

FRANK CAMPOS, CPA

A Professional Limited Liability Company

The Auditor's Communication with Those Charged with Governance

March 23, 2012

To the Honorable Mayor and City Council
City of Palestine, Texas

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of Palestine, Texas for the year ended September 30, 2011. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and applicable, *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated October 21, 2011. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by City of Palestine, Texas are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2011. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the financial statements was:

Management's estimate of the allowance for doubtful accounts is based on historical water, sewer and sanitation revenues, historical loss levels, and an analysis of the collectibility of individual accounts. We evaluated the key factors and assumptions used to develop the allowance in determining that it is reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Member of Texas Society of CPAs and American Institute of CPAs

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Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 23, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of city council and management of City of Palestine, Texas and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Frank Campos

Frank Campos, CPA PLLC

FRANK CAMPOS, CPA

A Professional Limited Liability Company

MANAGEMENT LETTER

To the Honorable Mayor, City Council
And Management
City of Palestine, Texas

In planning and performing our audit of the financial statements of the governmental activities, and the General Fund of City of Palestine, Texas as of and for the year ended September 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered City of Palestine's internal control over financial reporting (internal control) 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 Governmental Unit's internal control. Our consideration of internal control included procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented, but it did not include procedures to test the operating effectiveness of controls, and accordingly, was not directed to discovering significant deficiencies in internal control. Accordingly, we do not express an opinion on the effectiveness of the Governmental Unit's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore there can be no assurance that all such deficiencies have been identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed on attached schedule, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency or 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. The attached schedule lists the material weakness of City of Palestine, Texas.

This communication is intended solely for the information and use of management, mayor, city council members, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Frank Campos

Frank Campos, CPA
March 23, 2012

**CITY OF PALESTINE
SCHEDULE OF FINDINGS**

**CURRENT YEAR FINDINGS
MATERIAL WEAKNESSES**

1. COUNTY CONTRIBUTION FOR LIBRARY

Finding

City and County have an agreement for the County to pay \$75,000 annually for support of the City Library. The Amount is budgeted every year on the City's budget. The City failed to bill the County \$75,000 for annual support until the auditor informed the Finance Department, during audit process, County had not paid.

Recommendation

City needs to bill County annually at first of fiscal year. City also needs to review budget to actual to ensure payments are received.

2. LICENSES AND PERMITS

Finding

Licenses and permits are issued by the Development Department after proof of payment. Licenses and permits are printed out of computer. No preprinted forms with control numbers or computer control numbers that are tied to a receipt are used. Cashiers have entered cash receipts for licenses and permits into receipting system differently, making it difficult to determine if licenses and permits have been paid. Licenses and permits can be issued without payment to cashiers and without oversight.

Recommendation

City needs to develop a system to control licenses and permits issuance to make sure payment is received before licenses and permits are issued. Cashiers need to be retrained to post receipts for licenses and permits the same way. An alternative is for the Finance Department to perform internal testing on license and permits.

3. CIVIC CENTER RENTALS

Finding

Duties for collection of payment and scheduling of rentals for the Civic Center are done at Civic Center with no oversight.

Recommendation

City needs to develop a system to ensure payment is received for all rentals. Alternative is for Finance Department to perform internal testing on rentals.

4. POLICE EVIDENCE ROOM

Finding

Personnel in charge of Evidence Room keeps keys to Evidence Room with alarm switch in office drawer, unsecured. Office is left opened and keys and alarm switch are not secured. Officer in charge of maintaining inventory semi-annual and annually also has access to keys and alarm switch.

Recommendation

City needs to keep Evidence Room keys and alarm switch secured. Officer in charge of maintaining inventory should have an employee outside of the police department count inventory with officer and sign off on inventory.

5. POLICE GRANTS

Finding

Prior officer in charge of police grants left abruptly without leaving passwords to grants reporting websites. Also knowledge of grant requirements and grant documentation has difficult been to locate without passwords.

Recommendation

City needs to have supervisor of employee in charge of grant passwords be informed of password. Also cross-training of employees on grants will cut down on confusion of grants after employee leaves.

MATTERS PREVIOUSLY REPORTED

MATERIAL WEAKNESSES:

1. BANK RECONCILIATIONS

Finding

Some of the City's bank accounts were not reconciled monthly in a timely manner. Errors and fraud will take longer to discover when accounts are not reconciled timely. Also, monthly financial reports may contain errors since accounts are not reconciled.

Recommendation

Bank reconciliations need to be prepared and reviewed monthly in a timely manner to ensure all cash transactions are recorded.

Management Response

All bank accounts are to be reconciled and reviewed by a supervisor within 30 days of receipt of bank statements.

Status

Control implemented.

2. CHECK DISBURSEMENT

Finding

City policy is to allow accounts payable clerk and payroll clerk to enter payable data and to print checks after approval from management. Clerks have access to password for check signer's signatures and print checks with signatures.

Recommendation

Best internal control practice is to not allow clerks to have access to signature passwords. If that is not feasible then additional verification of check, invoices and reconciliation of check numbers is needed. This will not eliminate risk but will lower the risk of fraud.

Management Response

Management will input password for clerk when checks need to be printed.

Status

Control implemented.

3. BANK RECONCILIATIONS AND CHECK DISBURSEMENT

Finding

Account payable clerk enters invoices, write checks, signs checks and reconciles bank accounts.

Recommendation

Best internal control practice is to separate responsibilities to different personnel, but if that is not feasible then extra effort should be taken in reviewing bank reconciliation and any discrepancies.

Management Response

Assistant finance director to review bank reconciliations.

Status

Control implemented.

4. PAYROLL

Finding

Payroll clerk enters payroll time, write checks, signs payroll checks and has access to modify employee setup and maintenance information.

Recommendation

Payroll clerk should not have ability to modify employee information. Clerk should have access to view information, but not modify information.

Management Response

Ability to modify employee setup and maintenance information will be restricted to Human Resources personnel only.

Status

Incomplete. Software system does not allow for viewing only of employee set information. The system does provide a report showing modification of employee information and user who modified it. Report should be printed monthly and reviewed by assistant finance director to ensure only authorize user modified employee information.

5. MONTH END CLOSING PROCEDURES

Finding

It appeared the City lacked a formal process for closing books at end of each month. A number of adjustments were required at year end during audit process to correct general ledger account balances after audit commenced. Accordingly, it did not appear that some subsidiary ledgers and other support were being compared to the general ledger on a monthly basis to ensure interim financial reporting were correct.

Recommendation

City should develop a formal closing process at month end including reviewing supporting subsidiary ledgers and other supporting documents to determine accuracy and to ensure the general ledger is appropriately adjusted and the financial statements accurate.

Management Response

Finance Director will develop formal monthly closing schedule.

Status

In progress. Although general ledger was in better condition than last year. Delays in audit field work occurred due to major accounts not being adjusted at year end. Such as governmental receivables, utility receivables, governmental and utility notes payable, governmental and utility reserve for bad debts and other accounts.

6. MONTHLY REPORTING

Finding

Over the last several years, city council has not received monthly financial information on the city's major funds. The city council needs timely, monthly financial information to make informed decisions on City's finances.

Recommendation

Finance department should give city council timely, monthly reports on City's major funds.

Management Response

Develop monthly reports to council.

Status

Control implemented.

7. DISMISSAL OF COURT CASES

Finding

City policy is to allow court clerks to dismiss cases after judge has approved dismissal. System allows clerks to dismiss cases without judges approval and no one verifies that dismissed cases were approved by judge.

Recommendation

City should have a system in place to ensure dismissed cases are approved by judge for dismissal. The employee verifying dismissal should not be authorized to dismiss cases.

Management Response

Finance director will pull a sample for verification purposely at least quarterly.

Status

Control implemented.

8. DAILY DEPOSITS

Finding

City policy is to have cashiers put their daily deposits in lock bags, but keys to bags are kept in supervisor's office on her desk unsecured.

Recommendation

Keys to unlock deposit bags should be kept in secure location or preferably cashier should only have key to their deposit bag.

Management Response

We concur with recommendation.

Status

Control implemented.

9. DAILY DEPOSITS

Finding

Deposit bags are kept in file cabinet in safe until deposit is made later in day. Safe is kept unlocked during day and only locked at night. Also, cashier video cameras do not tape anyone coming in or out of safe.

Recommendation

Daily deposit should be stored in secure location. Also a review of video cameras' placement should be done since partitions are being used in utility department, which obscure video line of sight.

Management Response

We concur with recommendation.

Status

Control implemented.

10. AIRPORT FUEL

Finding

No system is in place to verify that a decrease in fuel inventory is a result from sale of fuel.

Recommendation

A system should be in place to reconcile a decrease in fuel inventory with fuel sales.

Management Response

Develop formal inventory system; recommend that tanks are taped at month end.

Status

In progress. Airport personnel are taking inventory and keeping up with gallons sold but there is no oversight of Airport personnel. No one verifies information reported is correct.

11. FINANCIAL STATEMENT PRESENTATION

Finding

The City has engaged a licensed certified public accounting firm to prepare and audit the City's annual financial report. The City ensures the quality of its annual financial report by engaging a qualified audit firm with particular experience in governmental audits and reading a preliminary draft of the report. The City does not have specific controls in place to separately review the selection and application of accounting principles and resulting disclosures and presentations with the financial statements. Although it is common within the government sector and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect. Since some presentations and disclosures may be material to the financial statements, this weakness in internal control would be classified material.

Recommendation

The City should continue to read its annual financial report and ensure the quality of both the document and the preparer. No changes in operation are recommended.

Management Response

We concur with recommendation.

12. AUDIT ADJUSTMENTS

Finding

In the normal course of the audit process the auditor recommends adjustments to the City's accounting records, as well as proposes other adjustments needed for preparing full accrual statements in compliance with GASB 34. The City does not have specific controls in place to eliminate all adjustments or to review other calculation required by GASB 34. Although it is common within the government sector and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect. Since some adjustments and calculations may be material to the financial statements, this weakness in internal control would be classified material.

Recommendation

The City should continue to read its annual financial report and ensure the quality of both the document and the preparer. No changes in operation are recommended.

Management Response

We concur with recommendation.

13. SEGREGATION OF DUTIES

Background

Segregation of duties refers to assigning tasks among personnel so that no one person handles substantially all aspects of a transaction. The extent to which the City can segregate duties is limited based on the number of personnel, their skill set and work load, and the organizational structure of the City.

Finding

As with other Cities of the same staff size, there are instances where additional controls could be put in place if more personnel were available and further segregation in duties could be achieved. While the City's segregation of duties appear reasonable given the number of personnel there are some inherent risks given the City's staff size.

This matter is being reported to comply with new reporting requirements pertaining to matters commonly known or previously reported.

Recommendation

The City should continue to evaluate opportunities for greater segregation of duties.

Management Response

We concur with recommendation.

OTHER MATTERS

1. DEFICIT FUND BALANCE

Finding

We noted the following funds reported a deficit fund balance:

<u>Fund</u>	<u>Deficit</u>
Airport	\$ 150,509
Municipal Court Technolgy	\$ 1,199
Fitness	\$ 787
Home Grant	\$ 5,980
Sanitation	\$ 362,882
Health Insurance	\$ 903,306

Recommendation

The city should adopt fund balance policy, whereby, each fund has an established target or reserve to meet the objective of that fund.

Status

In progress. Same funds plus Central Warehouse fund have deficit fund balances in 2011.

Airport Fund – City discovered during the year customers were getting various discounts on fuel and fuel prices were not being adjusted for increase in fuel costs. At times, fuel sale prices did not cover fuel cost due to evaporation.

Status

Corrected.

Sanitation Fund – City discovered during year, that city was being billed monthly for sanitation services in excess of 1,000 more residential accounts than actual city residential customers.

Status

Corrected.

Health Insurance Fund - Health insurance fund is self-insured. The general fund has loaned the health insurance \$450,000 to pay employee medical claims. The fund balance has a deficit balance of over \$900,000. The city should review its health insurance program and consider changing plan so it is not self-insured. The city should also review employee health benefits to reduce city costs.

Status

In progress. Health Insurance fund has deficit fund balance of \$1,088,240 at September 30, 2011.

ANNUAL FINANCIAL REPORT

of the

CITY OF PALESTINE, TEXAS

For the Year-ended September 30, 2011

Officials Issuing Report:

**Michael Ohrt, City Manager
Elizabeth Saegert, Finance Director**

CITY OF PALESTINE, TEXAS
TABLE OF CONTENTS
September 30, 2011

INTRODUCTORY SECTION

Letter of Transmittal	2
-----------------------	---

FINANCIAL SECTION

Independent Auditors' Report	7
-------------------------------------	---

Management's Discussion and Analysis	10
---	----

BASIC FINANCIAL STATEMENTS

Government-Wide Financial Statements

Statement of Net Assets	20
Statement of Activities	21

Fund Financial Statements Governmental Funds Financial Statements

Balance Sheet - Governmental Funds	23
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	24
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds	25
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities	26

Proprietary Funds Financial Statements

Statement of Net Assets	27
Statement of Revenues, Expenses, and Changes in Fund Net Assets	29
Statement of Cash Flows	31

Notes to Financial Statements	35
--------------------------------------	----

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual:	
General Fund	58
Schedule of Funding Progress - Texas Municipal Retirement System	59
Schedule of Funding Progress - Post-Employment Healthcare Benefits	60

COMBINING STATEMENTS AND SCHEDULES

Combining Balance Sheet - Nonmajor Governmental Funds	63
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances - Nonmajor Special Revenue Funds	67

CITY OF PALESTINE, TEXAS
TABLE OF CONTENTS, Continued
September 30, 2011

Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual: Special	
Revenue:	
Tourism and Civic Center	71
Airport	72
Cemetery	73
Municipal Court Technology	74
Municipal Court Security	75
Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - Debt Service Fund	76
Combining Statement of Net Assets - Internal Service Funds	78
Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets- Internal Service Funds	80
Combining Statement of Cash Flows - Internal Service Funds	82

INTRODUCTORY SECTION



City of Palestine

March 26, 2012

Honorable Mayor, City Council, and Citizens of the City of Palestine, Texas:

The Finance Department and City Manager's Office are pleased to submit the Annual Financial Report for the City of Palestine, Texas (the City), for the year-ended September 30, 2011.

This report is published to provide the City Council, City staff, our citizens, our bondholders, and other interested parties with detailed information concerning the financial condition and activities of the City government. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the City.

To the best of our knowledge and belief, the enclosed data is accurate in all material respects, and is organized in a manner designed to fairly present the financial position and results of operations of the City as measured by the financial activity of its various funds. We also consider that all disclosures necessary to enable the reader to gain the maximum understanding of the City's financial affairs have been included.

As required by the City's charter, the financial statements have been audited by Frank Campos, CPA, PLLC. The goal of the independent audit was to provide reasonable assurances that the financial statements of the City of Palestine for the fiscal year-ended September 30, 2011, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the City of Palestine's financial statements for fiscal year-ended September 30, 2011, are presented in conformity with generally accepted accounting principles (GAAP).

THE REPORT

This Annual Financial Report is presented in two sections: Introductory and Financial. The introductory section includes this transmittal letter. The financial section includes a Management Discussion and Analysis (MD&A), basic financial statements and combining and individual fund statements and schedules, as well as the independent auditor's report on the basic financial statements. The MD&A is a narrative introduction, overview, and analysis to accompany the basic financial statements. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with the MD&A. The City of Palestine's MD&A can be found immediately following the report of the independent auditor.

The Financial Section described above is prepared in accordance with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board (GASB) and other professional associations, as applicable.

CITY PROFILE

Location

The City is located in the Piney Woods of East Texas in the geographic center of Anderson County. Palestine is 100 miles southeast of Dallas and 160 miles north of Houston. The City is located on a ridge between the Neches and Trinity Rivers, offering beautiful rolling hills covered by tall pine trees. The City has a major rail corridor and several state and federal highways that traverse the City, creating a major commercial and residential hub for the Anderson County region. The City encompasses approximately 19.5 square miles as well as an extensive extraterritorial jurisdiction. Being a community of significant regional importance for well over 100 years, Palestine is rich in history and culture making it a recognized tourist destination. The Texas State Railroad operates several historical trains that provide a unique living history to those who visit this local park. The City is a short distance from the impressive Lake Palestine to the north and grand fishing at Richland-Chambers Lake to the west. The City is proud of its natural resources and offers over a thousand acres of city parkland for its citizens and visitors to enjoy.

Organization

The City was incorporated in 1848, and currently operates under a Council-Manager form of government. The City Council is comprised of a Mayor and six council members, and is responsible for enacting legislation in the form of ordinances, resolutions, and regulations governing the City, as well as the Mayor appointing members of various statutory and advisory boards.

The City Manager is the chief administrative officer of the City, and is responsible for enforcement of laws and ordinances, as well as appointment of the various department heads of the municipal organization.

Services Provided

The City provides to its citizens those services that have proven to be necessary and meaningful in which the City can provide at the least cost. Major services provided under general government and enterprise functions are: fire and rescue, police, streets, water and wastewater utilities, solid waste, code enforcement, parks and recreation, public improvements, community development and planning, and general administrative services. The City also offers the Civic Center and is aggressive in servicing the region's economic development.

Accounting System and Budgetary Control

The City's accounting records for general governmental operations are maintained on a modified accrual basis, with the revenues being recorded when available and measurable and expenditures being recorded when the services or goods are received and the liabilities are incurred. Accounting records for the City's utilities and other proprietary activities are maintained on the accrual basis.

In developing and evaluating the City's accounting system, consideration is given to the adequacy of internal accounting controls as deemed appropriate by the City Manager. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by the City Manager. All internal control evaluations occur within the above framework, Internal controls are designed to provide reasonable, but not absolute assurance regarding (1) safeguarding of assets against loss from unauthorized use or disposition and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The City believes that its internal controls adequately safeguard and provide reasonable assurance from improper recording of financial transactions. The City's controls are designed to provide reasonable assurance that errors or irregularities that could be material to the financial statements are prevented or would be detected within a timely period by employees in the normal course of performing their assigned duties.

The objective of budgetary controls is to ensure compliance with legal provisions contained in the annual appropriated budget approved by the City Council. Annual appropriation budgets are adopted for the general, special revenue, debt service, enterprise, and internal service funds. The original budget is adopted by the City Council prior to the beginning of the fiscal year. Amendments to the original budget are also approved by the City Council and/or City Manager during the year. The original and final amended budgets are used in this report. Budgets for capital projects funds are normally budgeted on a project basis and not a fiscal year basis. The level of budgetary control (the level at which expenditures cannot legally exceed appropriations) is maintained at the department or project level. The City Manager may approve transfers of unencumbered appropriations between general classifications of expenditures within a department, provided the transfer amounts do not result in a net increase in total appropriations and further provided that the amount should not be transferred from or to any capital outlay line item account. All transfers are reported to the City Council on a monthly basis. The City also maintains an encumbrance accounting system as one method of accomplishing budgetary control. Open encumbrances are reported as reservations of the fund balance at year-end, and are generally re-appropriated as part of the subsequent year's budget. Otherwise, unspent and unencumbered budget appropriations lapse at year-end.

ECONOMIC OUTLOOK AND FINANCIAL CONDITION

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the City operates.

Regional Economy

Palestine and the surrounding area have experienced a downturn local economy during 2010 and into 2011, with a continued positive outlook even amid a national recession that will surely be remembered as one of the nation's most difficult economic challenges. The City of Palestine has been insulated, primarily from the housing crisis, and even benefited from the increase in oil and gas prices that peaked to historic rates at the end of the fiscal year. Unemployment, nationally, has taken a toll of jobs over this recession period and the City of Palestine lost several employers over the last few years. Palestine still has major employers. One major employer in Palestine is the Texas Department of Corrections which houses over 12,000 inmates and provides over 21% of county employment opportunities. Other stable employers include the Wal-Mart Distribution and Retail Centers with 2,200 employees and a large hospital system with over 800 employees and two 3A independent school districts within the city limits.

As one of the older cities in Texas, Palestine has a large number of historic landmarks. This combined with the native beauty of the area, the nearby Texas State Railroad, and several festivals, make tourism a significant part of the economy.

The City has worked hard in attracting a diversity of jobs relating to retail, distribution, destination tourism, medical and light manufacturing, several hotel chains, a large medical clinic and several assisted living centers. The community is excited about our future with the recent opening of the University of Texas at Tyler expanded campus for the growing student body at Palestine.

Cash Management

The City's investment policy defines the parameters by which the City's investments are made. The objectives of the policy are safety, liquidity, and yield, of which safety is of primary importance. Idle cash is pooled for short-term investment in collateralized bank certificates of deposit, U.S. government obligations or in TexPool or TexSTAR, state investment pools.

Risk Management

Insurance coverage for property, liability, and Workers' Compensation is provided by the Texas Municipal League Intergovernmental Risk Pool (the Risk Pool), a State Insurance Pool. Contributions to the Risk Pool for Workers' Compensation rates are based on the City's past claims history. The Risk Pool retains a limit of loss and reinsurance companies insure the risks beyond those limits. During the fiscal year, representatives from the Risk Pool physically reviewed City facilities to identify possible risks.

Through September 30, 2000, the City had a self-funded Workers' Compensation fund with stop loss insurance for larger claims. Effective October 1, 2000, the City converted to a fully insured Workers Compensation program. Due to favorable results and intended over-funding in prior years, the fund balance in the Workers' Compensation Fund of \$113,770 is considered by plan administrators and City staff to be far more than needed for any possible unexpected claim losses that existed prior to ending self insurance.

Independent Audit

State and local statutes require an annual audit by independent certified public accountants. The accounting firm of Frank Campos, CPA, PLLC, was selected by the City Council to conduct the audit and to assure compliance with generally accepted accounting principles in the United States of America.

ACKNOWLEDGEMENTS

Acknowledgements

In closing, without the dedication of the employees and the direction of the Mayor and members of City Council, preparation of this report would not have been possible. As Finance Director, I want to express my sincere appreciation to our employees who have demonstrated their professionalism and abilities in management of the financial function. I also want to thank the Mayor and City Council for their support in planning and conducting financial operations of the City with progressive leadership.

Respectfully submitted,

Elizabeth Sanders Saegert, CPA

FINANCIAL SECTION

FRANK CAMPOS, CPA

A Professional Limited Liability Company

INDEPENDENT AUDITORS' REPORT

The Honorable Mayor and
Members of City Council
City of Palestine, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Palestine, Texas (the City), as of September 30, 2011 and for the year then ended, 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 of Palestine'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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Palestine, Texas as of September 30, 2011, 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 March 23, 2012, 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.

Accounting principles generally accepted in the United States of America require that management's discussion analysis on pages 10-17 and budgetary comparison information on pages 58, pension information on page 59 and post-employment healthcare benefit and page 60 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 of Palestine, Texas's financial statements as a whole. The introductory section, combining and individual nonmajor fund financial statements, are presented for purposes of additional analysis and are not a required part of the financial statements. The combining and individual nonmajor fund financial statements 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. The introductory section has 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 them.

Frank Campos

Frank Campos, CPA, PLLC
March 23, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
September 30, 2011

The purpose of the Management's Discussion and Analysis (MD&A) is to give the readers an objective and easily readable analysis of the financial activities of the City of Palestine, Texas (the City) for the year-ending September 30, 2011. The analysis is based on currently known facts, decisions, or economic conditions. It presents a short and long-term analysis of the City's activities, compares current year results with those of the prior year, and discusses the positive and negative aspects of that comparison. Governmental Accounting Standards Board (GASB) Statement No. 34 establishes the content of the minimum requirements for the MD&A. Please read the MD&A in conjunction with the transmittal letter at the front of this report and the City's financial statements, which follow this section.

THE STRUCTURE OF OUR ANNUAL REPORT

The annual financial report is presented as compliant with the financial reporting model in effect pursuant to GASB Statement No. 34. This financial reporting model requires governments to present certain basic financial statements as well as the MD&A and certain other Required Supplementary Information (RSI). The basic financial statements include (1) government-wide financial statements, (2) individual fund financial statements, and (3) notes to the financial statements.

Government-Wide Statements

The government-wide statements report information for the City as a whole. These statements include transactions and balances relating to all assets, including infrastructure capital assets. These statements are designed to provide information about cost of services, operating results, and financial position of the City as an economic entity. The Statement of Net Assets and the Statement of Activities, which appear first in the City's financial statements, report information on the City's activities that enable the reader to understand the financial condition of the City. These statements are prepared using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account even if cash has not yet changed hands.

The Statement of Net Assets presents information on all of the City's assets and liabilities. The difference between the two is 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 is improving or deteriorating. Other nonfinancial factors, such as the City's property tax base and the condition of the City's infrastructure, need to be considered in order to assess the overall health of the City.

The Statement of Activities presents information showing how the City's net assets changed during the most recent year. All changes in the net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows using the accrual method rather than modified accrual that is used in the fund level statements.

The Statement of Net Assets and the Statement of Activities divide the City into two classes of activities:

1. Governmental Activities - Most of the City's basic services are reported here including general government, community development, fire and rescue, leisure services, maintenance, Municipal Court, police, and streets and drainage. Interest payments on the City's debt are also reported here. Sales tax, property tax, franchise taxes, Municipal Court fines, and permit fees finance most of these activities.
2. Business-Type Activities - Services involving a fee for those services are reported here. These services include the City's water distribution, wastewater collection/treatment, and sanitation.

The government-wide financial statements can be found after the MD&A.

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2011

FUND FINANCIAL STATEMENTS

Funds may be considered as operating companies of the parent corporation, which is the City. They are usually segregated for specific activities or objectives. The City uses fund accounting to ensure and demonstrate compliance with finance-related legal reporting requirements. The two categories of City funds are governmental and proprietary.

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 inflows and outflows of spendable resources*, as well as *on balances of spendable resources* available at the end of the 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 government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains 27 individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund, which is considered to be a major fund. The City adopts an annual appropriated budget for its general fund and several of the special revenue funds. Budgetary comparison schedules have been provided for these funds to demonstrate compliance with these budgets.

Proprietary Funds

The City maintains three types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water distribution, wastewater collection/treatment, solid waste and retail operations. The proprietary fund financial statements provide separate information for the water distribution, wastewater collection/treatment, and solid waste and retail funds. The basic proprietary fund financial statements can be found in the basic financial statements of this report.

The City also uses internal service funds to account for its equipment replacement services, workers' compensation, central warehouse, health insurance, and unemployment. These internal service funds have been included within governmental activities in the government-wide financial statements.

Notes to Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes are the last section of the basic financial statements.

Other Information

In addition to basic financial statements, MD&A, and accompanying notes, this report also presents certain Required Supplementary Information (RSI). The RSI that GASB Statement No. 34 requires includes budgetary comparison schedules for the general fund and schedule of funding progress for the Texas Municipal Retirement System. RSI can be found after the basic financial statements.

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2011

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of the City's financial position. For the City, assets exceed liabilities by \$36,041,062 as of year-end in the primary government. As required by GASB Statement No. 34, a comparative analysis of government-wide data has been presented as a component of the MD&A for the year. The largest portion of the City's net assets (85%) reflects its investments in capital assets (e.g., land, building, equipment, improvements, construction in progress, and infrastructure), less any debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's 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 assets themselves cannot be used to liquidate these liabilities.

Statement of Net Assets

The following table reflects the condensed Statement of Net Assets:

SUMMARY OF STATEMENT OF NET ASSETS

	Governmental Activities		Business -type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Current and other assets	\$ 4,609,883	\$ 5,154,648	\$ 10,207,275	\$ 13,949,752	\$ 14,817,158	\$ 19,104,400
Capital assets	20,168,402	21,311,236	29,018,469	26,165,822	49,186,871	47,477,058
Total assets	24,778,285	26,465,884	39,225,744	40,115,574	64,004,029	66,581,458
Other liabilities	1,091,426	1,332,285	1,388,155	1,285,565	2,479,581	2,617,850
Long-term liabilities	11,614,720	12,334,107	13,868,666	15,467,104	25,483,386	27,801,211
Total liabilities	12,706,146	13,666,392	15,256,821	16,752,669	27,962,967	30,419,061
Net Assets:						
Invested in capital assets,						
net of related debt	10,032,101	10,638,424	20,515,764	15,027,092	30,547,865	25,665,516
Restricted	723,203	1,634,759	1,742,282	5,947,381	2,465,485	7,582,140
Unrestricted	1,316,835	526,309	1,710,877	2,388,432	3,027,712	2,914,741
Total net assets	\$ 12,072,139	\$ 12,799,492	\$ 23,968,923	\$ 23,362,905	\$ 36,041,062	\$ 36,162,397

A portion of the primary government's net assets, \$2,465,485, represents resources that are subject to external restriction on how they may be used. The remaining balance of unrestricted net assets, \$3,027,712, may be used to meet the City's ongoing obligation to citizens and creditors. The overall financial condition of the City slightly decreased during the year due to the local economy improving, but not yet overcome the decline in the economy in 2010.

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued

September 30, 2011

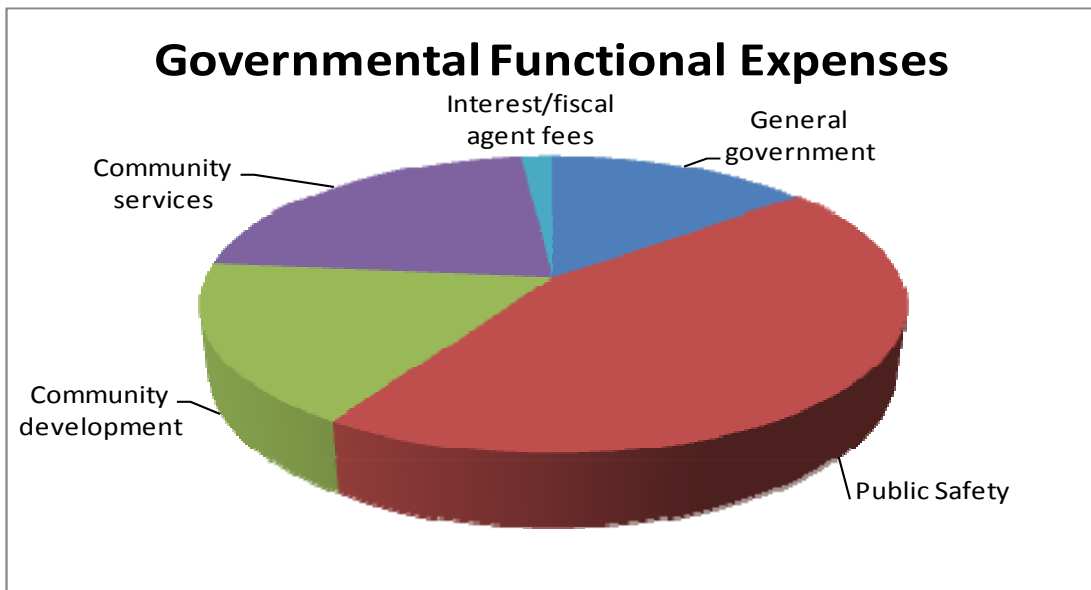
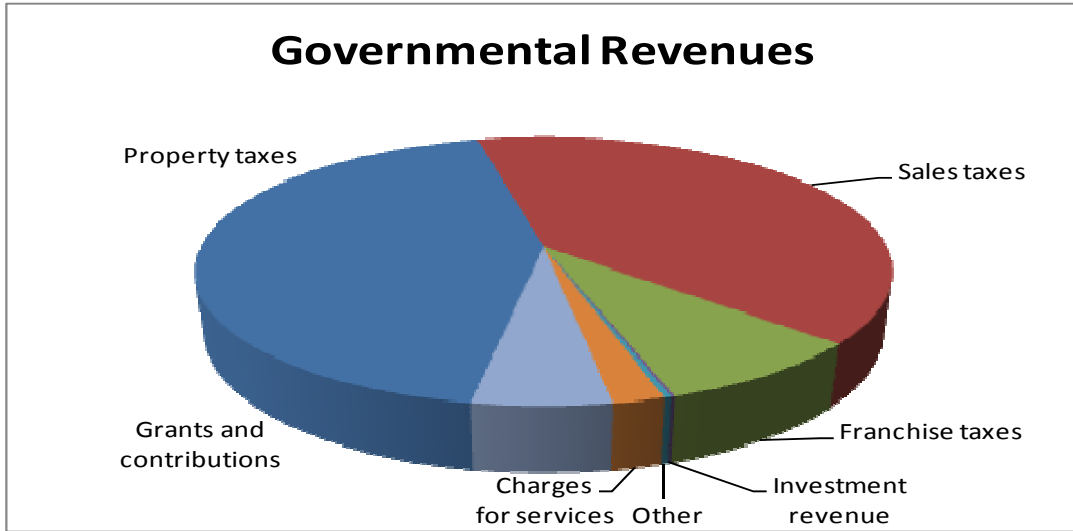
Statement of Activities

The following table provides a summary of the City's changes in net assets:

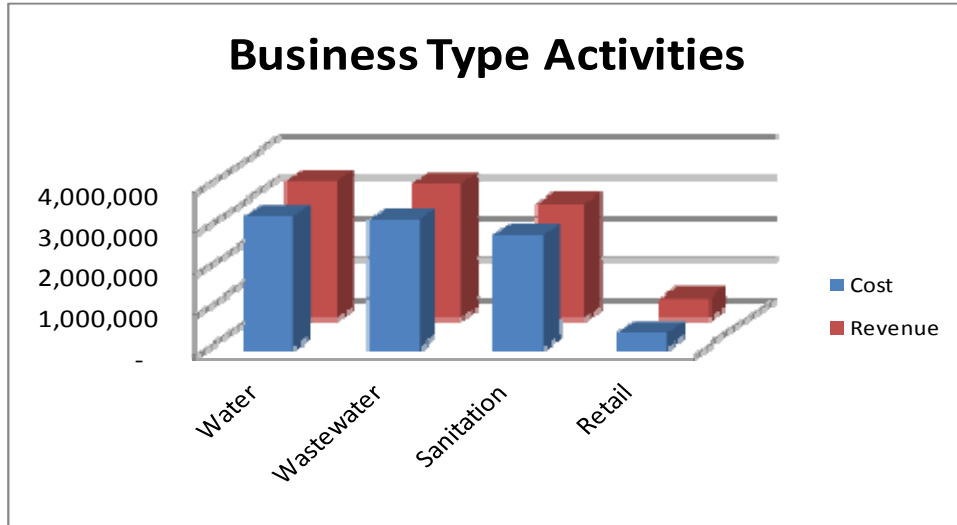
	CITY OF PALESTINE'S CHANGES IN NET ASSETS					
	Governmental Activities		Business -type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Revenues:						
Program revenues:						
Charges for services	\$ 947,095	\$ 948,927	\$ 9,991,622	\$ 8,820,313	\$ 10,938,717	\$ 9,769,240
Operating grants and contributions	274,365	285,923	-	-	274,365	285,923
Capital grants and contributions	457,124	175,280	681,996	148,334	1,139,120	323,614
General revenues:						
Property taxes	5,894,097	5,780,079	-	-	5,894,097	5,780,079
Sales taxes	5,425,434	5,118,332	-	-	5,425,434	5,118,332
Franchise taxes	1,147,029	1,227,490	-	-	1,147,029	1,227,490
Investment earnings	20,004	41,719	13,945	56,060	33,949	97,779
Other income (loss)	(37,566)	123,808	-	-	(37,566)	123,808
Total revenues	<u>14,127,582</u>	<u>13,701,558</u>	<u>10,687,563</u>	<u>9,024,707</u>	<u>24,815,145</u>	<u>22,726,265</u>
Expenses:						
General government	2,256,316	1,746,493	-	-	2,256,316	1,746,493
Public safety	6,923,063	7,670,153	-	-	6,923,063	7,670,153
Community services	3,374,158	4,710,114	-	-	3,374,158	4,710,114
Community development	2,748,876	1,601,529	-	-	2,748,876	1,601,529
Interest on long-term debt	266,496	486,914	-	-	266,496	486,914
Water	-	-	3,237,448	2,908,460	3,237,448	2,908,460
Wastewater	-	-	3,018,876	2,888,087	3,018,876	2,888,087
Sanitation	-	-	2,755,960	2,277,362	2,755,960	2,277,362
Retail	-	-	355,287	190,662	355,287	190,662
Total expenses	<u>15,568,909</u>	<u>16,215,203</u>	<u>9,367,571</u>	<u>8,264,571</u>	<u>24,936,480</u>	<u>24,479,774</u>
Increases (decreases) in net assets before transfers	(1,441,327)	(2,513,645)	1,319,992	760,136	(121,335)	(1,753,509)
Extraordinary item - destruction of govt. prop.	-	16,257	-	-	-	16,257
Transfers	713,974	(7,211,980)	(713,974)	7,211,980	-	-
Change in net assets	(727,353)	(9,709,368)	606,018	7,972,116	(121,335)	(1,737,252)
Net Assets - beginning	<u>12,799,492</u>	<u>22,508,860</u>	<u>23,362,905</u>	<u>15,390,789</u>	<u>36,162,397</u>	<u>37,899,649</u>
Net Assets - ending	<u>\$ 12,072,139</u>	<u>\$ 12,799,492</u>	<u>\$ 23,968,923</u>	<u>\$ 23,362,905</u>	<u>\$ 36,041,062</u>	<u>\$ 36,162,397</u>

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2011

Graphic presentations of selected data from the summary tables follow to assist in the analysis of the City's activities.



CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*
September 30, 2011



For the year, revenue from governmental activities totaled \$14,127,582. Property and sales tax revenues are the City's largest revenue sources. Property and sales tax revenues both increased by 6.53% and 6%, respectively. The local economy is slowly improving from the recession in 2010 that affected the entire country.

Franchise fees collected from electric, gas, cable, and telephone/telecommunications utilities, totaled \$1,147,029 for the year, a decrease of 7% from the prior year.

For the year, expenses for governmental activities totaled \$15,568,909. This represents a decrease of \$646,294 over last year. The decrease was budgeted by management and council to improve city finances.

Business-type activities net assets increased by \$606,018, which is largely attributable to water fund increases resulting from a very dry year.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As noted earlier, fund accounting is used to demonstrate and ensure compliance with finance-related legal requirements.

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 the City's net resources available for spending at the end of the year.

The City's governmental funds reflect a combined fund balance of \$3,135,568. Of this, \$547,882 is reported in nonspendable –notes receivables, \$1,131,305 is reported as restricted, \$301,208 is reported as committed and the remaining fund balance of \$1,155,173 is unassigned.

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2011

The general fund reported a increase in fund balance due to a increase in sales and property tax revenue for the current year and transfer in from other funds of \$776,583.

Proprietary Funds - The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

GENERAL FUND BUDGETARY HIGHLIGHTS

There had been a planned increase in budgeted fund balance in the amount of \$15,540 in the general fund. However, the net change in fund balance increased by \$114,441 resulting in a positive variance of \$98,901 from budgeted as amended over actual. General fund revenues were under budget by \$185,373 and general fund expenditures were under budget by \$282,274. Main revenues under budget were property taxes, licenses, permits, fees, fines and forfeitures. Main expenditures under budget were community services and community development.

CAPITAL ASSETS

At year-end, the City's governmental activities funds had invested \$20,168,402 in a variety of capital assets and infrastructure (net of accumulated depreciation). Depreciation is included with the governmental capital assets as required by GASB Statement No. 34 with depreciation expense of \$1,686,779.

Major capital asset events during the current year include the following:

- Purchase of equipment
- Infrastructure improvements

The following table reflects the summary schedule of City's capital assets at year-end:

CITY OF PALESTINE'S CAPITAL ASSETS AT YEAR END

	Governmental Activities		Business -type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Land	\$ 1,716,505	\$ 1,720,328	\$ 1,800,469	\$ 1,800,469	\$ 3,516,974	\$ 3,520,797
Buildings	5,637,206	6,097,050	9,992,965	9,689,088	15,630,171	15,786,138
Improvements	7,545,903	7,473,888	-	-	7,545,903	7,473,888
Machinery and equipment	8,109,205	7,997,408	332,337	237,694	8,441,542	8,235,102
Infrastructure	30,134,299	30,134,299	36,133,914	31,648,869	66,268,213	61,783,168
Construction in progres	671,633	135,370	3,224,230	3,821,109	3,895,863	3,956,479
Less accumulated depreciation	(33,646,349)	(32,247,107)	(22,465,446)	(21,031,407)	(56,111,795)	(53,278,514)
Net Assets - ending	<u>\$ 20,168,402</u>	<u>\$ 21,311,236</u>	<u>\$ 29,018,469</u>	<u>\$26,165,822</u>	<u>\$ 49,186,871</u>	<u>\$ 47,477,058</u>

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

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2011

LONG-TERM DEBT

At the end of the current year, the City had total certificates of obligation of \$9,582,000 and \$13,719,128 in revenue bonds outstanding. The City redeemed \$390,000 of certificates of obligations bonds and \$1,478,200 of revenue bonds, during the year. The City also entered into capital lease of \$123,736.

The following table reflects the summary schedule of City's outstanding debt at year-end:

CITY OF PALESTINE'S OUTSTANDING DEBT AT YEAR END

	Governmental Activities		Business -type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Capital leases	\$ 554,301	\$ 700,812	\$ 199,920	\$ 384,278	\$ 754,221	\$ 1,085,090
Revenue Bonds	-	-	\$ 13,519,208	\$ 14,997,448	13,519,208	14,997,448
Certificates of obligation	9,582,000	9,972,000	-	-	9,582,000	9,972,000
Total	\$ 10,136,301	\$ 10,672,812	\$ 13,719,128	\$ 15,381,726	\$ 23,855,429	\$ 26,054,538

More detailed information about the City's long-term liabilities is presented in Note E to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The national unemployment rate for September 2011 was 8.3% and the State of Texas rate was 8.0%. The Anderson County unemployment rate has historically run slightly higher than the state average and was recorded at 9.5% which is a .4% increase from September of 2010. The national economic condition has supplied a great deal of caution into our local employment expansion and business commerce. Much of the economic climate and data for the community suggest that the national economy is actually suppressing the growth potential in the local economy. The region has been insulated from most of the national economic hardships that are more deeply felt outside East Texas. Some uncertainty and decline in the consumer confidence has been related to the prolonged national economic outlook. On the other hand, it is believed that job availability and opportunity does exist and if the downturn continued, these jobs would be obtainable by qualified persons. One such example of job availability is employment with the State of Texas at one of the area correctional facilities.

The City continues to work towards attracting a diverse business base. One of the mistakes in years past was that the key industry was predominately oil and gas; an industry that is dependent on global variables that are outside the control and influence of the local economy. The City has worked hard in attracting a diversity of jobs. Community leaders have focused on educational opportunities within the community by locating a trade facility within the city limits and an expansion of the local University of Texas campus. It is believed that these educational sources will provide future economic growth and new job opportunities to the community. The Texas State Railroad continues to grow ridership since its operation was privatized and is a major boost in our local tourism. The Main Street program has helped downtown businesses with improvements to several storefront facades and marketing the downtown as a tourist destination.

CITY OF PALESTINE, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2011

The local economy has managed to endure what is believed to be the tail end of the national recession with predictions that the decline is over; the local economy has seen an increase in sales tax collections in the first of 2012 fiscal year. The City will continue to aggressively pursue ways to expand the community resources and create greater economic opportunities for its citizens so that the City can endure the national economy downturn and land with our feet first as the City races to build the market as the national economy recovers.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the City's finances. Questions concerning this report or requests for additional financial information should be directed to Elizabeth Saegert, Finance Director, 504 N. Queen, Palestine, TX, 75801, telephone 903.731.8439, or email esaegert@palestine-tx.org.

BASIC FINANCIAL STATEMENTS

CITY OF PALESTINE, TEXAS

STATEMENT OF NET ASSETS

September 30, 2011

	Primary Government			Component
	Governmental	Business-type	Total	Unit
	Activities	Activities		PEDC
ASSETS				
Current Assets				
Cash and cash equivalents	\$ 1,134,088	\$ 746,171	\$ 1,880,259	\$ 1,348,273
Receivable (net of allowance of doubtful accounts)	1,622,668	1,225,634	2,848,302	175,300
Prepaid items	-	-	-	42,972
Inventories	130,592	-	130,592	-
Internal Balances	(46,310)	46,310	-	-
Total Current Assets	<u>2,841,038</u>	<u>2,018,115</u>	<u>4,859,153</u>	<u>1,566,545</u>
Noncurrent Assets				
Restricted Assets				
Cash and cash equivalents	1,048,089	7,634,223	8,682,312	-
Receivable (net of allowance of doubtful accounts)	172,874	-	172,874	-
Notes receivable	47,882	-	47,882	-
Deferred charges (net)	-	554,937	554,937	17,425
Notes receivable	500,000	-	500,000	811,892
Capital Assets :				
Nondepreciable	2,388,138	5,024,699	7,412,837	1,009,435
Depreciable, net	<u>17,780,264</u>	<u>23,993,770</u>	<u>41,774,034</u>	<u>3,237,118</u>
Total Noncurrent Assets	<u>21,937,247</u>	<u>37,207,629</u>	<u>59,144,876</u>	<u>5,075,870</u>
Total Assets	<u>\$ 24,778,285</u>	<u>\$ 39,225,744</u>	<u>\$ 64,004,029</u>	<u>\$ 6,642,415</u>
LIABILITIES				
Accounts payable and accrued Liabilities	\$ 1,036,644	\$ 681,108	\$ 1,717,752	\$ 22,661
Accrued interest payable	54,782	82,970	137,752	13,534
Water meter Deposits - Refundable	-	624,077	624,077	-
Unearned revenue	-	-	-	835,092
Non-current Liabilities:				
Due within a year	1,123,902	1,759,142	2,883,044	250,581
Due in more than a year	<u>10,490,818</u>	<u>12,109,524</u>	<u>22,600,342</u>	<u>3,938,422</u>
Total Liabilities	<u>12,706,146</u>	<u>15,256,821</u>	<u>27,962,967</u>	<u>5,060,290</u>
Net Assets				
Invested in Capital Assets, Net of Related Debt	10,032,101	20,515,764	30,547,865	57,550
Restricted For:				
Debt Service	88,896	1,742,282	1,831,178	-
Capital Projects	67,930	-	67,930	-
Other purposes	566,377	-	566,377	-
Unrestricted	<u>1,316,835</u>	<u>1,710,877</u>	<u>3,027,712</u>	<u>1,524,575</u>
Total Net Assets	<u>\$ 12,072,139</u>	<u>\$ 23,968,923</u>	<u>\$ 36,041,062</u>	<u>\$ 1,582,125</u>

See Notes to Financial Statements.

CITY OF PALESTINE, TEXAS
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2011

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government				
Governmental Activities				
General government	\$ 2,256,316	\$ -	\$ 263,911	-
Public Safety	6,923,063	451,736	10,454	62,764
Community Services	3,374,158	398,235	-	106,591
Community Development	2,748,876	97,124	-	287,769
Interest expense on long term debt	266,496	-	-	-
Total Governmental Activities	<u>15,568,909</u>	<u>947,095</u>	<u>274,365</u>	<u>457,124</u>
Business-type Activities				
Water fund	3,237,448	3,369,784	-	681,996
WasteWater fund	3,018,876	3,305,560	-	-
Sanitation	2,755,960	2,817,587	-	-
Retail	355,287	498,691	-	-
Total Business-type Activities	<u>9,367,571</u>	<u>9,991,622</u>	<u>-</u>	<u>681,996</u>
Total Primary Government	<u>\$ 24,936,480</u>	<u>\$ 10,938,717</u>	<u>\$ 274,365</u>	<u>\$ 1,139,120</u>
Component Unit				
PEDC	<u>\$ 911,074</u>	<u>\$ 60,000</u>		<u>\$ -</u>

General Revenues:
Property Taxes
Franchise Taxes
Sales and Use Taxes
Investment Earnings
Other income (loss)
Transfers
Total General Revenues and Transfers

Change in Net Assets
Net Assets, beginning
Net Assets, ending

See Notes to Financial Statements.

Net (Expense) Revenue and Changes in Net Assets

Primary Government		Component Unit	
Governmental Activities	Business- type Activities	Total	PEDC
\$ (1,992,405)	\$ -	\$ (1,992,405)	\$ -
(6,398,109)	-	(6,398,109)	-
(2,869,332)	-	(2,869,332)	-
(2,363,983)	-	(2,363,983)	-
(266,496)	-	(266,496)	-
<u>(13,890,325)</u>	<u>-</u>	<u>\$ (13,890,325)</u>	<u>-</u>
-	814,332	814,332	-
-	286,684	286,684	-
-	61,627	61,627	-
-	143,404	143,404	-
<u>-</u>	<u>1,306,047</u>	<u>1,306,047</u>	<u>-</u>
<u>(13,890,325)</u>	<u>1,306,047</u>	<u>(12,584,278)</u>	<u>-</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>(851,074)</u>
5,894,097	-	5,894,097	-
1,147,029	-	1,147,029	-
5,425,434	-	5,425,434	995,598
20,004	13,945	33,949	2,498
(37,566)	-	(37,566)	1,570
713,974	(713,974)	-	-
<u>13,162,972</u>	<u>(700,029)</u>	<u>12,462,943</u>	<u>999,666</u>
(727,353)	606,018	(121,335)	148,592
12,799,492	23,362,905	36,162,397	1,433,533
<u>\$ 12,072,139</u>	<u>\$ 23,968,923</u>	<u>\$ 36,041,062</u>	<u>\$ 1,582,125</u>

CITY OF PALESTINE, TEXAS

BALANCE SHEET - GOVERNMENTAL FUNDS

SEPTEMBER 30, 2011

	General Fund	Nonmajor Governmental Funds	Total Governmental Funds
ASSETS			
Assets:			
Cash and cash equivalents	\$ 35,375	\$ 192,992	\$ 228,367
Restricted Cash and cash equivalents	-	1,048,089	1,048,089
Receivables, net	1,606,353	16,315	1,622,668
Restricted Receivables	-	172,874	172,874
Due from other funds	652,731	144,197	796,928
Notes Receivable	500,000	-	500,000
Restricted Notes Receivables	-	47,882	47,882
Total Assets	\$ 2,794,459	\$ 1,622,349	\$ 4,416,808
 LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 422,148	\$ 41,508	\$ 463,656
Deferred Revenue Taxes	304,883	39,149	344,032
Due to other funds	250,000	223,552	473,552
Total Liabilities	977,031	304,209	1,281,240
 Fund balances:			
Nonspendable:			
Notes receivables	500,000	47,882	547,882
Restricted for:			
Economic development	-	444,155	444,155
Debt service	-	88,896	88,896
Capital projects	-	476,032	476,032
Public safety	-	103,599	103,599
Other purposes	-	18,623	18,623
Committed for:			
Community forest	-	82,746	82,746
Capital projects	-	67,930	67,930
Cemetery	-	150,532	150,532
Unassigned	1,317,428	(162,255)	1,155,173
Total Fund balances	1,817,428	1,318,140	3,135,568
Total Liabilities and Fund Balances	\$ 2,794,459	\$ 1,622,349	\$ 4,416,808

See Notes to Financial Statements.

CITY OF PALESTINE, TEXAS
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
September 30, 2011

Total fund balances - governmental funds balance sheet	\$ 3,135,568
<p>Amounts reported for governmental activities in the statement of net assets (SNA) are different because:</p>	
<p>Capital assets used in governmental activities are not financial resources and, therefore, are not reported in funds.</p>	
Capital assets, non-depreciable	2,388,138
Capital assets, depreciable	16,440,510
<p>Other long term assets are not available to pay for current period expenditures and, therefore, are deferred in the funds</p>	
	344,032
<p>Internal service funds are used by management to charge the cost of certain capital assets to individual funds.</p>	
<p>The assets and liabilities of the internal service funds are included in governmental activities in the SNA.</p>	
	879,090
<p>Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds.</p>	
Accrued interest payable	(54,782)
Noncurrent liabilities due in one year	(880,000)
Noncurrent liabilities due in more than one year	<u>(10,180,417)</u>
Net assets of governmental activities - statement of net assets	<u>\$ 12,072,139</u>

CITY OF PALESTINE, TEXAS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	General Fund	Other Governmental Funds	Total Governmental Funds
Revenue:			
Taxes	\$ 11,117,245	\$ 1,356,875	\$ 12,474,120
License, permits and fees	97,124	-	97,124
Intergovernmental	337,483	394,006	731,489
Charges for services	103,976	388,685	492,661
Fines and Forfeitures	406,234	22,751	428,985
Investment	15,914	4,090	20,004
Other revenues	49,268	18,064	67,332
Total revenues	<u>12,127,244</u>	<u>2,184,471</u>	<u>14,311,715</u>
Expenditures:			
General government	1,883,257	-	1,883,257
Public Safety	6,734,481	28,939	6,763,420
Community Services	3,104,129	668,890	3,773,019
Community Development	1,067,519	884,437	1,951,956
Debt service:			
Principal	-	390,000	390,000
Interest and fiscal charges	-	550,590	550,590
Total expenditures	<u>12,789,386</u>	<u>2,522,856</u>	<u>15,312,242</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(662,142)</u>	<u>(338,385)</u>	<u>(1,000,527)</u>
Other financing sources (uses):			
Transfers in	776,583	120,227	896,810
Transfers out	-	(182,836)	(182,836)
Total other financing sources (uses)	<u>776,583</u>	<u>(62,609)</u>	<u>713,974</u>
Net change in fund balance	114,441	(400,994)	(286,553)
Fund balances, October 1	<u>1,702,987</u>	<u>1,719,134</u>	<u>3,422,121</u>
Fund balances, September 30	<u>\$ 1,817,428</u>	<u>\$ 1,318,140</u>	<u>\$ 3,135,568</u>

See Notes to Financial Statements.

CITY OF PALESTINE, TEXAS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF THE GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2011

Net change in fund balances - total governmental funds \$ (286,553)

Amounts reported for governmental activities in the statement of activities (SOA) are different because:

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Capital outlay	720,508
Depreciation	(1,397,193)

Revenue in the Statement of Activities that does not provide current financial resources is not reported as revenue in the funds	(7,560)
--	---------

The issuance of long-term debt (e.g., bonds, certificated of obligations) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction however, has any effect on net assets. Also, governmental funds report the effect of issuance cost, premiums, discounts, and similar items when debt is first issued; whereas, these amounts are deferred and amortized in the Statement of Activities.

Principal expenditures	390,000
Interest expense	316,823

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.	6,305
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Internal Service funds are used by management to charge the costs of certain capital assets to individual funds. The net revenue is reported with governmental activities.	(469,683)
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Change in net assets of governmental activities - statement of net assets	\$ (727,353)
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CITY OF PALESTINE, TEXAS

STATEMENT OF NET ASSETS

PROPRIETARY FUNDS

SEPTEMBER 30, 2011

	Business-Type Activities-Enterprise Funds				Total
	Water	Wastewater	Sanitation	Retail	
ASSETS					
Current Assets:					
Cash and cash equivalents	\$ 213,296	\$ 500,815	\$ 7,080	\$ 24,980	\$ 746,171
Receivable (net)	383,592	408,780	433,262	-	1,225,634
Inventory	-	-	-	-	-
Due from other funds	454,009	-	-	45,487	499,496
Total Current Assets	<u>1,050,897</u>	<u>909,595</u>	<u>440,342</u>	<u>70,467</u>	<u>2,471,301</u>
Noncurrent Assets:					
Cash and cash equivalents (restricted)	3,530,801	3,879,586	-	223,836	7,634,223
Deferred charges (net)	113,273	415,488	-	26,176	554,937
Capital Assets					
Nondepreciable	3,234,409	36,663	20,281	1,733,346	5,024,699
Depreciable, net	9,384,639	12,872,133	-	1,736,998	23,993,770
Total Capital Assets	<u>12,619,048</u>	<u>12,908,796</u>	<u>20,281</u>	<u>3,470,344</u>	<u>29,018,469</u>
(Net of Accumulated Depreciation)	<u>16,263,122</u>	<u>17,203,870</u>	<u>20,281</u>	<u>3,720,356</u>	<u>37,207,629</u>
Total Noncurrent Assets	<u>16,263,122</u>	<u>17,203,870</u>	<u>20,281</u>	<u>3,720,356</u>	<u>37,207,629</u>
Total assets	<u>\$ 17,314,019</u>	<u>\$ 18,113,465</u>	<u>\$ 460,623</u>	<u>\$ 3,790,823</u>	<u>\$ 39,678,930</u>
LIABILITIES					
Current Liabilities					
Accounts payable and accrued liabilities	\$ 370,725	\$ 75,288	\$ 222,736	\$ 12,359	\$ 681,108
Due to other funds	-	17,276	375,000	60,910	453,186
Accrued interest payable	10,067	72,903	-	-	82,970
Water meter deposits - refundable (restricted)	624,077	-	-	-	624,077
Long-term debt - due within one year	398,921	1,287,999	-	72,222	1,759,142
Total current liabilities	<u>1,403,790</u>	<u>1,453,466</u>	<u>597,736</u>	<u>145,491</u>	<u>3,600,483</u>
Noncurrent liabilities					
Long-term debt - due in more than one year	817,734	10,514,804	-	776,986	12,109,524
Total noncurrent liabilities	<u>817,734</u>	<u>10,514,804</u>	<u>-</u>	<u>776,986</u>	<u>12,109,524</u>
Total Liabilities	<u>2,221,524</u>	<u>11,968,270</u>	<u>597,736</u>	<u>922,477</u>	<u>15,710,007</u>
NET ASSETS					
Invested in capital assets, net of related debt	13,489,822	4,134,513	20,281	2,871,148	20,515,764
Restricted for Debt Service	1,051,145	691,137	-	-	1,742,282
Unrestricted	551,528	1,319,545	(157,394)	(2,802)	1,710,877
Total net assets	<u>\$ 15,092,495</u>	<u>\$ 6,145,195</u>	<u>\$ (137,113)</u>	<u>\$ 2,868,346</u>	<u>\$ 23,968,923</u>

See Notes to Financial Statements.

Governmental
Activities
Internal Service
Funds

\$ 905,721
-
130,592
370,000

1,406,313

-
-

-
1,339,754

1,339,754

1,339,754

\$ 2,746,067

\$ 572,988
739,686
-
-
243,902

1,556,576

310,401

310,401

1,866,977

785,451
-
93,639

\$ 879,090

CITY OF PALESTINE, TEXAS
STATEMENT OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET ASSETS - PROPRIETARY FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Business-Type Activities-Enterprise Funds				
	Water	Wastewater	Sanitation	Retail	Total
OPERATING REVENUES:					
Charges For Services	\$ 3,369,784	\$ 3,305,560	\$2,817,587	\$ 493,603	\$ 9,986,534
Other revenues	-	-	-	5,088	5,088
Total Operating Revenues	<u>3,369,784</u>	<u>3,305,560</u>	<u>2,817,587</u>	<u>498,691</u>	<u>9,991,622</u>
OPERATING EXPENSES:					
Cost of sales and services	1,718,619	1,232,071	2,660,891	148,698	5,760,279
Personnel	962,300	576,347	95,069	41,111	1,674,827
Depreciation	495,415	868,039	-	101,834	1,465,288
Total Operating Expenses	<u>3,176,334</u>	<u>2,676,457</u>	<u>2,755,960</u>	<u>291,643</u>	<u>8,900,394</u>
Operating Income (Loss)	<u>193,450</u>	<u>629,103</u>	<u>61,627</u>	<u>207,048</u>	<u>1,091,228</u>
NON-OPERATING REVENUES					
(EXPENSES):					
Investment revenue	10,059	3,184	32	670	13,945
Gain on Disposal of Fixed Assets	-	-	-	-	-
Interest expense	(61,114)	(342,419)	-	(63,644)	(467,177)
Total Non-operating Revenues					
(Expenses)	<u>(51,055)</u>	<u>(339,235)</u>	<u>32</u>	<u>(62,974)</u>	<u>(453,232)</u>
Income (Loss) before					
Contributions and Transfers	<u>142,395</u>	<u>289,868</u>	<u>61,659</u>	<u>144,074</u>	<u>637,996</u>
Transfer in	324,928	13,652	-	35,906	374,486
Transfers (out)	(574,628)	(128,400)	(126,700)	(258,732)	(1,088,460)
Capital Contribution	681,996	-	-	-	681,996
Change in net assets	<u>574,691</u>	<u>175,120</u>	<u>(65,041)</u>	<u>(78,752)</u>	<u>606,018</u>
Net assets, October 1	14,517,804	5,970,075	(72,072)	2,947,098	23,362,905
Net assets, September 30	<u>\$ 15,092,495</u>	<u>\$ 6,145,195</u>	<u>\$ (137,113)</u>	<u>\$ 2,868,346</u>	<u>\$23,968,923</u>

See Notes to Financial Statements.

Governmental Activities Internal Service Funds	
\$	2,844,241
	-
	<u>2,844,241</u>
	2,993,458
	-
	289,586
	<u>3,283,044</u>
	<u>(438,803)</u>
	1,849
	-
	(32,729)
	<u>(30,880)</u>
	<u>(469,683)</u>
	35,000
	(35,000)
	-
	<u>(469,683)</u>
	<u>1,348,773</u>
\$	<u><u>879,090</u></u>

CITY OF PALESTINE, TEXAS

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS (Page 1 of 2)
For the Year Ended September 30, 2011

	Business-Type Activities-Enterprise Funds				Total
	Water	Wastewater	Sanitation	Retail	
Cash Flows from Operating Activities					
Receipts from customers and users	\$ 3,336,211	\$ 3,299,045	\$ 2,801,710	\$ 498,691	\$ 9,935,657
Payments to suppliers	(1,671,828)	(1,209,414)	(2,624,099)	(153,046)	(5,658,387)
Payments to employees	(911,054)	(560,234)	(95,736)	(41,111)	(1,608,135)
Internal Activity-payments to other funds	(96,530)	(457,969)	19,126	101,810	(433,563)
Net Cash Provided by Operating Activities	<u>656,799</u>	<u>1,071,428</u>	<u>101,001</u>	<u>406,344</u>	<u>2,235,572</u>
Cash Flows from Noncapital Financing Activities					
Transfer from (to) other funds	(249,700)	(114,748)	(126,700)	(222,826)	(713,974)
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(249,700)</u>	<u>(114,748)</u>	<u>(126,700)</u>	<u>(222,826)</u>	<u>(713,974)</u>
Cash Flows from Capital and Related Financing Activities					
Acquisition and construction of capital assets	(2,826,318)	(1,158,407)	-	(208,024)	(4,192,749)
Capital contribution	681,996	-	-	-	681,996
Principal paid on capital debt	(340,819)	(1,248,538)	-	(73,241)	(1,662,598)
Interest paid on capital debt	(33,605)	(420,751)	-	(62,873)	(517,229)
Proceeds from capital debt	-	-	-	-	-
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(2,518,746)</u>	<u>(2,827,696)</u>	<u>-</u>	<u>(344,138)</u>	<u>(5,690,580)</u>
Cash Flows from Investing Activities					
Interest received	10,059	3,184	32	670	13,945
Net Cash Provided by Investing Activities	<u>10,059</u>	<u>3,184</u>	<u>32</u>	<u>670</u>	<u>13,945</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(2,101,588)	(1,867,832)	(25,667)	(159,950)	(4,155,037)
Beginning cash and cash equivalents	5,845,685	6,248,233	32,747	408,766	12,535,431
Ending Cash and Cash Equivalents	<u>\$ 3,744,097</u>	<u>\$ 4,380,401</u>	<u>\$ 7,080</u>	<u>\$ 248,816</u>	<u>\$ 8,380,394</u>
Ending Cash and Cash Equivalents					
Unrestricted cash and cash equivalents	213,296	500,815	7,080	24,980	746,171
Restricted cash and cash equivalents	3,530,801	3,879,586	-	223,836	7,634,223
	<u>\$ 3,744,097</u>	<u>\$ 4,380,401</u>	<u>\$ 7,080</u>	<u>\$ 248,816</u>	<u>\$ 8,380,394</u>

See Notes to Financial Statements.

Governmental
Activities
Internal Service
Funds

\$ 2,844,241
(2,875,305)
-
799,179
768,115

-
-

-
-
(270,255)
(36,429)
123,736
(182,948)

1,849
1,849

587,016
318,705
\$ 905,721

905,721
-
\$ 905,721

CITY OF PALESTINE, TEXAS

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS (Page 2 of 2)
For the Year Ended September 30, 2011

	Business-Type Activities-Enterprise Funds				
	Water	Wastewater	Sanitation	Retail	Total
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities					
Operating income (loss)	\$ 193,450	\$ 629,103	\$ 61,627	\$ 207,048	\$ 1,091,228
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:					
Depreciation	495,415	868,039	-	101,834	1,465,288
Changes in Operating Assets and Liabilities:					
(Increase) Decrease in Current Assets:					
Accounts receivable	(33,573)	(6,515)	(15,877)	-	(55,965)
Inventory	-	-	-	-	-
Due from other funds	45,143	92,865	-	101,810	239,818
Increase (Decrease) in Current Liabilities:					
Due to other funds	(141,673)	(550,834)	19,126	-	(673,381)
Accounts payable and accrued liabilities	98,037	38,770	36,125	(4,348)	168,584
Net Cash Provided by Operating Activities	<u>\$ 656,799</u>	<u>\$ 1,071,428</u>	<u>\$ 101,001</u>	<u>\$ 406,344</u>	<u>\$ 2,235,572</u>

Governmental
Activities
Internal Service
Funds

\$ (438,803)

289,586

-

5,306

-

799,179

112,847

\$ 768,115

CITY OF PALESTINE, TEXAS

NOTES TO FINANCIAL STATEMENTS

September 30, 2011

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The City of Palestine, Texas (the City) was incorporated in 1871. The City has operated under a "Home Rule Charter" which provides for a Council-Manager form of government.

The City Council is the principal legislative body of the City. The City Manager is appointed by a majority vote of the City Council and is responsible to the Council for the administration of all the affairs of the City. The City Manager is also responsible for the appointment and removal of department directors and employees, supervision and control of all City departments, and preparation of the annual budget.

The City provides the following services: general government; community development, fire and rescue, leisure services, maintenance, Municipal Court, police, streets and drainage, water distribution, wastewater collection/treatment, sanitation and retail.

The City is an independent political subdivision of the State of Texas governed by an elected council and a mayor and is considered a primary government. As required by generally accepted accounting principles, these basic financial statements have been prepared based on considerations regarding the potential for inclusion of other entities, organizations, or functions as part of the City's financial reporting entity. The Palestine Economic Development Corporation, although legally separate, is considered part of the reporting entity. No other entities have been included in the City's reporting entity. Additionally, as the City is considered a primary government for financial reporting purposes, its activities are not considered a part of any other governmental or other type of reporting entity.

Considerations regarding the potential for inclusion of other entities, organizations or functions in the City's financial reporting entity are based on criteria prescribed by generally accepted accounting principles. These same criteria are evaluated in considering whether the City is a part of any other governmental or other type of reporting entity. The overriding elements associated with prescribed criteria considered in determining that the City's financial reporting entity status is that of a primary government are that it has a separately elected governing body; it is legally separate; and it is fiscally independent of other state and local governments. Additionally, prescribed criteria under generally accepted accounting principles include considerations pertaining to organizations for which the primary government is financially accountable and considerations pertaining to organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

Discretely Presented Component Unit

Palestine Economic Development Corporation

Palestine Economic Development Corporation, Inc. (the Corporation) has been included in the reporting entity as a discretely presented component unit. The Corporation is a governmental entity that promotes the creation of new and expanded industry and manufacturing activity with the City. The Corporation's board of directors is appointed by and serves at the discretion of City Council. City Council approval is required for the annual budget and the issuance of any debt. In the event of dissolution, any assets of the Corporation will be transferred to the City. Separate financial statements of the Corporation may be obtained from the Finance Department of the City.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

B. Financial Statement Presentation

These financial statements include implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis -for State and Local Governments*. Certain requirements of the statement include the following:

- A Management's Discussion and Analysis (MD&A) section providing an analysis of the City's overall financial position and results of operations.
- Financial statements prepared using full accrual accounting for all of the City's activities.
- A change in the fund financial statements to focus on the major funds.

GASB Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a Statement of Net Assets and a Statement of Activities. It requires the classification of net assets into three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- **Invested in capital assets, net of related debt** - This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted** - This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted** - This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

C. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information about the City as a whole. These statements include all activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are 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 presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include charges paid by the recipients of goods or services offered by the programs and grants that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, such as taxes and investment earnings, are presented as general revenues.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

C. Government-Wide and Fund Financial Statements , continued

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. In the fund financial statements, the accounts of the City are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures or expenses, as appropriate. The following is a description of the various funds:

Governmental Funds

Governmental funds are those funds through which most governmental functions are typically financed.

General Fund

The general fund is used to account for all financial transactions not properly includable in other funds. The principal sources of revenues include local property taxes, sales and franchise taxes, licenses and permits, fines and forfeitures, and charges for services. Expenditures include general government, public safety, community services, and community development.

Special Revenue Funds

The special revenue funds are used to account for proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. The special revenue funds are considered nonmajor funds for reporting purposes.

Debt Service Fund

The debt service fund is used to account for the payment of interest and principal on all general obligation bonds and other long-term debt of the City. The primary source of revenue for debt service is local property taxes. The debt service fund is considered a nonmajor fund for reporting purposes.

Capital Projects Funds

The capital projects funds are used to account for the expenditures of resources accumulated from sales tax revenues and the sale of bonds and related interest earnings for capital improvement projects. The capital projects funds are considered nonmajor funds for reporting purposes.

Proprietary Funds

Proprietary funds are used to account for activities that are similar to those often found in the private sector. All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business activities are accounted for through proprietary funds. The measurement focus is on determination of net income, financial position, and cash flows. Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues include charges for services. Operating expenses include costs of materials, contracts, personnel, and depreciation. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Proprietary funds follow GAAP prescribed by the Governmental Accounting Standards Board (GASB) and all Financial Accounting Standards Board's standards issued prior to November 30, 1989. Subsequent to this date, the City accounts for its enterprise funds as presented by GASB.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

C. Government-Wide and Fund Financial Statements , continued

The proprietary funds used by the City include the following:

Enterprise Funds

The enterprise funds are used to account for the operations that provide water and wastewater collection, wastewater treatment operations, solid waste collection and disposal and retail mall operations. The services are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses including depreciation) of providing goods or services to the general public on a continuing basis will be financed or recovered primarily through user charges. The water fund, wastewater fund, sanitation fund, and retail are considered major funds for reporting purposes.

Additionally, the government reports the following fund types:

Internal Service Funds

Internal service funds account for services provided to other departments or agencies of the government, or to other governments, on a cost reimbursement basis. These funds account for supply inventory management, equipment replacement programs, Workers Compensation insurance, unemployment, and employee health insurance.

D. Measurement Focus and Basis of Accounting

The government-wide Statements of Net Assets and Statements of Activities and all proprietary funds are accounted for on a flow of economic resources measurement focus, accrual basis of accounting. With this measurement focus, all assets and all liabilities associated with the operations of these activities are included on the balance sheet. Proprietary fund equity consists of net assets. Proprietary fund operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and component units are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The City utilizes the modified accrual basis of accounting in the governmental fund and component units. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they are susceptible to accrual (i.e., when they are measurable and available). Measurable means the amount of the transaction can be determined and available means collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues available if they are collected within 60 days of the end of the current period. Revenues susceptible to accrual include charges for services and interest on temporary investments.

Property taxes, sales taxes, franchise taxes, and interest associated with the current period, are all considered to be susceptible to accrual and so have been recognized as revenues of the current period. Other receipts and other taxes become measurable and available when cash is received by the government and are recognized as revenue at that time.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

D. Measurement Focus and Basis of Accounting, continued

Under modified accrual accounting, expenditures are recognized in the accounting period in which the liability is incurred, if measurable, except for interest on general long-term debt, which is recognized when due.

The accrual basis of accounting is used for the proprietary fund types. This basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable, and expenses in the accounting period in which they are incurred and become measurable.

The Statements of Net Assets, Statements of Activities, and Financial Statements of Proprietary Funds are presented on the accrual basis of accounting. Under this method of accounting, revenues are recognized in the accounting period in which they are earned, and expenses in the accounting period in which they are incurred.

Generally, the effect of interfund activity has been eliminated from the government-wide financial statements. Interfund services provided and used are not eliminated in the process of consolidation.

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

E. Assets, Liabilities, and Net Assets or Fund Equity

1. Deposits and Investments

The City maintains a pooled cash and investments account. Each fund whose monies are deposited in the pooled cash and investment account has equity therein, and interest earned on the investment of these monies is allocated based upon relative equity at the previous month end. Amounts on deposit in interest bearing accounts and other investments are displayed on the combined balance sheet as "cash and cash equivalents."

In accordance with GASB Statement No. 31, *Accounting and Reporting for Certain Investments and External Investment Pools*, the City reports all investments at fair value, except for "money market investments" and "2a7-like pools." Money market investments, which are short-term highly liquid debt instruments that may include U.S. Treasury and agency obligations, are reported at amortized costs. Investment positions in external investment pools that are operated in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940, such as TexPool and TexSTAR, are reported using the pools' share price.

The City has adopted a written investment policy regarding the investment of its funds as defined in the Public Funds Investment Act, Chapter 2256, Texas Governmental Code. In summary, the City is authorized to invest in the following:

- Direct obligations of the U.S. Government
- Money market mutual funds that meet certain criteria
- Statewide investment pools

2. Receivables and Payables

Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the year are referred to as either "interfund receivables/payables" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds" in the fund financial statements. If the transactions are between the primary government and its component unit, these receivables and payables are classified as "due to/from component unit/primary government."

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

2. Receivables and Payables, continued

Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

The city provides for an allowance for doubtful accounts based upon the anticipated collectability of each specific account, as determined by experience. All trade receivables are shown net of an allowance for uncollectibles.

Property taxes are levied during October of each year and are due upon receipt of the City's tax bill. Taxes become delinquent, with an enforceable lien on property, on February 1 of the following year. Revenue from taxes accessed is recorded as deferred revenue on October 1. The deferred revenue from taxes is then recognized as revenue during the year as the taxes are actually received. All delinquent property taxes receivable are assets of the General and Debt Service Funds.

3. Inventories and Prepaid Items

The costs of governmental fund-type inventories are recorded as expenditures when the related liability is incurred (i.e., the purchase method). Certain payments to vendors reflect costs applicable to future accounting periods (prepaid expenditures) are recognized as expenditures when utilized.

4. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. In accordance with GASB Statement No. 34, infrastructure has been capitalized retroactively. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. 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. Major outlays for capital assets and improvements are capitalized as projects are constructed. Amortization from assets acquired with capital leases is reported as depreciation in proprietary funds.

Interest costs incurred in connection with construction of enterprise fund capital assets are capitalized when the effects of capitalization materially impact the financial statements.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Property, plant, and equipment of the primary government, as well as the component units, are depreciated using the straight-line method over the following estimated useful years:

<u>Asset Description</u>	<u>Estimated Useful Life</u>
Buildings	20 to 50 years
Improvements	5 to 50 years
Equipment	5 to 10 years
Water and sewer system	20 to 30 years
Infrastructure	40 to 50 years

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

5. Compensated Employee Absences

It is the City's policy to permit employees to accumulate earned but unused vacation, sick pay benefits, and compensatory time. Amounts accumulated, up to certain amounts, may be paid to employees upon termination of employment. The estimated amount of compensation for services provided that is expected to be liquidated with expendable available financial resources is reported as an expenditure and a fund liability of the governmental fund that will pay it when it matures or becomes due. Amounts of vested or accumulated vacation leave that are not expected to be liquidated with expendable available financial resources are maintained separately and represent a reconciling item between the fund and government-wide presentations.

6. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities Statement of Net Assets. The long-term debt consists primarily of bonds payable and accrued compensated absences.

Long-term debt for governmental funds is not reported as a liability in the fund financial statements until due. The debt proceeds are reported as other financing sources, net of the applicable premium or discount and payments of principal and interest are reported as expenditures. In the governmental funds, issuance costs, even if withheld from the actual net proceeds received, are reported as debt service expenditures. However, claims and judgments paid from governmental funds are reported as a liability in the fund financial statements only for the portion expected to be financed from expendable available financial resources.

Long-term debt and other obligations financed by proprietary funds are reported as liabilities in the appropriate funds. For proprietary funds, bond premiums, discounts, and issuance costs are deferred and amortized over the life of the bonds using the effective interest method, if material. Bonds payable are reported net of the applicable bond premium or discount. Issuance costs are reported as deferred charges.

The property tax rate is allocated each year between the general and debt service funds. The full amount estimated to be required for debt service on general obligation debt is provided by the tax along with interest earned in the debt service fund. Though a portion of the general obligation debt was directly related to the purchase of water and sewer infrastructure, the debt service expenditures are included in the governmental fund financial statements as they are expected to be paid from debt service tax revenues instead of water system revenues.

Assets acquired under the terms of capital leases are recorded as liabilities and capitalized in the government-wide financial statements at the present value of net minimum lease payments at inception of the lease. In the year of acquisition, capital lease transactions are recorded as other financing sources and as capital outlay expenditures in the general fund. Lease payments representing both principal and interest are recorded as expenditures in the general fund upon payment with an appropriate reduction of principal recorded in the government-wide financial statements.

7. Fund Equity

In February 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which establishes accounting and financial reporting requirements to improve the usefulness information about fund balance by providing clearer, more structured fund balance, classifications and clarifying the definitions of existing governmental fund types. This statement is effective for financial statements for years beginning after June 15, 2010. The Statement classifies fund balance into the following categories, nonspendable, restricted, committed, assigned and unassigned.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

7. Fund Equity, continued

Committed fund balance is constrained by City Council through legislation, resolutions or ordinance. The City Manager and Finance Director are authorized to assign amounts to specific purpose or policy established by city council to which authorization is given.

The City considers restricted expenditures expended first when restricted and unrestricted resources exist. In addition, the City considers unrestricted classifications of resources are considered to have been spent by committed amounts first followed by assigned and unassigned.

8. Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all short-term debt securities purchased with maturity of three months or less to be cash equivalents.

9. Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

II. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP) except the capital projects funds, which adopt a project length budget. The following special revenue funds have legally adopted budgets: Tourism and Civic Center, Airport, Municipal Court security, Municipal Court technology, and Cemetery. The original budget is adopted by the City Council prior to the beginning of the year. The legal level of control, as defined by the charter, in the approved budget is the object and purpose therein named. The City Manager may transfer appropriations within a department without seeking the approval of City Council provided the transfer does not result in a net increase in total appropriations. Appropriations lapse at the end of the year, excluding capital project budgets. Supplemental budget appropriations were made for the year-ended.

A. Deficit Fund Balance/Net Assets

For the year-ended, deficit fund balance/net assets were reported in the following funds:

Fund	Deficit
Airport	\$ 125,271
Municipal Court Technolgy	\$ 3,227
Fitness	\$ 787
Home Grant	\$ 33,045
Sanitation	\$ 137,113
Health Insurance	\$ 1,088,240
Central Warehouse	\$ 20,193

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

B. Expenditures Over Appropriations

The city general fund expenditures were under budget by \$98,901 but following expenditure categories were in excess of appropriations:

	<u>Expenditures</u>	<u>Appropriations</u>	<u>Expenditures In excess of Appropriations</u>
General government	\$1,883,257	\$1,855,230	\$28,027
Public safety	\$6,734,481	\$6,729,341	\$5,140

III. DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

As of year- end, the City had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Weighted Average Maturity (Years)</u>
External investment pools	\$7,137,165	0.00

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 investment policy requires funds on deposit at the depository bank to be collateralized by securities. As of yearend, market values of pledged securities and FDIC insurance exceeded bank balances.

Credit risk. As of September 30, 2011 the City's investments in TexPool and TexStar were rated AAAM by Standard & Poor's. All other investments are guaranteed (either express or implied) by the full faith and credit of the United States Government or the issuing U.S. agency.

More specifically, the U.S. agencies held by the City as of September 30, 2011, consist of bonds issued by the Federal National Mortgage Association. These investments were rated not less than AAA by Moody's and Standard & Poor's. In addition to limiting the City's investments to those specifically authorized by policy, the City also protects against credit risk by diversifying their portfolio. The maximum allowable portion of the City's portfolio invested in state and local government securities is 50 percent of the total portfolio, with exposure to any one issuer of less than ten percent of the total portfolio at the time of purchase.

TexPool

TexPool was established as a trust company with the Treasurer of the State of Texas as trustee, segregated from all other trustees, investments, and activities of the trust company. The State Comptroller of Public Accounts exercises oversight responsibility over TexPool. Oversight includes the ability to significantly influence operations, designation of management, and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed of both participants in TexPool and other persons who do not have a business relationship with TexPool. The advisory board members review the investment policy and management fee structure. Standard & Poor's rate TexPool AAAM weekly portfolio information must be submitted to Standard & Poor's, as well as to the office of the Comptroller of Public Accounts for review.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

A. Deposits and Investments, continued

TexSTAR

The Texas Short Term Asset Reserve Fund ("TexSTAR") is a local government investment pool organized under the authority of the Interlocal Cooperation Act, Chapter 791, Texas Government Code, and the Public Funds Investment Act, Chapter 2256, Texas Government Code. TexSTAR was created in April 2002 by contract among its participating governmental units and is governed by a board of directors. JPMorgan Fleming Asset Management (USA), Inc. and First Southwest Asset Management, Inc. act as co-administrators, providing investment management services, participant services, and marketing, respectively. JPMorgan Chase Bank and/or its subsidiary, J.P. Morgan Investor Services, Inc., provide custodial, transfer agency, fund accounting, and depository services.

TexPool and TexSTAR operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. TexPool and TexSTAR use amortized cost rather than market value to report net assets to compute share prices. Accordingly, the fair value of the position in TexPool and TexSTAR are the same as the value of TexPool and TexSTAR shares.

B. Receivables

The following comprise receivable balances at year-end

	General	Nonmajor Governmental	Water	Wastewater	Sanitation
Receivables					
Ad valorem taxes	\$ 593,346	\$ 77,459	\$ -	\$ -	\$ -
Other Taxes	1,194,402	57,302	-	-	-
Other	23,001	88,435	8,730	15,841	-
Accounts	<u>50,216</u>	<u>-</u>	<u>472,924</u>	<u>434,021</u>	<u>486,055</u>
Gross receivables	1,860,965	223,196	481,654	449,862	486,055
Less: allowance for uncollectibles	<u>254,612</u>	<u>34,008</u>	<u>98,062</u>	<u>41,082</u>	<u>52,793</u>
Net total receivables	<u><u>\$ 1,606,353</u></u>	<u><u>\$ 189,188</u></u>	<u><u>\$ 383,592</u></u>	<u><u>\$ 408,780</u></u>	<u><u>\$ 433,262</u></u>

C. Note Receivables

The City loaned \$500,000 to the Texas State Railroad Authority in December 2007. The promissory note matures on December 1, 2015. The Authority is to pay the City interest only for the first four years of the loan. The payments will be \$6,250 beginning on March 1, June 1, September 1, December 1, of 2008 through 2011. The Authority will pay interest and principal over a four-year period concluding on December 1, 2015.

The City, through its revolving loan fund, loaned two local companies funds for certain approved business needs. The balance outstanding on notes at September 30, 2011 totaled \$47,882. Interest rates on notes are fixed at 2.25% and 2.75%. Principle and interest payments are due monthly and are \$656.04 and \$1198.44. Notes are collateralized by personal property and real estate. Notes mature on February 1, 2015 and April 15, 2013.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

D. Capital Assets

A summary of changes in capital assets for the year-end were as follows:

	Balance	Increases	Decreases	Balance
Government activities:				
Capital assets, not being depreciated:				
Land	\$ 1,720,328	\$ 431	\$ (4,254)	\$ 1,716,505
Construction in progress	135,370	536,263	-	671,633
Total capital assets not being depreciated	<u>1,855,698</u>	<u>536,694</u>	<u>(4,254)</u>	<u>2,388,138</u>
Capital assets, being depreciated:				
Buildings	6,097,050	-	(459,844)	5,637,206
Improvements	7,473,888	72,015	-	7,545,903
Machinery and equipment	7,997,408	111,797	-	8,109,205
Infrastructure	30,134,299	-	-	30,134,299
Total capital assets being depreciated	<u>51,702,645</u>	<u>183,812</u>	<u>(459,844)</u>	<u>51,426,613</u>
Less accumulated depreciation:				
Buildings	(4,146,683)	(86,430)	287,537	(3,945,576)
Improvements	(5,894,273)	(300,951)	-	(6,195,224)
Machinery and equipment	(5,227,873)	(502,478)	-	(5,730,351)
Infrastructure	(16,978,278)	(796,920)	-	(17,775,198)
Total accumulated depreciation	<u>(32,247,107)</u>	<u>(1,686,779)</u>	<u>287,537</u>	<u>(33,646,349)</u>
Total capital assets being depreciated, net	<u>19,455,538</u>	<u>(1,502,967)</u>	<u>(172,307)</u>	<u>17,780,264</u>
Governmental activities capital assets, net	<u>\$ 21,311,236</u>	<u>\$ (966,273)</u>	<u>\$ (176,561)</u>	<u>\$ 20,168,402</u>
Governmental activities capital assets, net				\$ 20,168,402
Less associated debt				<u>(10,136,301)</u>
Invested in Capital Assets, Net of Related debt				<u>\$ 10,032,101</u>

Depreciation was charged to governmental functions as follows:

Governmental activities:	
General government	\$ 382,974
Public Safety	207,196
Community Development	796,920
Community Service	299,689
Total depreciation expenses - governmental activities	<u>\$ 1,686,779</u>

The PEDC reported land of \$1,009,433 and depreciable capital assets net of accumulated depreciation of \$3,237,118 at year-end.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

D. Capital Assets, continued

Depreciation was charged to business-type functions as follows:

Business-type activities

Capital assets, not being depreciated:

Land	\$ 1,800,469	\$ -	\$ -	\$ 1,800,469
Construction in progress	3,821,109	4,064,028	(4,660,907)	3,224,230
Total capital assets not being depreciated	<u>5,621,578</u>	<u>4,064,028</u>	<u>(4,660,907)</u>	<u>5,024,699</u>

Capital assets, being depreciated:

Buildings	9,689,088	303,877	-	9,992,965
Machinery and equipment	206,442	125,895	-	332,337
Infrastructure	31,648,869	4,485,045	-	36,133,914
Total capital assets being depreciated	<u>41,544,399</u>	<u>4,914,817</u>	<u>-</u>	<u>46,459,216</u>

Less accumulated depreciation:

Buildings	(5,948,014)	(285,908)	-	(6,233,922)
Machinery and equipment	(131,349)	(14,923)	-	(146,272)
Infrastructure	(14,920,795)	(1,164,457)	-	(16,085,252)
Total accumulated depreciation	<u>(21,000,158)</u>	<u>(1,465,288)</u>	<u>-</u>	<u>(22,465,446)</u>

Total capital assets being depreciated, net	<u>20,544,241</u>	<u>3,449,529</u>	<u>-</u>	<u>23,993,770</u>
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Business-type activities capital assets, net	<u>\$ 26,165,819</u>	<u>\$ 7,513,557</u>	<u>\$(4,660,907)</u>	<u>\$ 29,018,469</u>
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Less associated debt	(13,719,128)
Unspent proceeds of capital related debt	4,661,486
Deferred charges	554,937
Invested in Capital Assets, Net of Related debt	<u><u>\$ 20,515,764</u></u>

Depreciation was charged to business-type functions as follows:

Business-type activities:

Water and wastewater	\$ 1,363,454
Retail	101,834
Total depreciation expenses - business-type activities	<u>\$ 1,465,288</u>

Business type activities interest expense capitalized during construction for the year is \$125,186 net of related interest income of 2,505.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

E. Long-Term Debt

The following is a summary of changes in the City's total governmental long-term liabilities for the year-ended. In general, the City uses the general and debt service funds to liquidate governmental long-term liabilities.

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Government activities:					
Certificate of obligation	\$ 9,972,000	\$ -	\$ 390,000	\$ 9,582,000	* \$ 430,000
Capital leases	704,512	123,736	273,947	554,301	* 243,902
Compensated absences	1,469,264	498,669	741,300	1,226,633	450,000
Net OPEB obligation	188,331	109,927	46,472	251,786	-
Governmental activities					
Long - term liabilities	<u>\$ 12,334,107</u>	<u>\$ 732,332</u>	<u>\$ 1,451,719</u>	<u>\$ 11,614,720</u>	<u>\$ 1,123,902</u>
				<u>\$ 10,490,818</u>	
				<u>\$ 10,136,301</u>	
Business type activities					
Revenue Bonds	\$ 14,997,408	\$ -	\$ 1,478,200	\$ 13,519,208	* \$ 1,522,222
Capital Leases	384,278	-	184,358	199,920	* 199,920
Compensated absences	85,378	101,265	37,105	149,538	37,000
Business-type activities					
Long - term liabilities	<u>\$ 15,467,064</u>	<u>\$ 101,265</u>	<u>\$ 1,699,663</u>	<u>\$ 13,868,666</u>	<u>\$ 1,759,142</u>
				<u>\$ 12,109,524</u>	
				<u>\$ 13,719,128</u>	
PEDC					
Notes	<u>\$ 4,421,391</u>	<u>\$ -</u>	<u>\$ 232,388</u>	<u>\$ 4,189,003</u>	<u>\$ 250,581</u>
Long-term debt due in more than a year				<u>\$ 3,938,422</u>	

Long-term liabilities applicable to the City's governmental activities are not due and payable in the current period and, accordingly, are not reported as fund liabilities in the governmental funds. The governmental activities compensated absences are generally liquidated by the general fund. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due.

Federal Arbitrage

General obligation bonds, combination tax and revenue bonds and certificates of obligation are subject to the provisions of the Internal Revenue Code of 1986 related to arbitrage and interest income tax regulations under those provisions.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

E. Long – Term Debt, continued

The PEDC notes payable have outstanding balances of \$1,278,223 and \$2,910,780 and interest rates of 4.61% and 7.35%, respectively.

Long-term debt was comprised of following debt issues:

<u>Description</u>	<u>Interest Rates</u>	<u>Balance</u>
Governmental Activities		
Certificate of obligation		
Series 2006	4.100%	\$ 1,110,000
Series 2008	3.874%	1,815,000
Series 2010A Taxable	6.75%	1,875,000
Series 2010 B	4.125%	3,880,000
Series 2010 A Non taxable	5.25%	902,000
Total Governmental Activities Long-term Debt		<u>\$ 9,582,000</u>
Business-Type Activities		
Water and sewer, series 1995A *	2.70-4.50%	\$ 1,725,000
Water and sewer, series 1999 *	5.00-6.75%	780,000
Water and sewer, refunding series 2003A	2.00-4.125%	1,875,000
Water and sewer, series 2003	.035-3.10%	3,210,000
Water and sewer, series 2006	2.20-4.20%	665,000
Water and sewer, series 2007	2.40-4.60%	3,865,000
Water and sewer, series 2009	.015-4.125%	550,000
Lease Revenue - Taxable	6.50%	849,208
Total Business-Type Activities Long-term Debt		<u>\$ 13,519,208</u>

* See IV -E, Subsequent Events - Bonds Refunded

Annual debt service requirements to maturity for bonds, notes and leases are as follows:

Year Ending <u>September 30,</u>	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>PEDC</u>	
	<u>Certificates of Obligation</u>		<u>Revenue Bonds</u>		<u>Notes</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 430,000	\$ 422,679	\$ 1,522,222	\$ 450,012	\$ 250,581	\$ 262,805
2013	450,000	408,017	1,567,134	399,753	265,780	\$ 247,606
2014	460,000	392,028	1,342,266	346,771	281,954	\$ 231,432
2015	475,000	374,784	1,397,777	297,538	299,166	\$ 214,220
2016	610,000	237,086	783,670	244,872	317,486	\$ 195,900
2017-2021	2,122,000	1,357,289	4,221,139	799,248	1,585,859	672,569
2022-2026	2,675,000	805,546	2,280,000	225,419	1,188,177	191,392
2027-2030	2,360,000	221,868	405,000	17,599	-	-
	<u>\$ 9,582,000</u>	<u>\$ 4,219,297</u>	<u>\$ 13,519,208</u>	<u>\$ 2,781,212</u>	<u>\$ 4,189,003</u>	<u>\$ 2,015,924</u>

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

E. Long – Term Debt, continued

Year Ending September 30,	Governmental Activities		Business-type Activities	
	Capital Leases		Capital Leases	
	Principal	Interest	Principal	Interest
2012	\$ 243,902	\$ 20,942	\$ 199,920	\$ 11,851
2013	152,614	8,243	-	-
2014	95,566	2,277	-	-
2015	62,219	2,540	-	-
	<u>\$ 554,301</u>	<u>\$ 34,002</u>	<u>\$ 199,920</u>	<u>\$ 11,851</u>

General obligation bonds are direct obligations of the City for which its full faith and credit are pledged. Repayment of general obligation bonds are from taxes levied on all taxable property located within the City. The City is not obligated in any manner for special assessment debt. Capital assets acquired under current capital lease obligations were a total of \$1,387,507 less accumulated depreciation of \$593,400, net \$794,107.

F. Operating Leases

Operating Leases -Lessee

The City has entered into thirteen operating leases for various equipment. These leases are considered to be operating for accounting purposes. Lease expenditures for the year totaled \$59,363.

Operating Leases –Lessor

The City has leasing arrangements with nine tenants in City owned mall. The term of lease arrangements range from 12 months to 60 months. Monthly rental amounts range from \$160 to \$15,000.

Future minimum rentals on non-cancelable leases are as follows:

Year	Amount
2012	484,650
2013	280,936
2014	24,711
Total	<u>\$ 790,297</u>

Cost of mall, excluding city library in mall, \$3,613,372. Total amount of accumulated depreciation on mall at year-end was \$143,027.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

G. Interfund Transactions

The compositions of interfund balances as of yearend were as follows:

	Payable						
	Total	General	Nonmajor Governmental	Internal Service	Wastewater	Sanitation	Retail
Receivable							
General	\$ 652,731	\$ -	\$ 33,045	\$ 619,686	\$ -	\$ -	\$ -
Nonmajor governmental	144,197	-	144,197	-	-	-	-
Internal Service	370,000	250,000	-	120,000	-	-	-
Water	454,009	-	823	-	17,276	375,000	60,910
Retail	45,487	-	45,487	-	-	-	-
Total	<u>\$ 1,666,424</u>	<u>\$ 250,000</u>	<u>\$ 223,552</u>	<u>\$ 739,686</u>	<u>\$ 17,276</u>	<u>\$ 375,000</u>	<u>\$ 60,910</u>

	Transfers in						
	Total	Nonmajor Governmental	Internal Service	Water	Wastewater	Sanitation	Retail
Transfer out:							
General	\$ 776,583	\$ 72,002	\$ -	\$ 440,749	\$ 3,400	\$ 1,700	\$ 258,732
Nonmajor governmental	120,227	-	-	120,227	-	-	-
Internal service funds	35,000	-	35,000	-	-	-	-
Water	324,928	74,928	-	-	125,000	125,000	-
Wastewater	13,652	-	-	13,652	-	-	-
Retail	35,906	35,906	-	-	-	-	-
Total transfers	<u>\$ 1,306,296</u>	<u>\$ 182,836</u>	<u>\$ 35,000</u>	<u>\$ 574,628</u>	<u>\$ 128,400</u>	<u>\$ 126,700</u>	<u>\$ 258,732</u>

Transfers to the general fund were subsidies for administrative expenditures. Other amounts transferred between funds related to amounts collected by the nonmajor governmental funds and enterprise funds are for various governmental expenditures and utility expenses.

H. Fund Equity

The City's restricted fund balance for other purposes are for the following:

Library	\$ 14,850
Community beautification	3,773
Total restricted for other purposes	<u>\$ 18,623</u>

I. Net Assets

The City's restricted net assets for other purposes are for the following:

Community Services	\$ 18,623
Economic Development	444,155
Public Safety	103,599
Total restricted for other purposes	<u>\$ 566,377</u>

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

IV. OTHER INFORMATION

A. 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; and natural disasters for which the City participates in the Texas Municipal League's Intergovernmental Risk Pools. The Pool purchases commercial insurance at group rates for participants in the Pool. The City has no additional risk or responsibility to the Pool, outside of the payment of insurance premiums. The City has not significantly reduced insurance coverage or had settlements which exceeded coverage amounts for the past three years.

The City established a limited risk management program for health benefits claims in October 2006. A separate fund was established to account for the City's self-insurance activities and the accumulation of resources to satisfy potential claims of subsequent periods. The City's exposure is limited due to stop-loss protection and reinsurance. Changes in the balance of claim liabilities during the past year are as follows:

Beginning claims payable	\$ 447,242
Claims incurred	1,527,795
Claims incurred but not reported	221,189
Claims paid	<u>(1,662,267)</u>
Ending claims payable	<u>\$ 533,959</u>

Claims payable for year- end are estimated based upon prior year actual claims and claims activity at year-end.

B. Contingent Liabilities

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

The City is a defendant in several lawsuits. Although the outcome of these lawsuits is not presently determinable, it is the opinion of the City's management that resolution of these matters will not have a material adverse effect on the financial condition of the City.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends, including frequency and amount of payouts, and other economic and social factors. No claim liabilities are reported at year-end.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

C. Pension Plans - Texas Municipal Retirement System

Plan Description

The City provides pension benefits for all of its full-time employees through a non-traditional, joint contributory, hybrid-defined benefit plan in the state-wide Texas Municipal Retirement System (TMRS), one of 833 administered by 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 TMRS, P.O. Box 149153, Austin, TX 78714-9153 or by calling 800-924-8611. 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 state statutes governing TMRS. Plan provisions for the City were as follows:

	2011	2010	2009	2008
Employee deposit rate	6.00%	6.00%	6.00%	6.00%
Matching ratio (city to employee)	2 to 1	2 to 1	2 to 1	2 to 1
Years required for vesting	5	5	5	5
Service requirement eligibility (expressed as age/ys of service)	60/50/20	60/50/20	60/50/20	60/50/20
Updated service credit	100% Repeating Transfers	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	70% of CPI Repeating

The following governmental funds have been used in prior years to liquidate the net pension obligation and net other postemployment benefit obligation:

General Fund
 Airport Fund
 Warehouse Fund

Benefits

Upon retirement, benefits depend upon the sum of the employee's contributions to the plan, with interest, and the City-financed monetary credits, with interest. City-financed monetary credits are composed of three sources: prior service credits, current service credits, and updated service credits. At the date the plan began, the City granted monetary credits for service rendered before the plan began of a theoretical amount at least equal to two times what would have been contributed by the employee, with interest, prior to establishment of the plan. Monetary credits for service since the plan began are a percent (100%, 150%, or 200%) of the

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

C. Pension Plans - Texas Municipal Retirement System, continued

employee's accumulated contributions. In addition, the City can grant, as often as annually, another type of monetary credit referred to as an updated service credit. This is a theoretical amount which, when added to the employee's accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and city matching percent had always been in existence, and if the employee's salary had always been the average of his salary in the last three years that are one year before the effective date. At retirement, the benefit is calculated as if the sum of the employee's accumulated contributions, with interest, and the employer-financed monetary credits, with interest, were used to purchase an annuity.

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 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 active member's projected benefit allocated annually; the prior service contribution rate amortizes the underfunded (overfunded) actuarial liability (asset) over the remainder of the plan's 30-year amortization period. 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 (i.e., December 31, 2010 valuation is effective for rates beginning January 2012). The annual pension cost and the net pension obligation (asset) are as follows:

	2011	2010	2009	2008	2007
Annual Req. Contrib.(ARC)	\$ 1,113,722	\$ 1,117,323	\$ 968,429	\$ 920,255	\$ 865,122
Contributions Made	\$ 1,113,722	\$ 1,117,323	\$ 968,429	\$ 920,255	\$ 865,122
NPO at End of Period	\$ -	\$ -	\$ -	\$ -	\$ -

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

	2011	2010
Actuarial Valuation Date	12/31/10	12/31/09
Actuarial Valuation of Assets	\$ 26,207,894	\$ 14,523,310
Actuarial Accrued Liability	\$ 35,433,051	\$ 25,546,260
Percentage Funded	74.0%	56.9%
Unfunded Actuarial Accrued Liability (UAAL)	\$ 9,225,157	\$ 11,022,950
Annual Coverage Payroll	\$ 7,908,331	\$ 7,509,706
UAAL as Percentage of Covered Payroll	117%	147%

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

C. Pension Plans - Texas Municipal Retirement System, continued

	2010	2009	2008	2007
Actuarial Valuation Date	12/31/09	12/31/08	12/31/07	12/31/06
Actuarial Cost Method	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit	Unit Credit
Amortization Method	Level % of Payroll	Level % of Payroll	Level % of Payroll	Level % of Payroll
GASB 25 equivalent single amortization period	27.1 Years	28 Years	29 Years	30 Years
Remaining Amortization Period	30 Years - Closed period	30 Years - Closed period	30 Years - Closed period	25 Years - Open period
Asset Valuation Method	Amortized cost	Amortized cost	Amortized cost	Amortized cost
Investment Rate of Return	7.0%	7.5%	7.5%	7.0%
Projected Salary Increases	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	3.00%	2.10%	2.10%	N/A

D. Other Post Employment Benefits

1. City of Palestine Retiree Health Care Plan

Plan Description

The City administers a single-employer defined benefit Other Post-Employment Benefits (OPEB) plan that will allow the retiree to pay their premium for continuation of the medical and dental insurance coverage. The plan is known as the City Retiree Health Care Plan. In order to be eligible for this benefit, the retiree must separate from service as a current recipient of retirement benefits from the TMRS and with at least five years of service with the City at age 60 or at least 20 years of service at any age. The health care benefit of the plan is available to the spouse if they were enrolled on the plan immediately before retirement or disability.

Funding Policy

The City has elected to finance the OPEB plan on a pay-as-you-go basis. The City contributed \$21,788 to the OPEB plan during the year.

Actuarial Information

The contribution requirement has been actuarially determined. The actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and that actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress immediately following the notes presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Projections of benefits are based on the types of benefits provided under the substantive plan at the time of each valuation and on the pattern of sharing of benefit costs between the employer and plan members to that point, and the projections of benefits for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future. Actuarial calculations reflect a long-term perspective, and consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

D. Other Post Employment Benefits, continued

accrued liabilities and the actuarial value of assets. As of the actuarial valuation date of October 1, 2008, the actuarial value of plan assets is zero dollars, the actuarial accrued liability is \$1,108,971, the total underfunded actuarial liability is \$1,108,971, and the actuarial value of assets as a percentage of the actuarial accrued liability is zero percent. The actuarial determined annual required contribution (ARC) is \$109,927. The components of the ARC consist of the employer's normal cost and the amortization of the underfunded actuarial accrued liabilities. The following is a summary of the actuarial assumptions:

Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level % of payroll
Remaining Amortization Period	30 Years - Closed period
Asset Valuation Method	Not applicable
Investment Rate of Return	Not applicable
Projected Salary Increases	3.0%
Healthcare Cost Trend Rate (Initial/Ultimate)	4.25%

Three-Year Contribution Information

	2011	2010	2009
Annual Req. Contrib. (ARC)	\$ 109,927	\$ 105,310	\$ 100,731
Interest on net OPEB obligation	121	111	-
Contributions Made	(21,788)	(24,805)	(17,821)
Beginning OPEB Obligation	163,526	82,910	-
Ending OPEB Obligation	<u>\$ 295,362</u>	<u>\$ 213,136</u>	<u>\$ 118,552</u>

The funded status as of October 1, 2008, the most recent valuation date, is as follows:

	2011
Actuarial Valuation Date	10/01/08
Actuarial Valuation of Assets	\$ -
Actuarial Accrued Liability	\$ 1,108,971
Percentage Funded	0.0%
Unfunded Actuarial Accrued Liability (UAAL)	\$ 1,108,971
Annual Coverage Payroll	\$ 7,908,331
UAAL as Percentage of Covered Payroll	14%

The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability of benefits.

CITY OF PALESTINE, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2011

2. TMRS - Supplemental Death Benefit Fund

Plan Description

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

The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary (calculated based on the employee's actual earnings, for the 12-month period preceding the month of death); retired employees are insured for \$7,500; this coverage is an "other post-employment benefit," or OPEB. The obligations of this plan are payable only from the SDBF and are not an obligation of, or a claim against, the Pension Trust Fund. For the year-ended September 30, 2011, the City offered the supplemental death benefit to both active and retired employees.

Contributions

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 the retiree's term life insurance during employees' entire careers.

The City's contribution rate to the TMRS SDBF, for the retiree portion, for the year-ended September 30, 2011 is shown below.

	<u>2011</u>
Annual Req. Contrib. (ARC)	0.10%
Actual Contributions Made	0.10%
Percentage of ARC Contrib.	100.00%

E. Subsequent Event

In October 2011, the City entered into a capital lease for vehicles and equipment. The amount acquired property cost and lease payable is \$409,502.

In December 2011 the City sold \$2,545,000 of general obligation refunding bonds. Proceeds from sale of bonds were used to refund \$1,725,000 of Water and Sewer, series 1995A and \$780,000 of Water and Sewer, series 1999. The issuance of refunding bonds consist of \$2.1 million of serial bonds, payable semi-annual, maturing on august 15, 2015 and \$365 thousand term bonds due on August 15, 2017 and August 15, 2019.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF PALESTINE, TEXAS

GENERAL FUND

BUDGETARY COMPARISON SCHEDULE FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget Positive (Negative)
Revenue:				
Taxes				
Property Taxes	\$ 5,022,305	\$ 5,022,305	\$ 4,965,555	\$ (56,750)
Business Franchise Taxes	1,172,000	1,172,000	1,147,029	(24,971)
City Sales Taxes	4,930,000	4,930,000	5,004,661	74,661
Licenses, Permits and Fees	213,500	213,500	97,124	(116,376)
Intergovernmental Revenues	276,237	276,237	337,483	61,246
Charges For Services	16,300	87,975	103,976	16,001
Fines and Forfeitures	472,600	472,600	406,234	(66,366)
Investment	54,000	54,000	15,914	(38,086)
Other revenues	84,000	84,000	49,268	(34,732)
Total revenues	12,240,942	12,312,617	12,127,244	(185,373)
Expenditures:				
General Government	1,889,043	1,855,230	1,883,257	(28,027)
Public Safety	6,729,341	6,729,341	6,734,481	(5,140)
Community Services	3,289,739	3,289,739	3,104,129	185,610
Community Development	1,069,362	1,199,350	1,067,519	131,831
Total expenditures	12,977,485	13,073,660	12,789,386	284,274
Excess (deficiency) of revenues over (under) expenditures	(736,543)	(761,043)	(662,142)	98,901
Other financing sources (uses):				
Operating transfers in	776,583	776,583	776,583	-
Operating transfers out	-	-	-	-
Total other financing sources (uses)	776,583	776,583	776,583	-
Net change in fund balance	40,040	15,540	114,441	\$ 98,901
Fund balances, October 1			\$ 1,702,987	
Fund balances, September 30			\$ 1,817,428	

Notes to Required Supplementary Information:

1. Annual budgets are adopted on a basis consistently with general accepted accounting principles (GAAP).
2. *Expenditures exceeded appropriations at the legal level of control.

CITY OF PALESTINE, TEXAS

SCHEDULE OF FUNDING PROGRESS TEXAS MUNICIPAL RETIREMENT SYSTEM

September 30, 2011

The City's annual covered payroll and pension costs are actuarially valued on a calendar year basis. Because the City makes all the annually required contributions, no net pension obligation (NPO) exists. The information presented below represents the City's Schedule of Funding Progress.

Fiscal Year	2011	2010	2009	2008	2007
Actuarial Valuation Date	12/31/10	12/31/09	12/31/08	12/31/07	12/31/06
Actuarial Value of Assets	\$26,207,894	\$14,523,310	\$13,418,753	\$14,185,105	\$13,876,432
Actuarial Accrued Liability	\$35,433,051	\$25,546,260	\$24,106,626	\$23,495,097	\$19,465,019
Percentage Funded	74.0%	56.9%	55.7%	60.4%	71.3%
Unfunded Actuarial Accrued Liability	\$9,225,157	\$11,022,950	\$10,687,873	\$9,309,992	\$5,588,587
Annual Covered Payroll	\$7,908,331	\$7,509,706	\$7,116,470	\$5,954,932	\$5,720,728
Unfunded Actuarial Accrued Liability (UAAL) % of Covered Payroll	116.7%	146.8%	150.2%	156.3%	97.7%
Net Pension Obligation (NPO) at the Beginning of Period	\$ -	\$ -	\$ -	\$ -	\$ -
Annual Req. Contrib. (ARC)	1,113,722	1,186,240	968,429	920,255	865,122
Contributions Made	1,113,722	1,186,240	968,429	920,255	865,122
NPO at the End of Period	\$ -	\$ -	\$ -	\$ -	\$ -

CITY OF PALESTINE, TEXAS

SCHEDULE OF FUNDING PROGRESS (1) POST-EMPLOYMENT HEALTHCARE BENEFITS

September 30, 2011

Year Ended	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
09/30/09	10/01/08	\$ -	\$ 944,042	\$ 944,042	0%	\$ 7,532,755	12.53%
09/30/10	10/01/08	\$ -	\$ 1,028,210	\$ 1,028,210	0%	\$ 7,509,706	13.69%
09/30/11	10/01/08	\$ -	\$ 1,108,971	\$ 1,108,971	0%	\$ 7,509,706	14.77%

(1) 2009 is the first year the City is required to implement GASB Statement No. 45 and the requirements have been implemented prospectively, therefore, the above illustration does not reflect similar information for the two preceding years.

COMBINING STATEMENTS AND SCHEDULES

CITY OF PALESTINE, TEXAS

NONMAJOR GOVERNMENTAL FUNDS

September 30, 2011

Economic Development Grant Fund

Tourism and Civic Center Fund

Airport Fund

Cemetery Fund

Municipal Court Security and Technology Funds

Gates Pac Hug Grant Fund

Carnegie Library Memorial Fund

Tobacco Grant 10-11 Fund

Equitable Sharing Federal Forfeitures Fund

Police Confiscated Money Fund

TxDOT Depot Enhancement Project Fund

Loop 256 Tree Project Fund

Community Forest Fund

Fitness Grant Fund

Search and Recovery Grant Fund

Fire Prevention Fund

PD JAG Grant 2010 and 2011

Legacy in the Park

Home Program

Debt Service Fund

Capital Projects Funds

CITY OF PALESTINE, TEXAS

COMBINING BALANCE SHEET (Page 1 of 2)

NONMAJOR GOVERNMENTAL FUNDS

SEPTEMBER 30, 2011

Special Revenue Funds

	Economic Development Grant	Tourism & Civic Center	Airport	Cemetery	Municipal Court Security	Municipal Court Technology
ASSETS						
Current Assets						
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ 6,335	\$ -	\$ -
Restricted cash and cash equivalents	350,182	43,976	-	-	16,410	-
Receivables	-	-	16,315	-	-	-
Restricted Receivables	-	57,302	-	-	-	-
Due from other funds	-	-	-	144,197	-	-
Restricted note receivables	47,882	-	-	-	-	-
Total Assets	\$ 398,064	\$ 101,278	\$ 16,315	\$ 150,532	\$ 16,410	\$ -
Liabilities:						
Accounts Payable	\$ -	\$ 7,305	\$ 1,403	\$ -	\$ 115	\$ -
Deferred Revenues	-	-	-	-	-	-
Due to other funds	-	-	140,183	-	-	3,227
Total Liabilities	-	7,305	141,586	-	115	3,227
Fund Balances:						
Nonspendable:						
Notes receivables	47,882	-	-	-	-	-
Restricted for:						
Capital projects	-	-	-	-	-	-
Debt service	-	-	-	-	-	-
Public safety	-	-	-	-	16,295	-
Other Purposes	-	-	-	-	-	-
Economic Development	350,182	93,973	-	-	-	-
Committed for:						
Community forest	-	-	-	-	-	-
Capital projects	-	-	-	-	-	-
Cemetery	-	-	-	150,532	-	-
Unassigned	-	-	(125,271)	-	-	(3,227)
Total Fund Balances	398,064	93,973	(125,271)	150,532	16,295	(3,227)
Total Liabilities and Fund Balances	\$ 398,064	\$ 101,278	\$ 16,315	\$ 150,532	\$ 16,410	\$ -

<u>Gates Pac Hug Grant</u>	<u>Carnegie Library Memorial</u>	<u>Tobacco Grant 10-11</u>	<u>Equitable Sharing Federal Forfeitures</u>	<u>Police Confiscated Money</u>	<u>TXDot Depot Enhancement Project</u>	<u>Loop 256 Tree Project</u>
\$ -	\$ -	\$ -	\$ -	\$ -	\$ 35,981	\$ -
1,721	13,614	4,500	31,551	44,800	-	1,032
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
<u>\$ 1,721</u>	<u>\$ 13,614</u>	<u>\$ 4,500</u>	<u>\$ 31,551</u>	<u>\$ 44,800</u>	<u>\$ 35,981</u>	<u>\$ 1,032</u>
\$ 485	\$ -	\$ -	\$ -	\$ 15,441	\$ -	\$ -
-	-	-	-	-	-	-
-	-	-	-	-	35,906	-
<u>485</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>15,441</u>	<u>35,906</u>	<u>-</u>
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	4,500	31,551	29,359	-	-
1,236	13,614	-	-	-	-	1,032
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	75	-
<u>1,236</u>	<u>13,614</u>	<u>4,500</u>	<u>31,551</u>	<u>29,359</u>	<u>75</u>	<u>1,032</u>
<u>\$ 1,721</u>	<u>\$ 13,614</u>	<u>\$ 4,500</u>	<u>\$ 31,551</u>	<u>\$ 44,800</u>	<u>\$ 35,981</u>	<u>\$ 1,032</u>

CITY OF PALESTINE, TEXAS

COMBINING BALANCE SHEET (Page 2 of 2)

NONMAJOR GOVERNMENTAL FUNDS

SEPTEMBER 30, 2011

	Special Revenue Funds						
	Community	Fitness	Search and	Fire	PD JAG		PD JAG
	Forest	Grant	Recovery Grant	Prevention	Grants 2011		Grant 2010
ASSETS							
Current Assets							
Cash and cash equivalents	\$ 82,746	\$ -	\$ -	\$ -	\$ -	\$ -	
Restricted cash and cash equivalents	-	-	5,236	7,387	4,958	4,313	
Receivables	-	-	-	-	-	-	
Restricted Receivables	-	-	-	-	-	-	
Due from other funds	-	-	-	-	-	-	
Note Receivables	-	-	-	-	-	-	
Total Assets	\$ 82,746	\$ -	\$ 5,236	\$ 7,387	\$ 4,958	\$ 4,313	
Liabilities:							
Accounts Payable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
Deferred Revenues	-	-	-	-	-	-	
Due to other funds	-	787	-	-	-	-	
Total Liabilities	-	787	-	-	-	-	
Fund Balances:							
Nonspendable:							
Notes receivables	-	-	-	-	-	-	
Restricted for:							
Capital projects	-	-	-	-	-	-	
Debt service	-	-	-	-	-	-	
Public safety	-	-	5,236	7,387	4,958	4,313	
Other Purposes	-	-	-	-	-	-	
Economic Development	-	-	-	-	-	-	
Committed for:							
Community forest	82,746	-	-	-	-	-	
Capital projects	-	-	-	-	-	-	
Cemetery	-	-	-	-	-	-	
Unassigned	-	(787)	-	-	-	-	
Total Fund Balances	82,746	(787)	5,236	7,387	4,958	4,313	
Total Liabilities and Fund Balances	\$ 82,746	\$ -	\$ 5,236	\$ 7,387	\$ 4,958	\$ 4,313	

Legacy in the Park	Home Program	Debt Service	Capital Projects Funds				Total Nonmajor Governmental Funds
			2006 Series Improvements	Library Project	Water Capital Projects	Capital Projects	
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 67,930	\$ 192,992
2,741	-	84,593	125,071	84,181	221,823	-	1,048,089
-	-	-	-	-	-	-	16,315
-	-	43,452	72,120	-	-	-	172,874
-	-	-	-	-	-	-	144,197
-	-	-	-	-	-	-	47,882
<u>\$ 2,741</u>	<u>\$ -</u>	<u>\$128,045</u>	<u>\$ 197,191</u>	<u>\$ 84,181</u>	<u>\$ 221,823</u>	<u>\$ 67,930</u>	<u>\$ 1,622,349</u>
\$ -	\$ -	\$ -	\$ 16,759	\$ -	\$ -	\$ -	\$ 41,508
-	-	39,149	-	-	-	-	39,149
-	33,045	-	-	10,404	-	-	223,552
-	33,045	39,149	16,759	10,404	-	-	304,209
-	-	-	-	-	-	-	47,882
-	-	-	180,432	73,777	221,823	-	476,032
-	-	88,896	-	-	-	-	88,896
-	-	-	-	-	-	-	103,599
2,741	-	-	-	-	-	-	18,623
-	-	-	-	-	-	-	444,155
-	-	-	-	-	-	-	82,746
-	-	-	-	-	-	67,930	67,930
-	-	-	-	-	-	-	150,532
-	(33,045)	-	-	-	-	-	(162,255)
<u>2,741</u>	<u>(33,045)</u>	<u>88,896</u>	<u>180,432</u>	<u>73,777</u>	<u>221,823</u>	<u>67,930</u>	<u>1,318,140</u>
<u>\$ 2,741</u>	<u>\$ -</u>	<u>\$128,045</u>	<u>\$ 197,191</u>	<u>\$ 84,181</u>	<u>\$ 221,823</u>	<u>\$ 67,930</u>	<u>\$ 1,622,349</u>

CITY OF PALESTINE
COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES (Page 1 of 2)
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Special Revenue Funds				
	Economic Development Grant	Tourism & Civic Center	Airport	Cemetery	Municipal Court Security
Revenues:					
Taxes	\$ -	\$ 420,773	\$ -	\$ -	\$ -
Intergovernmental	-	-	8,454	-	-
Charges for services	-	-	335,270	8,500	-
Fines and forfeitures	-	-	-	-	7,631
Rentals	-	19,184	25,731	-	-
Investment revenue	1,768	22	6	226	23
Other revenue	-	13,384	-	-	-
Total revenues	<u>1,768</u>	<u>453,363</u>	<u>369,461</u>	<u>8,726</u>	<u>7,654</u>
Expenditures:					
Current					
Public Safety	-	-	-	-	11,654
Community Services	-	322,711	344,223	700	-
Community Development	-	-	-	-	-
Debt service					
Principal	-	-	-	-	-
Interest and fiscal agent fees	-	-	-	-	-
Total expenditures	<u>-</u>	<u>322,711</u>	<u>344,223</u>	<u>700</u>	<u>11,654</u>
Excess (deficiency) of revenues over (under) expenditures	1,768	130,652	25,238	8,026	(4,000)
Other financing sources (uses):					
Transfers in	-	-	-	-	-
Transfers out	-	(67,102)	-	(600)	-
Total other financing sources (uses)	<u>-</u>	<u>(67,102)</u>	<u>-</u>	<u>(600)</u>	<u>-</u>
Net change in fund balance	1,768	63,550	25,238	7,426	(4,000)
Fund balances, October 1	<u>396,296</u>	<u>30,423</u>	<u>(150,509)</u>	<u>143,106</u>	<u>20,295</u>
Fund balances, September 30	<u>\$ 398,064</u>	<u>\$ 93,973</u>	<u>\$ (125,271)</u>	<u>\$ 150,532</u>	<u>\$ 16,295</u>

Municipal Court Technology	Gates Pac Hug Grant	Carnegie Library Memorial	Tobacco Grant 10-11	Equitable Sharing Federal Forfeitures	Police Confiscated Money	TXDot Depot Enhancement Project	Loop 256 Tree Project
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
-	-	-	2,000	-	-	-	-
-	-	-	-	-	-	-	-
9,364	-	-	-	-	5,756	-	-
-	-	-	-	-	-	-	-
-	3	15	-	113	52	43	1
-	-	1,923	-	-	-	-	-
<u>9,364</u>	<u>3</u>	<u>1,938</u>	<u>2,000</u>	<u>113</u>	<u>5,808</u>	<u>43</u>	<u>1</u>
7,092	-	-	200	-	-	-	-
-	-	1,256	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
<u>7,092</u>	<u>-</u>	<u>1,256</u>	<u>200</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
2,272	3	682	1,800	113	5,808	43	1
-	-	-	-	-	-	-	-
<u>(4,300)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(35,906)</u>	<u>-</u>
<u>(4,300)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(35,906)</u>	<u>-</u>
(2,028)	3	682	1,800	113	5,808	(35,863)	1
<u>(1,199)</u>	<u>1,233</u>	<u>12,932</u>	<u>2,700</u>	<u>31,438</u>	<u>23,551</u>	<u>35,938</u>	<u>1,031</u>
<u>\$ (3,227)</u>	<u>\$ 1,236</u>	<u>\$ 13,614</u>	<u>\$ 4,500</u>	<u>\$ 31,551</u>	<u>\$ 29,359</u>	<u>\$ 75</u>	<u>\$ 1,032</u>

CITY OF PALESTINE
COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES (Page 2 of 2)
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Special Revenue Funds					
	Community Forest	Fitness Grant	Search and Recovery Grant	Fire Prevention	PD Grants 2011	PD JAG Grant 2010
Revenues:						
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Intergovernmental	-	-	2,961	-	4,957	13,978
Charges for services	-	-	-	-	-	-
Fines and forfeitures	-	-	-	-	-	-
Rentals	-	-	-	-	-	-
Investment revenue	100	-	6	3	1	-
Miscellaneous revenue	-	-	-	17	-	-
Total revenues	<u>100</u>	<u>-</u>	<u>2,967</u>	<u>20</u>	<u>4,958</u>	<u>13,978</u>
Expenditures:						
Current						
Public Safety	-	-	-	-	-	9,993
Community Services	-	-	-	-	-	-
Community Development	-	-	-	-	-	-
Debt service						
Principal	-	-	-	-	-	-
Interest and fiscal agent fees	-	-	-	-	-	-
Total expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,993</u>
Excess (deficiency) of revenues over (under) expenditures	100	-	2,967	20	4,958	3,985
Other financing sources (uses):						
Transfers in	-	-	-	-	-	-
Transfers out	-	-	-	-	-	-
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balance	100	-	2,967	20	4,958	3,985
Fund balances, October 1	<u>82,646</u>	<u>(787)</u>	<u>2,269</u>	<u>7,367</u>	<u>-</u>	<u>328</u>
Fund balances, September 30	<u>\$ 82,746</u>	<u>\$ (787)</u>	<u>\$ 5,236</u>	<u>\$ 7,387</u>	<u>\$ 4,958</u>	<u>\$ 4,313</u>

Legacy in the Park	Home Program	Debt Service	Capital Projects Funds				Total Nonmajor Governmental Funds
			2006 Series Improvements	Library Project	Water Capital Projects	Capital Projects	
\$ -	\$ -	\$ 936,102	\$ -	\$ -	\$ -	\$ -	\$ 1,356,875
-	287,769	-	73,887	-	-	-	394,006
-	-	-	-	-	-	-	343,770
-	-	-	-	-	-	-	22,751
-	-	-	-	-	-	-	44,915
1	-	403	266	291	526	221	4,090
2,740	-	-	-	-	-	-	18,064
<u>2,741</u>	<u>287,769</u>	<u>936,505</u>	<u>74,153</u>	<u>291</u>	<u>526</u>	<u>221</u>	<u>2,184,471</u>
-	-	-	-	-	-	-	28,939
-	-	-	-	-	-	-	668,890
-	314,834	-	102,389	453,534	-	13,680	884,437
-	-	390,000	-	-	-	-	390,000
-	-	550,590	-	-	-	-	550,590
<u>-</u>	<u>314,834</u>	<u>940,590</u>	<u>102,389</u>	<u>453,534</u>	<u>-</u>	<u>13,680</u>	<u>2,522,856</u>
2,741	(27,065)	(4,085)	(28,236)	(453,243)	526	(13,459)	(338,385)
-	-	-	-	-	120,227	-	120,227
-	-	-	-	-	(74,928)	-	(182,836)
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>45,299</u>	<u>-</u>	<u>(62,609)</u>
2,741	(27,065)	(4,085)	(28,236)	(453,243)	45,825	(13,459)	(400,994)
-	(5,980)	92,981	208,668	527,020	175,998	81,389	1,719,134
<u>\$ 2,741</u>	<u>\$ (33,045)</u>	<u>\$ 88,896</u>	<u>\$ 180,432</u>	<u>\$ 73,777</u>	<u>\$ 221,823</u>	<u>\$ 67,930</u>	<u>\$ 1,318,140</u>

CITY OF PALESTINE, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

TOURISM AND CIVIC CENTER				Variance with Final Budget Positive (Negative)
	Budgeted Amounts		Actual	
	Original	Final		
Revenue:				
Taxes	\$ 375,000	\$ 375,000	\$ 420,773	\$ 45,773
Rentals	28,000	28,000	19,184	(8,816)
Other revenue	-	-	13,384	13,384
Interest	1,000	1,000	22	(978)
Total revenues	404,000	404,000	453,363	49,363
Expenditures:				
Community Services	330,516	330,516	322,711	7,805
Total expenditures	330,516	330,516	322,711	7,805
Excess (deficiency) of revenues over (under) expenditures	73,484	73,484	130,652	57,168
Other financing sources (uses)				
Transfers out	(67,102)	(67,102)	(67,102)	-
Total other financing sources (uses)	(67,102)	(67,102)	(67,102)	-
Net change in fund balance	\$ 6,382	\$ 6,382	63,550	\$ 57,168
Fund balances, October 1			30,423	
Fund balances, September 30			\$ 93,973	

CITY OF PALESTINE, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	AIRPORT			Variance with Final Budget Positive (negative)
	Budgeted Amounts		Actual	
	Original	Final		
Revenue:				
Intergovernmental	\$ -	\$ -	\$ 8,454	\$ 8,454
Rentals	38,000	38,000	25,731	(12,269)
Charges for services	344,100	344,100	335,270	(8,830)
Interest	-	-	6	6
Total revenues	382,100	382,100	369,461	(12,639)
Expenditures:				
Community Services	347,446	347,446	344,223	3,223
Total expenditures	347,446	347,446	344,223	3,223
Excess (deficiency) of revenues over (under) expenditures	34,654	34,654	25,238	(9,416)
Net change in fund balance	\$ 34,654	\$ 34,654	25,238	\$ (9,416)
Fund balances, October 1			(150,509)	
Fund balances, September 30			\$ (125,271)	

CITY OF PALESTINE, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	CEMETERY			
	Budgeted Amounts		Actual	Variance with Final Budget Positive (negative)
	Original	Final		
Revenue:				
Charges for services	\$ 5,000	\$ 5,000	\$ 8,500	\$ 3,500
Interest	500	500	226	(274)
Total revenues	5,500	5,500	8,726	3,226
Expenditures:				
Community Services	700	700	700	-
Total expenditures	700	700	700	-
Excess (deficiency) of revenues over (under) expenditures	4,800	4,800	8,026	3,226
Other financing sources (uses):				
Transfers out	(600)	(600)	(600)	-
Total other financing sources (uses)	(600)	(600)	(600)	-
Net change in fund balance	\$ 4,200	\$ 4,200	7,426	\$ 3,226
Fund balances, October 1			143,106	
Fund balances, September 30			\$ 150,532	

CITY OF PALESTINE, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

MUNICIPAL COURT TECHNOLOGY				Variance with Final Budget Positive (Negative)
	Budgeted Amounts		Actual	
	Original	Final		
Revenue:				
Fines	\$ 10,700	\$ 10,700	\$ 9,364	\$ (1,336)
Total revenues	10,700	10,700	9,364	(1,336)
Expenditures:				
Public Safety	6,400	6,400	7,092	(692)
Total expenditures	6,400	6,400	7,092	(692)
Excess (deficiency) of revenues over (under) expenditures	4,300	4,300	2,272	(2,028)
Other financing sources (uses):				
Transfers out	(4,300)	(4,300)	(4,300)	0
Total other financing sources (uses)	(4,300)	(4,300)	(4,300)	0
Net change in fund balance	\$ (4,300)	\$ (4,300)	(2,028)	\$ (2,028)
Fund balances, October 1			(1,199)	
Fund balances, September 30			\$ (3,227)	

CITY OF PALESTINE, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	MUNICIPAL COURT SECURITY			Variance with Final Budget Positive (Negative)
	Budgeted Amounts		Actual	
	Original	Final		
Revenue:				
Fines	\$ 8,000	\$ 8,000	\$ 7,631	\$ (369)
Investment revenue	-	-	23	23
Total revenues	8,000	8,000	7,654	(346)
Expenditures:				
Public Safety	4,500	4,500	11,654	(7,154)
Total expenditures	4,500	4,500	11,654	(7,154)
Excess (deficiency) of revenues over (under) expenditures	3,500	3,500	(4,000)	(7,500)
Net change in fund balance	\$ 3,500	\$ 3,500	(4,000)	\$ (7,500)
Fund balances, October 1			20,295	
Fund balances, September 30			\$ 16,295	

CITY OF PALESTINE, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	DEBT			Variance with Final Budget Positive (Negative)
	Budgeted Amounts		Actual	
	Original	Final		
Revenue:				
Taxes	\$ 948,089	\$ 948,089	\$ 936,102	\$ (11,987)
Interest	300	300	403	103
Total revenues	<u>948,389</u>	<u>948,389</u>	<u>936,505</u>	<u>(11,884)</u>
Debt Service:				
Principal	390,000	390,000	390,000	-
Interest and fiscal charges	<u>550,590</u>	<u>550,590</u>	<u>550,590</u>	<u>-</u>
Total expenditures	<u>940,590</u>	<u>940,590</u>	<u>940,590</u>	<u>-</u>
Excess (deficiency) of revenues over (under) expenditures	<u>7,799</u>	<u>7,799</u>	<u>(4,085)</u>	<u>(11,884)</u>
Net change in fund balance	<u>\$ 7,799</u>	<u>\$ 7,799</u>	(4,085)	<u>\$ (11,884)</u>
Fund balances, October 1			<u>92,981</u>	
Fund balances, September 30			<u>\$ 88,896</u>	

CITY OF PALESTINE, TEXAS
INTERNAL SERVICE FUNDS
September 30, 2011

Central Warehouse Fund

This internal service fund is used to account for inventory and maintenance services to departments or agencies of the City on a cost-reimbursement basis.

Health Insurance Fund

This internal service fund is used to account for the costs associated with health insurance for employees.

Workers Compensation Fund

This internal service fund is used to account for the costs associated with Workers Compensation of employees.

Equipment Replacement Fund

This internal service fund is used to account for equipment replacement to departments or agencies of the City on a cost reimbursement basis.

Unemployment Fund

This internal service fund is used to account for the costs associated with unemployment.

CITY OF PALESTINE, TEXAS

COMBINING STATEMENT OF NET ASSETS

INTERNAL SERVICE FUNDS

SEPTEMBER 30, 2011

ASSETS	<u>CENTRAL WAREHOUSE</u>	<u>HEALTH INSURANCE</u>	<u>WORKERS' COMPENSATION</u>	<u>EQUIPMENT REPLACEMENT</u>
Current Assets:				
Cash and cash equivalents	\$ 3,452	\$ 61,820	\$ 117,070	\$ 372,188
Due from other funds	-	-	-	370,000
Inventory	130,592	-	-	-
Total current assets	<u>134,044</u>	<u>61,820</u>	<u>117,070</u>	<u>742,188</u>
Noncurrent Assets:				
Capital Assets (net)	-	-	-	1,339,754
Total noncurrent assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,339,754</u>
Total assets	<u>\$ 134,044</u>	<u>\$ 61,820</u>	<u>\$ 117,070</u>	<u>\$ 2,081,942</u>
LIABILITIES				
Current Liabilities				
Accounts payable	\$ 33,951	\$ 533,960	\$ -	\$ -
Due to other funds	120,286	616,100	3,300	-
Long-term debt - due more than a year	-	-	-	243,902
Total current liabilities	<u>154,237</u>	<u>1,150,060</u>	<u>3,300</u>	<u>243,902</u>
Noncurrent liabilities				
Long-term debt - due more than a year	-	-	-	310,401
Total noncurrent liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>310,401</u>
Total Liabilities	154,237	1,150,060	3,300	554,303
NET ASSETS				
Invested in capital assets, net of related debt	-	-	-	785,451
Unrestricted	(20,193)	(1,088,240)	113,770	742,188
Total net assets	<u>(20,193)</u>	<u>(1,088,240)</u>	<u>113,770</u>	<u>1,527,639</u>
Total Liabilities and Net Assets	<u>\$ 134,044</u>	<u>\$ 61,820</u>	<u>\$ 117,070</u>	<u>\$ 2,081,942</u>

<u>UNEMPLOYMENT</u>	<u>TOTAL</u>
\$ 351,191	\$ 905,721
-	370,000
-	130,592
<u>351,191</u>	<u>1,406,313</u>
-	1,339,754
-	<u>1,339,754</u>
<u>\$ 351,191</u>	<u>\$ 2,746,067</u>
\$ 5,077	\$ 572,988
-	739,686
-	243,902
<u>5,077</u>	<u>1,556,576</u>
-	310,401
-	<u>310,401</u>
5,077	1,866,977
-	785,451
<u>346,114</u>	<u>93,639</u>
<u>346,114</u>	<u>879,090</u>
<u>\$ 351,191</u>	<u>\$ 2,746,067</u>

CITY OF PALESTINE, TEXAS
COMBINING STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN FUND NET ASSETS
INTERNAL SERVICE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	<u>CENTRAL WAREHOUSE</u>	<u>HEALTH INSURANCE</u>	<u>WORKERS' COMPENSATION</u>	<u>EQUIPMENT REPLACEMENT</u>
OPERATING REVENUES:				
Charges for Services and Sales	\$ 505,334	\$ 2,018,035	\$ -	\$ 320,872
Total Operating Revenues	<u>505,334</u>	<u>2,018,035</u>	<u>-</u>	<u>320,872</u>
OPERATING EXPENSES:				
Cost of Services	602,358	2,235,211	96,122	16,599
Depreciation	-	-	-	289,586
Total Operating Expenses	<u>602,358</u>	<u>2,235,211</u>	<u>96,122</u>	<u>306,185</u>
Operating Income (loss)	<u>(97,024)</u>	<u>(217,176)</u>	<u>(96,122)</u>	<u>14,687</u>
NON-OPERATING REVENUES (EXPENSES):				
Interest revenue	-	322	211	871
Interest expense	-	-	-	(32,729)
Total Non-operating Revenues (Expenses)	<u>-</u>	<u>322</u>	<u>211</u>	<u>(31,858)</u>
Net Income (Loss)	<u>(97,024)</u>	<u>(216,854)</u>	<u>(95,911)</u>	<u>(17,171)</u>
Transfer in	-	35,000	-	-
Transfer out	-	-	(35,000)	-
Change in net assets	<u>(97,024)</u>	<u>(181,854)</u>	<u>(130,911)</u>	<u>(17,171)</u>
Net assets, October 1	<u>76,831</u>	<u>(906,386)</u>	<u>244,681</u>	<u>1,544,810</u>
Net assets, September 30	<u>\$ (20,193)</u>	<u>\$ (1,088,240)</u>	<u>\$ 113,770</u>	<u>\$ 1,527,639</u>

<u>UNEMPLOYMENT</u>	<u>TOTAL</u>
\$ -	\$ 2,844,241
<u>-</u>	<u>2,844,241</u>
43,168	2,993,458
-	289,586
<u>43,168</u>	<u>3,283,044</u>
<u>(43,168)</u>	<u>(438,803)</u>
445	1,849
-	(32,729)
<u>445</u>	<u>(30,880)</u>
<u>(42,723)</u>	<u>(469,683)</u>
-	35,000
-	(35,000)
<u>(42,723)</u>	<u>(469,683)</u>
388,837	1,348,773
<u>\$ 346,114</u>	<u>\$ 879,090</u>

CITY OF PALESTINE, TEXAS

COMBINING STATEMENT OF CASH FLOWS

ALL INTERNAL SERVICE FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 2011

	CENTRAL WAREHOUSE	HEALTH INSURANCE	WORKERS' COMPENSATION	EQUIPMENT REPLACEMENT
Cash Flows from Operating Activities:				
Cash Received from Interfund services provided	\$ 505,334	\$ 2,018,035	\$ -	\$ 320,872
Cash Payments to Other Suppliers for Goods and Services	(568,596)	(2,148,723)	(96,122)	(23,773)
Internal Activity-payments to other funds	66,714	165,000	3,300	175,328
Net Cash Provided (Used) by Operating Activites	3,452	34,312	(92,822)	472,427
Cash Flows from Non-capital Financing Activities:				
Transfer from (to) other funds	-	35,000	(35,000)	-
Net Cash Provided (Used) by Non-capital Financing Activites	-	35,000	(35,000)	-
Cash Flows from Capital and Related Financing Activities:				
Principal paid on capital debt	-	-	-	(270,255)
Interest paid on capital debt	-	-	-	(36,429)
Proceeds from capital debt	-	-	-	123,736
Acquistion and Construction of Capital Assets	-	-	-	-
Proceeds from sale of assets	-	-	-	-
Net Cash Provided (Used) for Capital and Related Financing Activities	-	-	-	(182,948)
Cash Flows from Investing Activities:				
Interest received	-	322	211	871
Net Cash Provided (Used) for Investing Activities	-	322	211	871
Net Increase (Decrease) in Cash and Cash Equivalents	3,452	69,634	(127,611)	290,350
Cash and Cash Equivalents at Beginning of Year	-	(7,814)	244,681	81,838
Cash and Cash Equivalents at End of Year	3,452	61,820	117,070	372,188
Reconciliation of Operating Income to Net Cash Provided by Operating Activities				
Operating Income (Loss)	(97,024)	(217,176)	(96,122)	14,687
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities				
Depreciation	-	-	-	289,586
Change in Assets and Liabilities				
Decrease (Increase) in Inventories	5,306	-	-	-
Increase (Decrease) in Accounts Payable	28,456	86,488	-	(7,174)
Increase (Decrease) in Interfund payable	66,714	165,000	3,300	175,328
Total Adjustments	100,476	251,488	3,300	457,740
Net Cash Provided (Used) by Operating Activities	\$ 3,452	\$ 34,312	\$ (92,822)	\$ 472,427

<u>UNEMPLOYMENT</u>	<u>TOTAL</u>
\$ -	\$ 2,844,241
(38,091)	(2,875,305)
388,837	799,179
<u>350,746</u>	<u>768,115</u>
-	-
-	-
-	(270,255)
-	(36,429)
-	123,736
-	-
-	-
<u>-</u>	<u>(182,948)</u>
445	1,849
<u>445</u>	<u>1,849</u>
351,191	587,016
-	318,705
<u>351,191</u>	<u>905,721</u>
(43,168)	(438,803)
	289,586
-	5,306
5,077	112,847
388,837	799,179
<u>393,914</u>	<u>1,206,918</u>
<u>\$ 350,746</u>	<u>\$ 768,115</u>