(4,438)
Fines and fees	12,403	12,403	9,652	(2,751)
Charges for services	209,331	209,331	220,082	10,751
Interest income	3,635	3,635	3,339	(296)
Intergovernmental	9,958	9,958	141,317	131,359
Contributions and donations	-	-	1,825	1,825
Other	4,680	4,680	21,956	17,276
Total revenues	736,476	736,476	781,657	45,181
EXPENDITURES				
Current:				
General government:				
Finance and administration	338,449	338,449	370,522	(32,073)
Municipal court	29,194	29,194	28,309	885
Public safety:				
Fire	26,540	26,540	16,056	10,484
Police	227,076	227,076	230,992	(3,916)
Streets	106,521	106,521	116,644	(10,123)
Sanitation	213,018	213,018	212,832	186
Parks and recreation	10,418	10,418	32,772	(22,354)
Health and welfare	22,364	22,364	21,458	906
Cemetery	7,450	7,450	5,750	1,700
Debt service	-	-	-	-
Capital outlay	-	63,650	144,706	(81,056)
Total expenditures	981,030	1,044,680	1,180,041	(135,361)
Excess (deficiency) of revenues over expenditures	(244,554)	(308,204)	(398,384)	(90,180)
OTHER FINANCING SOURCES (USES)				
Transfers in	268,756	268,756	368,088	99,332
Total other financing sources (uses)	268,756	268,756	368,088	99,332
Net change in fund balance	24,202	(39,448)	(30,296)	9,152
Fund balance - beginning	121,959	121,959	121,959	-
Fund balance - ending	146,161	82,511	91,663	9,152

See accompanying notes to the financial statements

Other Schedules

**CITY OF HEMPHILL, TEXAS
GENERAL FUND
SCHEDULE OF CURRENT EXPENDITURES BY DEPARTMENT
BUDGET AND ACTUAL FOR THE YEAR ENDED JUNE 30, 2010**

General Government	Budget	Actual	Variance favorable (unfavorable)
Administration:			
Personnel	256,900	275,508	(18,608)
Supplies and materials	7,932	11,457	(3,525)
Maintenance and repairs	17,811	19,645	(1,834)
Contractual services	42,817	51,464	(8,647)
Miscellaneous	42,183	40,757	1,426
Total administration	367,643	398,831	(31,188)
Public Safety			
Fire Department:			
Personnel	2,638	600	2,038
Supplies and materials	9,336	7,540	1,796
Maintenance and repairs	6,263	2,558	3,705
Contractual services	5,142	4,308	834
Miscellaneous	3,161	1,050	2,111
Total fire department	26,540	16,056	10,484
Police department:			
Personnel	204,547	197,630	6,917
Supplies and materials	12,348	14,404	(2,056)
Maintenance and repairs	4,343	8,688	(4,345)
Contractual services	3,314	6,526	(3,212)
Miscellaneous	2,524	3,744	(1,220)
Total police department	227,076	230,992	(3,916)
Total public safety	253,616	247,048	6,568
Sanitation			
Personnel	-	1,210	(1,210)
Supplies and materials	5,361	7,530	(2,169)
Maintenance and repairs	-	2,052	(2,052)
Contractual services	207,407	194,409	12,998
Miscellaneous	250	7,631	(7,381)
Total sanitation	213,018	212,832	186

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
GENERAL FUND
SCHEDULE OF CURRENT EXPENDITURES BY DEPARTMENT
BUDGET AND ACTUAL FOR THE YEAR ENDED JUNE 30, 2010**

	Budget	Actual	Variance favorable (unfavorable)
Streets			
Personnel	80,803	79,494	1,309
Supplies and materials	20,558	29,513	(8,955)
Maintenance and repairs	2,847	1,407	1,440
Contractual services	2,213	6,230	(4,017)
Miscellaneous	100	-	100
Total streets	106,521	116,644	(10,123)
Parks and recreation			
Personnel	-	10,733	(10,733)
Supplies and materials	1,361	15,795	(14,434)
Maintenance and repairs	3,252	1,695	1,557
Contractual services	5,555	4,549	1,006
Miscellaneous	250	-	250
Total parks and recreation	10,418	32,772	(22,354)
Health and welfare			
Personnel	19,292	19,035	257
Supplies and materials	2,070	2,185	(115)
Maintenance and repairs	550	55	495
Contractual services	352	183	169
Miscellaneous	100	-	100
Total health and welfare	22,364	21,458	906
Cemetery			
Supplies and materials	250	-	250
Maintenance and repairs	6,300	5,750	550
Contractual services	800	-	800
Miscellaneous	100	-	100
Total cemetery	7,450	5,750	1,700
Total current expenditures	981,030	1,035,335	(54,305)

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
UTILITY FUND
SCHEDULE OF EXPENDITURES BY DEPARTMENT
BUDGET AND ACTUAL FOR THE YEAR ENDED JUNE 30, 2010**

	Budget	Actual	Variance favorable (unfavorable)
Electric Department			
Personnel	143,505	170,639	(27,134)
Supplies and materials	101,844	108,462	(6,618)
Maintenance and repairs	3,217	2,260	957
Contractual services	11,179	191	10,988
Cost of services	1,398,458	1,292,351	106,107
Depreciation	36,618	41,111	(4,493)
Other operating expenses	4,589	53	4,536
Total electric department	1,699,410	1,615,067	84,343
Gas department			
Supplies and materials	15,529	14,394	1,135
Maintenance and repairs	237	7	230
Contractual services	2,540	2,044	496
Cost of services	124,290	98,570	25,720
Depreciation	25,800	25,727	73
Other operating expenses	2,090	1,727	363
Total gas department	170,486	142,469	28,017
Water department			
Supplies and materials	35,913	30,198	5,715
Maintenance and repairs	250	4,225	(3,975)
Contractual services	1,101	1,218	(117)
Depreciation	22,572	21,055	1,517
Other operating expenses	855	2,717	(1,862)
Total water department	60,691	59,413	1,278

See accompanying notes to the financial statements

**CITY OF HEMPHILL, TEXAS
UTILITY FUND
SCHEDULE OF EXPENDITURES BY DEPARTMENT
BUDGET AND ACTUAL FOR THE YEAR ENDED JUNE 30, 2010**

	Budget	Actual	Variance favorable (unfavorable)
Sewer department			
Personnel	50,267	34,494	15,773
Supplies and materials	66,582	91,612	(25,030)
Maintenance and repairs	9,696	25,502	(15,806)
Contractual services	5,449	39,964	(34,515)
Depreciation	99,151	96,343	2,808
Other operating expenses	6,414	5,586	828
Total sewer department	237,559	293,501	(55,942)
Warehouse			
Personnel	322,283	287,381	34,902
Supplies and materials	36,816	36,218	598
Maintenance and repairs	6,504	7,381	(877)
Contractual services	17,265	51,366	(34,101)
Depreciation	21,826	21,573	253
Miscellaneous	25,434	22,767	2,667
Total warehouse	430,128	426,686	3,442
Water plant			
Personnel	195,690	148,726	46,964
Supplies and materials	98,047	117,996	(19,949)
Maintenance and repairs	18,403	21,950	(3,547)
Contractual services	21,218	26,806	(5,588)
Cost of services	723,463	714,059	9,404
Depreciation	111,844	110,531	1,313
Other operating expenses	12,777	11,245	1,532
Total water plant	1,181,442	1,151,313	30,129
Total expenditures	3,779,716	3,688,449	91,267

See accompanying notes to the financial statements

Statistical Tables

CITY OF HEMPHILL, TEXAS

SCHEDULE OF INSURANCE POLICIES IN FORCE

JUNE 30, 2010

Insurer	Amount of Coverage	Risk Covered	Expiration Date
Texas Municipal League Intergovernmental Risk Pool	\$2,000,000	Comprehensive General liability	10-01-10
	\$2,000,000	Sudden events - Pollution	10-01-10
	\$2,000,000	Automobile liability	10-01-10
	\$2,000,000	Law enforcement liability	10-01-10
	\$2,000,000	Errors and omissions	10-01-10
	\$3,360,900	Real and personal property	10-01-10
	\$500,000	Boiler and machinery accident	10-01-10
	As scheduled	Automobile physical damage	10-01-10
	\$161,684	Mobile equipment	10-01-10
	Statutory	Workers compensation	10-01-10
Texas Water Conservation Association Risk Management	\$1,487,365	Water treatment plant facilities and equipment	06-30-10

FEDERAL AWARDS SECTION



Certified Public Accountants

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Hemphill, Texas (City) as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements and have issued our report thereon dated September 24, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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

Honorable Mayor and Members of the City Council
City of Hemphill, Texas
Page 2

Compliance and Other Matters

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

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

Pipes & Associates

PIPES & ASSOCIATES
Certified Public Accountants

September 24, 2010

**CITY OF HEMPHILL, TEXAS
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010**

No findings reported.

**CITY OF HEMPHILL, TEXAS
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010**

No prior audit findings reported.

**CITY OF HEMPHILL, TEXAS
CORRECTIVE ACTION PLAN
FOR THE YEAR ENDED JUNE 30, 2010**

None required.