THE CITY OF VERNON, TEXAS

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED SEPTEMBER 30, 2012

The City of Vernon, Texas
Annual Financial Report
For The Year Ended September 30, 2012

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Financial Section

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Independent Auditor's Report on Financial Statements

Honorable Mayor and
Members of the City Commission
The City of Vernon, 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 Vernon, Texas as of and for the year ended September 30, 2012, 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 Vernon, Texas' management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the the financial statements of the City's component unit, the Business Development Corporation of Vernon (BDC). Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for BDC, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

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

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Budgetary Comparison Schedule, and the Schedule of Funding Progress for the Texas Municipal Retirement System identified as Required Supplementary Information in the table of contents 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.

Respectfully submitted,

Edgin, Parkman, Fleming & Fleming, PC

Edgin, Parkman, Fleming & Fleming, PC

February 21, 2013

City of Vernon

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Vernon, Texas 76384-4741
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MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Vernon, Texas, we offer readers of the City's Annual Financial Report this narrative overview and analysis of the City's financial performance during the fiscal year ended September 30, 2012. Please read it in conjunction with the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by $20,808,206 (net assets). Of this amount, $2,274,749 (unrestricted net assets) may be used to meet the City's obligations.
- During the year, the City's total net assets decreased by $142,530.
- The governmental funds reported a fund balance this year of $3,426,949, which is a decrease of $869,952 in comparison with the prior year amount of $4,296,901, or 20%. Of this total fund balance, $0 is available for spending at the government's discretion (unassigned fund balance).
- At the end of the current fiscal year, unassigned fund balance for the General Fund and all other Governmental Funds was $0. All of the total Governmental Funds fund balances are either restricted or committed.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the City's overall financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the government, reporting the City's operations in more detail than the government-wide statements.
- The *governmental funds* statements tell how *general government* services were financed in the *short term* as well as what remains for future spending.
- The *proprietary fund statements* offer *short-* and *long-term* financial information about the activities the government operates *like businesses*, such as the water and sewer system.

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

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

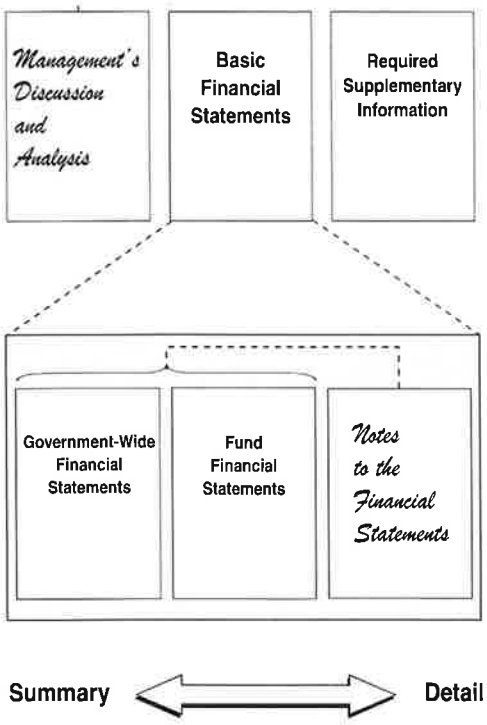


Figure A-2 summarizes the major features of the City's financial statements, including the portion of the City's government they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis explains the structure and contents of each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

Figure A-2. Major Features of the City's Government-wide and Fund Financial Statements

		Fund Statements	
Type of Statements	**Government-wide**	**Governmental Funds**	**Proprietary Funds**
Scope	Entire Agency's government (except fiduciary funds) and the Agency's component units	The activities of the City that are not proprietary or fiduciary	Activities the City operates similar to private businesses - the water and sewer system
Required financial statements	• Statement of net assets • Statement of activities	• Balance sheet • Statement of revenues, expenditures & changes in fund balances	• Statement of net assets • Statement of revenues, expenses, and changes in net assets • Statement of cash flows
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter, no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during year, regardless of when cash is received or paid

Government-wide Statements

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

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

- Over time, increases or decreases in the City's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.

- To assess the overall health of the City, one needs to consider additional non-financial factors such as changes in the City's tax base.

The government-wide financial statements of the City are divided into three categories:

- *Governmental activities.* Most of the City's basic services are included here, such as the fire department, law enforcement, street department, sanitation, parks services, the City cemetery, animal control and general administration.

- *Business-type activities.* The City charges fees to customers to help it cover the cost of certain services it provides. The City's water and sewer system are included here.

- *Component Units.* The City includes one other entity in its report - the Business Development Corporation of Vernon. Although legally separate, this "component unit" is important because the City is financially accountable for it.

Fund Financial Statements

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

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

The City has the following kinds of funds:

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

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

Net assets. The City's combined net assets were $20,808,206 at September 30, 2012. (See Table A-1)

Table A-1
City's Net Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Current and other assets	$ 5,554,115	$ 6,271,438	$ 2,006,264	$ 2,953,759	$ 7,560,379	$ 9,225,197
Capital assets, net	6,918,979	5,544,994	20,424,141	20,253,633	27,343,120	25,798,627
Total assets	12,473,094	11,816,432	22,430,405	23,207,392	34,903,499	35,023,824
Current and other liabilities	1,035,556	970,592	501,708	1,230,227	1,537,264	2,200,819
Long-term liabilities	2,857,518	2,328,661	9,700,511	9,543,608	12,558,029	11,872,269
Total liabilities	3,893,074	3,299,253	10,202,219	10,773,835	14,095,293	14,073,088
Net assets						
Invested in capital assets, net of related debt	3,834,494	3,035,162	10,802,515	9,914,956	14,637,009	12,950,118
Restricted	3,354,002	3,988,476	542,446	1,295,766	3,896,448	5,284,242
Unrestricted	1,391,524	1,493,541	883,225	1,222,835	2,274,749	2,716,376
Total net assets	$ 8,580,020	$ 8,517,179	$ 12,228,186	$ 12,433,557	$ 20,808,206	$ 20,950,736

The $2,274,749 of unrestricted net assets at September 30, 2012 represents resources available to fund the programs of the City next year if sufficient resources are not derived from future resources. The restricted net assets are required to be set aside for long-term debt, public improvements and various other activities.

Changes in net assets. The City's total revenues, both program and general, were $11,811,528. A significant portion, 67%, of the City's revenue comes from charges for services. (See Figure A-3.) 2% comes from operating and capital grants and contributions, 10% comes from sales taxes, 11% from property taxes and 5% from franchise fees. Other minor categories combined make up 5% of the City's total revenues.

The total cost of all programs and services was $11,954,058, 41% of these costs are for water, sewer and sanitation related expenses. The City's expenses cover a range of services, with 33% related to public safety, 7% for public works and 7% for general government. (See Figure A-4.)

Figure A-3
Source of Revenue for Fiscal Year 2012

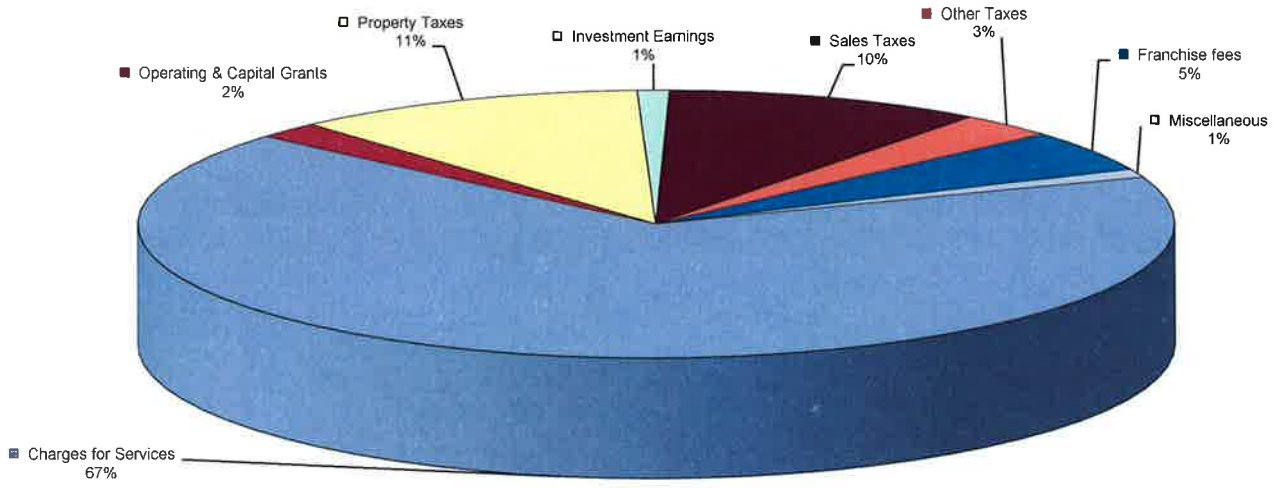
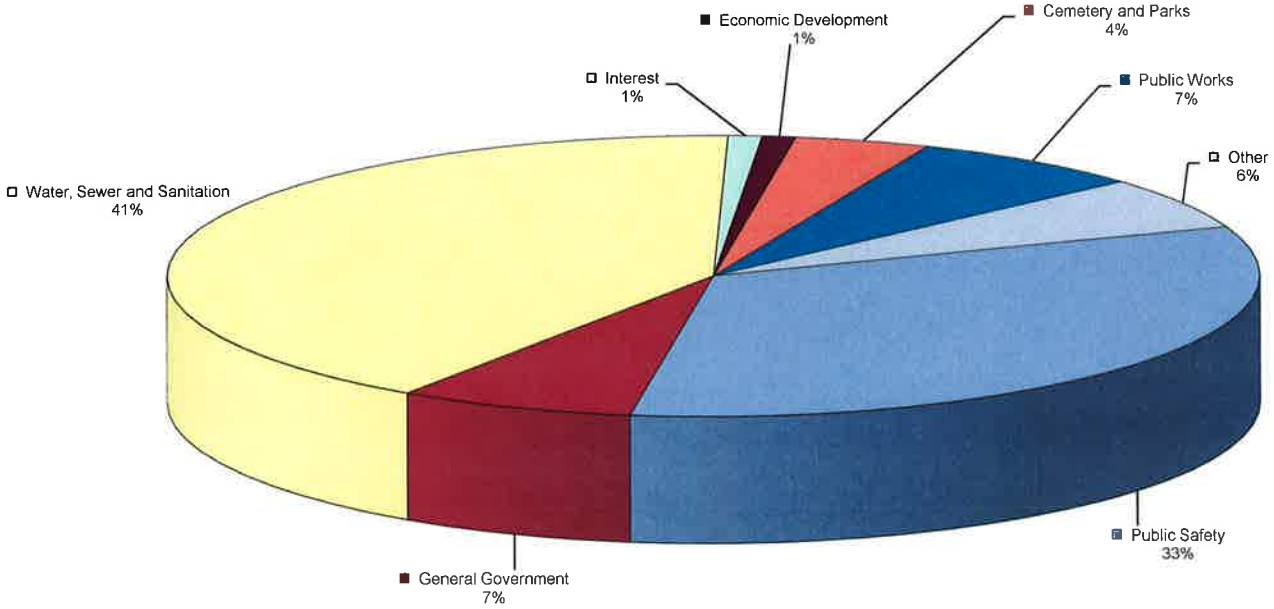


Figure A-4
Functional Expense for Fiscal Year 2012



Governmental Activities

Table A-2 presents the various revenue categories and gross costs of each of the City's functional areas for the current year.

Table A-2
Changes in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Revenues						
Program revenues						
Charges for services	$ 1,815,884	$ 1,170,186	$ 6,045,604	$ 5,975,940	$ 7,861,488	$ 7,146,126
Operating and capital grants	232,445	577,365			232,445	577,365
General revenues						
Property taxes	1,364,422	1,352,338			1,364,422	1,352,338
Sales taxes	1,178,628	1,099,362			1,178,628	1,099,362
Franchise fees	654,837	799,277			654,837	799,277
Other taxes	328,526	223,631			328,526	223,631
Investment earnings	52,438	62,326	12,236	17,849	64,674	80,175
Seizure income	-	89			-	89
Miscellaneous	96,932	102,702	29,576	40,488	126,508	143,190
Total revenues	5,724,112	5,387,276	6,087,416	6,034,277	11,811,528	11,421,553
Expenses						
General government	861,152	899,069			861,152	899,069
Public safety	3,959,729	4,000,768			3,959,729	4,000,768
Public works	875,395	933,971			875,395	933,971
Cemetery and Parks	470,179	365,593			470,179	365,593
Subsidies, donations, and other	403,451	427,724			403,451	427,724
Christmas decorations	10,802	4,513			10,802	4,513
Civic and cultural	306,502	109,405			306,502	109,405
Economic development	126,095	104,449			126,095	104,449
Interest	109,256	112,011			109,256	112,011
Water, sewer and sanitation			4,831,497	4,800,247	4,831,497	4,800,247
Total expenses	7,122,561	6,957,503	4,831,497	4,800,247	11,954,058	11,757,750
Transfers	1,461,290	1,205,242	(1,461,290)	(1,205,242)	-	-
Increase (decrease) in net assets	$ 62,841	$ (364,985)	$ (205,371)	$ 28,788	$ (142,530)	$ (336,197)

The most significant fluctuation between years relates to the following:

- Charges for Services increased by $645,699, which is mostly due to increased revenues from the ambulance operations and the new aquatic center.
- Grants decreased by $344,920, due to limited grant opportunities in 2011-12.
- Sales Tax increased by $79,266 due to stimulus of retail sales in the local economy.
- Public Safety and Public Works expenses decreased $41,039 and $58,576, mostly due to tightening of spending and budget cuts in the City's efforts of providing quality services at the lowest cost.
- Civic and Cultural expenses increased $197,097 due to several one-time expenses, including new stalls at WCEC, building improvement grants, Teagarden Museum, and billboards.

Table A-3 presents the cost of each of the City's largest functions as well as each function's net cost (total cost less fees generated by the activities and intergovernmental aid). The net cost reflects what was funded by state revenues as well as local tax dollars.

- The cost of all *governmental* activities this year was $7,122,561; however, the amount that our taxpayers paid for these activities through property taxes was only $1,364,422.

- Some of the cost was paid by those who directly benefited from the programs through charges for services of $1,815,884.

Table A-3
Net Cost of Governmental Activities

	Total Cost of Services		Net Cost of Services	
	2012	2011	2012	2011
General government	$ 861,152	$ 899,069	$ 527,956	$ 512,014
Public safety	3,959,729	4,000,768	2,639,514	3,403,322
Public w orks	875,395	933,971	767,110	729,711
Cemetery and parks	470,179	365,593	234,477	170,083
Economic development	126,095	109,405	126,095	(213,112)
Subsidies, donations and other	403,451	427,724	358,885	388,697
Christmas decorations	10,802	4,513	4,437	(2,179)
Civic and cultural	306,502	104,449	306,502	109,405
Interest	109,256	112,011	109,256	112,011
Total	$ 7,122,561	$ 6,957,503	$ 5,074,232	$ 5,209,952

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

Revenues from governmental funds totaled $5,627,271, an increase of $177,665 or 3%. The largest increase was in hotel/motel tax revenue, an increase of $104,714 or 48%. Positive revenue pressure was also seen in sales taxes, up by $49,266, an increase of 7% which can be attributed to stimulus of retail sales in the local economy.

Expenditures from governmental funds totaled $8,789,551, an increase of $847,983 or 11%. The largest increase was in capital outlay, an increase of $509,634 or 41%. The second largest increase was in civic and cultural, which was an increase of $197,097 or 108%. Transfers to the general fund increased by $338,973 or 28%.

General Fund Budgetary Highlights

Over the course of the year, the City revised its budget. Ambulance Revenue exceeded budget estimates and final budget. The first time paving project was deferred in part to help the overall General Fund fund balance. Various department expenditures exceeded budgeted amounts due to various unique conditions including construction of the new Aquatic Center, excessive wild fires and ambulance runs.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At September 30, 2012, the City had invested in a broad range of capital assets totaling $27,343,120, including land, equipment, buildings, and vehicles. (See Table A-4.)

Table A-4
Capital Assets Net of Accumulated Depreciation

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Land	$ 981,029	$ 981,029	$ 721,690	$ 721,690	$ 1,702,719	$ 1,702,719
Construction in progress	-	323,474	15,673	25,273	15,673	348,747
Buildings and improvements	3,857,086	2,224,630	19,171,688	19,121,997	23,028,774	21,346,627
Equipment, furniture, fixtures	928,906	711,395	433,223	322,715	1,362,129	1,034,110
Vehicles	1,151,958	1,304,466	81,867	61,958	1,233,825	1,366,424
Total net assets	$ 6,918,979	$ 5,544,994	$ 20,424,141	$ 20,253,633	$ 27,343,120	$ 25,798,627

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

For the City's fiscal year 2013, the City plans capital additions including:

Capital Item	Governmental Activities	Business Activities	Total
New Street Paving	$165,000		$165,000
*Radio Communication (Mandated)	21,000		21,000
*Mosquito Sprayer	10,705		10,705
Cemetery Mower (Perpetual care)	14,750		14,750
Pool Pump (Total cost $12,000)	6,000		6,000
*Laserfiche Records Management		$26,529	26,529
*New Server		5,388	5,388
Water Main and Leak Repairs (2009 Bond)		20,000	20,000
Equipment Trailer (2009 W&S Bond)		21,000	21,000
Wastewater pumps (2009 W&S Bond)		10,000	10,000
Safety Trench Box (2009 W&S Bond)		7,300	7,300
Laser Level for Wastewater		5,000	5,000
Total	$217,455	$95,217	$312,672

* Financed

Long-term Obligations

At September 30, 2012, the City had $13,052,172 in bonds, notes payable, compensated absences, and leases outstanding as shown in Table A-5. More detailed information about the City's long-term obligations is presented in the notes to the financial statements.

Table A-5
Outstanding Debt

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Capital Leases	$ 1,269,485	$ 1,149,832	$ 115,453	$ 119,417	$ 1,384,938	$ 1,269,249
Certificates of Obligation	1,315,000	1,360,000	-		1,315,000	1,360,000
Notes payable	500,000	-	-		500,000	
Compensated absences	267,176	276,684	78,885	74,912	346,061	351,596
Revenue Bonds	-	-	9,506,173	10,219,260	9,506,173	10,219,260
Total	$ 3,351,661	$ 2,786,516	$ 9,700,511	$ 10,413,589	$ 13,052,172	$ 13,200,105

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Appraised value used for the 2012-13 budget preparation was $376,988,230. This value is up over $9 million, or 2.4% above last year's value. Local sales tax revenue did show an upturn again at approximately $37,000, unlike other municipalities' sales tax revenue. These indicators were taken into consideration when adopting the General Fund budget for 2012-13.

The 2012-13 budgets were developed so as to increase fund balances in the General and Utility Funds due to recent declines. Revenues and other financing sources in the General Fund budget are $6,620,105, an increase of 2.4% over the prior year. Property tax revenue is expected to have a slight increase over the anticipated revenue for the prior year due to adoption of the same tax rate. The tax rate adopted is $0.360778 per $100 of assessed valuation. This rate is above the effective tax rate of $0.354745 per $100 valuation as calculated by the Wilbarger County Appraisal District. Ambulance revenue is expected to steady with some rebound. The City, County, and Hospital District agreed last year to a monthly increase in subsidy to offset anticipated short falls as calculated on a three year average.

Enterprise Fund budget was set with a 3.6% overall increase in water and sewer operation costs to cover increased costs due to debt service, permit renewal, increased testing, and fuel increases. Rates were increased approximately 4% and anticipation of additional industrial usage with planned expansion is anticipated to result in a 6.7% overall revenue increase which should increase the fund balance in excess of $120,000.

General Fund expenditures are budgeted at $6,498,600, an increase of 0.6% over the prior year. Enterprise Fund expenditures are budgeted at $6,580,778, an increase of 3.6% over the prior year.

If these estimates are realized, both the City's budgetary General Fund's fund balance and Enterprise Fund fund balance are expected to increase by the close of 2012-13.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the City's Administration Office.

Basic Financial Statements

THE CITY OF VERNON, TEXAS

STATEMENT OF NET ASSETS
SEPTEMBER 30, 2012

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Unit
ASSETS				
Cash and cash equivalents	$ 4,741,880	$ 468,240	$ 5,210,120	$ 240,669
Receivables, net of allowances for uncollectibles	945,187	499,717	1,444,904	
Due from primary government	--	--	--	105,376
Internal balances	(153,269)	153,269	--	--
Notes receivable, net of allowance for uncollectibles	--	--	--	63,395
Other assets	326	450	776	29,270
Escrow deposit	2,000	--	2,000	--
Restricted assets:				
Cash and cash equivalents	3,674	689,021	692,695	252,935
Bond issue costs, net of accumulated amortization	14,317	195,567	209,884	--
Capital assets, net of accumulated depreciation	6,918,979	20,424,141	27,343,120	618,511
Total assets	12,473,094	22,430,405	34,903,499	1,310,156
LIABILITIES				
Accounts payable	383,403	286,865	670,268	--
Sales tax payable	--	41,378	41,378	--
Due to component unit	105,376	--	105,376	--
Accrued interest payable	41,547	16,621	58,168	6,270
Customer deposits	--	156,844	156,844	--
Unearned revenue	11,087	--	11,087	--
Long-term liabilities:				
Portion due or payable within one year:				
Compensated absences	213,740	47,331	261,071	--
Capital leases payable	235,403	44,926	280,329	1,823
Bonds payable	45,000	910,000	955,000	--
Notes payable	--	--	--	147,662
Portion due or payable after one year:				
Compensated absences	53,436	31,554	84,990	--
Capital leases payable	1,034,082	70,527	1,104,609	2,834
Bonds payable	1,270,000	8,596,173	9,866,173	--
Notes payable	500,000	--	500,000	2,585,853
Total liabilities	3,893,074	10,202,219	14,095,293	2,744,442
NET ASSETS				
Invested in capital assets, net of related debt	3,834,494	10,802,515	14,637,009	300,272
Restricted for:				
Debt service	--	273,173	273,173	252,935
Capital projects	--	269,273	269,273	--
Public improvements:				
Expendable	49,127	--	49,127	--
Nonexpendable	2,831,070	--	2,831,070	--
Perpetual care:				
Nonexpendable	311,772	--	311,772	--
Public safety	14,063	--	14,063	--
Christmas decorations	12,675	--	12,675	--
Tourism program	135,295	--	135,295	--
Economic development	--	--	--	(1,987,493)
Unrestricted	1,391,524	883,225	2,274,749	--
Total net assets	$ 8,580,020	$ 12,228,186	$ 20,808,206	$ (1,434,286)

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2012

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Governmental activities:				
General government	$ 861,152	$ 310,713	$ 22,483	$ --
Public safety	3,959,729	1,176,735	101,054	42,426
Public works	875,395	91,002	17,283	--
Cemetery and parks	470,179	192,868	--	42,834
Subsidies, donations, and other	403,451	44,566	--	--
Christmas decorations	10,802	--	6,365	--
Civic and cultural	306,502	--	--	--
Economic development	126,095	--	--	--
Interest expense	109,256	--	--	--
Total governmental activities	7,122,561	1,815,884	147,185	85,260
Business-type activities:				
Water	1,983,285	2,871,913	--	--
Sewer	1,276,663	1,644,328	--	--
Sanitation	1,477,965	1,425,806	--	--
Other	93,584	103,557	--	--
Total business-type activities	4,831,497	6,045,604	--	--
Total primary government	$ 11,954,058	$ 7,861,488	$ 147,185	$ 85,260
Component unit:				
Business Development Corporation of Vernon	$ 909,177	$ 60,000	$ --	$ --

General Revenues:	
Taxes:	
Ad valorem taxes	
Franchise and occupation tax	
Sales tax	
Hotel occupancy tax	
Other taxes	
Interest	
Miscellaneous	
Transfers	
Total general revenues and transfers	
Change in net assets	
Net assets - beginning	
Net assets - ending	

The accompanying notes are an integral part of this statement.

Net (Expense) Revenue and Changes in Net Assets			
Governmental Activities	Business-type Activities	Total	Component Unit
$ (527,956)	$ --	$ (527,956)	$ --
(2,639,514)	--	(2,639,514)	--
(767,110)	--	(767,110)	--
(234,477)	--	(234,477)	--
(358,885)	--	(358,885)	--
(4,437)	--	(4,437)	--
(306,502)	--	(306,502)	--
(126,095)	--	(126,095)	--
(109,256)	--	(109,256)	--
(5,074,232)	--	(5,074,232)	--
--	888,628	888,628	--
--	367,665	367,665	--
--	(52,159)	(52,159)	--
--	9,973	9,973	--
--	1,214,107	1,214,107	--
(5,074,232)	1,214,107	(3,860,125)	--
			(849,177)
1,364,422	--	1,364,422	--
654,837	--	654,837	--
1,178,628	--	1,178,628	589,316
320,869	--	320,869	--
7,657	--	7,657	--
52,438	12,236	64,674	19,814
96,932	29,576	126,508	1,278
1,461,290	(1,461,290)	--	--
5,137,073	(1,419,478)	3,717,595	610,408
62,841	(205,371)	(142,530)	(238,769)
8,517,179	12,433,557	20,950,736	(1,195,517)
$ 8,580,020	$ 12,228,186	$ 20,808,206	$ (1,434,286)

THE CITY OF VERNON, TEXAS

BALANCE SHEET - GOVERNMENTAL FUNDS
SEPTEMBER 30, 2012

	General Fund	Electric Trust Principal	Other Governmental Funds	Total Governmental Funds
ASSETS				
Assets:				
Cash and cash equivalents	$ 1,409	$ 2,831,070	$ 543,793	$ 3,376,272
Receivables, net of allowances for uncollectibles:				
Ambulance	242,459	--	--	242,459
Ad valorem taxes	99,010	--	--	99,010
Sales taxes	313,351	--	--	313,351
Accounts	104,491	--	40,254	144,745
Due from other funds	2,778	--	357	3,135
Other assets	326	--	--	326
Restricted assets:				
Cash	3,674	--	--	3,674
Total Assets	$ 767,498	$ 2,831,070	$ 584,404	$ 4,182,972
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	$ 285,358	$ --	$ 65,146	$ 350,504
Sales tax payable	107	--	--	107
Due to other funds	3,277	--	--	3,277
Due to component unit	105,376	--	--	105,376
Deferred property tax revenue	92,752	--	--	92,752
Deferred ambulance revenue	192,920	--	--	192,920
Deferred franchise tax revenue	11,087	--	--	11,087
Total Liabilities	690,877	--	65,146	756,023
Fund Balances:				
Restricted for:				
Public improvements	3,674	2,831,070	45,453	2,880,197
Law enforcement	--	--	6,959	6,959
Fire department	--	--	7,104	7,104
Christmas decorations	--	--	12,675	12,675
Tourism promotion	--	--	135,295	135,295
Perpetual care	--	--	311,772	311,772
Committed for Main Street	72,947	--	--	72,947
Unassigned	--	--	--	--
Total Fund Balances	76,621	2,831,070	519,258	3,426,949
Total Liabilities and Fund Balances	$ 767,498	$ 2,831,070	$ 584,404	$ 4,182,972

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
SEPTEMBER 30, 2012

Total fund balances - governmental funds balance sheet	$	3,426,949
Amounts reported for governmental activities in the statement of net assets (SNA) are different because:		
Capital assets used in governmental activities are not reported in the funds.		6,918,979
Property taxes receivable unavailable to pay for current period expenditures are deferred in the funds.		92,752
Ambulance receivable unavailable to pay for current period expenditures are deferred in the funds.		192,920
Franchise tax receivable unavailable to pay for current period expenditures not recorded in the funds.		145,622
The assets and liabilities of internal service funds are included in governmental activities in the SNA.		1,181,689
Issuance costs of debt is recorded as an expenditure in the funds, but capitalized in the SNA.		14,317
Payables for Certificates of Obligation which are not due in the current period are not reported in the funds.		(1,315,000)
Payables for capital leases which are not due in the current period are not reported in the funds.		(1,269,485)
Payables for compensated absences which are not due in the current period are not reported in the funds.		(267,176)
Payables for note payable which are not due in the current period are not reported in the funds.		(500,000)
Payables for accrued interest on long-term debt which are not due in the current period are not reported in the funds.		(41,547)
Net assets of governmental activities - statement of net assets	$	8,580,020

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS FOR THE YEAR ENDED SEPTEMBER 30, 2012

	General Fund	Electric Trust Principal	Other Governmental Funds	Total Governmental Funds
Revenue:				
Current ad valorem taxes	$ 1,301,199	$ --	$ --	$ 1,301,199
Delinquent ad valorem taxes	33,010	--	--	33,010
Penalties and interest	32,645	--	--	32,645
Franchise and occupation tax	655,215	--	--	655,215
Fines and forfeitures	193,384	--	--	193,384
Property rentals	8,858	--	--	8,858
Cemetery income	65,312	--	--	65,312
Sales tax	1,178,628	--	--	1,178,628
Housing Authority	4,663	--	--	4,663
Permits	15,989	--	--	15,989
Plumbing inspection fees	164	--	--	164
Contracts	103,312	--	--	103,312
Swimming pool	73,715	--	--	73,715
Mixed drink tax	2,994	--	--	2,994
Ambulance service	592,683	--	--	592,683
Administrative charges to other funds	675,881	--	--	675,881
Grants and donations	22,483	--	203,597	226,080
Christmas decorations	--	--	6,365	6,365
Hotel/motel tax	--	--	320,869	320,869
Interest	3,891	28,189	7,293	39,373
Miscellaneous	73,409	--	23,523	96,932
Total revenues	5,037,435	28,189	561,647	5,627,271
Expenditures:				
Current:				
General government	840,931	--	2,289	843,220
Public safety	3,600,496	--	108,605	3,709,101
Public works	822,361	--	--	822,361
Cemetery and parks	455,306	--	2,260	457,566
Other	403,451	--	--	403,451
Christmas decorations	--	--	10,802	10,802
Civic and cultural	--	--	306,502	306,502
Economic development	--	--	126,095	126,095
Capital outlay	861,800	--	891,617	1,753,417
Debt service:				
Principal	252,837	--	--	252,837
Interest charges	104,199	--	--	104,199
Total expenditures	7,341,381	--	1,448,170	8,789,551
Excess of revenues over (under) expenditures	(2,303,946)	28,189	(886,523)	(3,162,280)
Other financing sources (uses):				
Transfers in	1,557,037	--	--	1,557,037
Transfers out	(15,500)	(21,258)	(58,989)	(95,747)
Debt proceeds	327,490	--	500,000	827,490
Proceeds from sale of perpetual care spaces	--	--	3,548	3,548
Total other financing sources (uses)	1,869,027	(21,258)	444,559	2,292,328
Excess of revenues and other financing sources over (under) expenditures and other financing uses	(434,919)	6,931	(441,964)	(869,952)
Fund balances, October 1	511,540	2,824,139	961,222	4,296,901
Fund balances, September 30	$ 76,621	$ 2,831,070	$ 519,258	$ 3,426,949

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED SEPTEMBER 30, 2012

Net change in fund balances - total governmental funds	$	(869,952)
Amounts reported for governmental activities in the statement of activities (SOA) are different because:		
Capital outlays are not reported as expenses in the SOA.		1,753,417
The depreciation of capital assets used in governmental activities is not reported in the funds.		(379,432)
The internal service funds' activities related to the General Fund are consolidated into the SOA.		50,290
Certain property tax revenues are deferred in the funds. This is the change in these amounts this year.		(2,432)
Certain ambulance revenues are deferred in the funds. This is the change in these amounts this year.		83,038
Franchise tax revenues in the SOA not providing current financial resources are not reported as revenues in the funds.		(378)
Repayment of capital lease principal is an expenditure in the funds but is not an expense in the SOA.		207,837
Repayment of certificate of obligation principal is an expenditure in the funds but is not an expense in the SOA.		45,000
(Increase) decrease in accrued interest on capital leases from beginning of period to end of period.		(5,057)
Compensated absences are reported as the amount earned in the SOA but as the amount paid in the funds.		9,508
Debt financing is reported in the funds but not in the SOA.		(827,490)
Debt issuance costs are capitalized and amortized in the SNA, but expended in the funds in the year of issuance. This is the amortization for this year.		(1,508)
Change in net assets of governmental activities - statement of activities	$	62,841

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
SEPTEMBER 30, 2012

	Enterprise Fund	
	Utility Fund	Internal Service Funds
ASSETS		
Cash and cash equivalents	$ 468,240	$ 1,365,608
Receivables, net of allowances for uncollectibles:		
Ad valorem taxes receivable	140	--
Utility billings	479,104	--
Accounts	20,473	--
Due from other funds	3,277	--
Escrow deposit	--	2,000
Other assets	450	--
Restricted assets:		
Cash	689,021	--
Bond issue costs, net of accumulated amortization	195,567	--
Capital assets, net of accumulated depreciation	20,424,141	
Total Assets	22,280,413	1,367,608
LIABILITIES		
Accounts payable	286,865	32,792
Sales tax payable	41,378	--
Due to other funds	3,135	--
Accrued interest payable	16,621	--
Customer deposits payable	156,844	--
Long-term liabilities:		
Portion due or payable within one year:		
Compensated absences payable	47,331	--
Capital leases payable	44,926	--
Bonds payable	910,000	--
Portion due or payable after one year:		
Compensated absences payable	31,554	--
Capital leases payable	70,527	--
Bonds payable	8,596,173	--
Total Liabilities	10,205,354	32,792
NET ASSETS:		
Invested in capital assets net of related debt	10,802,515	--
Restricted for:		
Construction	269,273	--
Debt service	273,173	--
Unrestricted	730,098	1,334,816
Total net assets	12,075,059	$ 1,334,816
Reconciliation to government-wide statement of net assets:		
Adjustment to reflect the consolidation of Internal Service Funds' activities related to the Enterprise Fund	153,127	
Net assets of business-type activities	$ 12,228,186	

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS - PROPRIETARY FUNDS FOR THE YEAR ENDED SEPTEMBER 30, 2012

	Enterprise Fund Utility Fund	Internal Service Funds
OPERATING REVENUES:		
Water	$ 2,847,411	$ --
Sewer	1,644,328	--
Sanitation	1,425,806	--
Charges and fees	--	822,577
Interest and carrying charges	103,557	--
Other operating revenues	29,576	--
Total Operating Revenues	6,050,678	822,577
OPERATING EXPENSES:		
Billing and collection	199,203	--
Water	1,396,870	--
Sewer	806,010	--
Sanitation	1,408,756	--
Other operating expenses	46,029	--
Insurance claims and related costs	--	775,754
Bad debts	47,555	--
Depreciation	694,457	--
Total Operating Expenses	4,598,880	775,754
Operating Income	1,451,798	46,823
NON-OPERATING REVENUES (EXPENSES):		
Interest income	12,236	13,065
Rent	24,502	--
Interest expense	(227,447)	--
Amortization of bond issue costs	(14,768)	--
Total Non-operating Revenues (Expenses)	(205,477)	13,065
Net Income before Transfers	1,246,321	59,888
TRANSFERS:		
Transfers in	8,990	--
Transfers out	(1,470,280)	--
Net income (loss)	(214,969)	59,888
Net assets, October 1	12,290,028	1,274,928
Net assets, September 30	$ 12,075,059	$ 1,334,816
Reconciliation to government-wide statement of activities:		
Adjustment to reflect the consolidation of Internal Service Funds' activities related to the Enterprise Fund	9,598	
Change in net assets of business-type activities	$ (205,371)	

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2012

	Enterprise Fund	
	Utility Fund	Internal Service Funds
Cash Flows from Operating Activities:		
Cash received from customers	$ 5,975,757	$ 822,577
Cash payments to suppliers for goods and services	(2,880,748)	--
Cash payments to employees for services	(881,342)	--
Cash payments to claimants/beneficiaries	--	(800,994)
Net Cash Provided by Operating Activities	2,213,667	21,583
Cash Flows from Non-capital Financing Activities:		
Increase in customer deposits	5,044	--
Transfers from other funds	8,990	--
Transfers to other funds	(1,470,278)	--
Net Cash Used by Non-capital Financing Activities	(1,456,244)	--
Cash Flows from Capital and Related Financing Activities:		
Issuance of long-term debt	1,917,840	--
Principal and interest paid	(3,082,208)	--
Acquisition or construction of capital assets	(706,428)	--
Net Cash Used by Capital & Related Financing Activities	(1,870,796)	--
Cash Flows from Investing Activities:		
Interest received	12,236	13,065
Rents received	24,502	--
Net Cash Provided by Investing Activities	36,738	13,065
Net Increase (Decrease) in Cash and Cash Equivalents	(1,076,635)	34,648
Cash and Cash Equivalents at Beginning of Year	2,233,896	1,330,960
Cash and Cash Equivalents at End of Year	$ 1,157,261	$ 1,365,608
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 1,451,798	$ 46,823
Depreciation expense	694,457	--
Decrease (increase) in receivables	(74,876)	--
Decrease (increase) in due from other funds	(45)	--
Increase (decrease) in accounts payable	137,004	(25,240)
Increase (decrease) in sales tax payable	2,091	--
Increase (decrease) in due to other funds	(735)	
Increase (decrease) in compensated absences	3,973	--
Net Cash Provided by Operating Activities	$ 2,213,667	$ 21,583
Reconciliation of cash and cash equivalents on the balance sheet to the statement of cash flows:		
Cash and cash equivalents	$ 468,240	$ 1,365,608
Restricted assets - cash and cash equivalents	689,021	--
Total cash and cash equivalents at end of year	$ 1,157,261	$ 1,365,608

The accompanying notes are an integral part of this statement.

THE CITY OF VERNON, TEXAS

STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES
FIDUCIARY FUNDS
SEPTEMBER 30, 2012

	Agency Funds
ASSETS	
Cash and cash equivalents	$ 55,333
Total Assets	$ 55,333
LIABILITIES	
Payable to others	$ 55,333
Total Liabilities	$ 55,333

The accompanying notes are an integral part of this statement.

A. Summary of Significant Accounting Policies

The combined financial statements of The City of Vernon, Texas (City) have been prepared in conformity with accounting principles applicable to governmental units which are generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

1. Reporting Entity

The City's basic financial statements include the accounts of all its operations. The City evaluated whether any other entity should be included in these financial statements. The criteria for including organizations as component units within the City's reporting entity, as set forth in GASB Statement No. 14, "The Financial Reporting Entity," as amended by GASB Statement No. 39, include whether:

- the organization is legally separate (can sue and be sued in its name)
- the City holds the corporate powers of the organization
- the City appoints a voting majority of the organization's board
- the City is able to impose its will on the organization
- the organization has the potential to impose a financial benefit/burden on the City
- there is fiscal dependency by the organization on the City
- the exclusion of the organization would result in misleading or incomplete financial statements

The City also evaluated each legally separate, tax-exempt organization whose resources are used principally to provide support to the City to determine if its omission from the reporting entity would result in financial statements which are misleading or incomplete. GASB Statement No. 14, as amended, requires inclusion of such an organization as a component unit when: 1) The economic resources received or held by the organization are entirely or almost entirely for the direct benefit of the City, its component units or its constituents; and 2) The City or its component units is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the organization; and 3) Such economic resources are significant to the City.

Based on these criteria, the City includes the Business Development Corporation of Vernon (BDC) as a component unit. The City is not a component unit of any other reporting entity as defined by the GASB Statement. The Vernon Business Development Corporation issued separately audited Component Unit Financial Statements, copies of which may be obtained at its office.

2. Basis of Presentation and Accounting

a. Governmental Accounting Standards Board Statement No. 34

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 (as amended by GASB Statement No. 37 - Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments). Significant requirements of these statements include the following:

A Management's Discussion and Analysis (MD&A) section providing an analysis of the City's overall financial position and changes in financial position.

Government-wide financial statements prepared using the accrual basis of accounting for all of the City's governmental activities.

Fund financial statements focusing on the major funds.

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 reclassification 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 assets use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulation of other governments or constraints imposed by law through contractual provisions or enabling legislation.

Unrestricted net assets - 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".

b. Basis of Presentation

Government-wide Statements: The statement of net assets and the statement of activities include the financial activities of the overall government. Eliminations have been made to minimize the double-counting of internal activities. These statements distinguish between the governmental and business-type activities of the City. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties.

The statement of activities presents a comparison between direct expenses and program revenues for the different 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. The City does not allocate indirect expenses in the statement of activities. Program revenues include (a) fees, fines, and charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the City's funds, with separate statements presented for each fund category. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

The City reports the following major governmental funds:

General Fund. This is the City's primary operating fund. It accounts for all financial resources of the City except those required to be accounted for in another fund.

Electric Trust Principal Fund. This is a permanent fund comprised of the proceeds from the sale of the City's electric utility and accumulated revenues thereon. The proceeds from the sale must remain in the fund and be invested. Twenty-five percent of the investment revenue of the fund must remain in the fund and be re-invested. The remaining seventy-five percent of revenue is transferred to the General Fund where its use is restricted to the acquisition of permanent public improvements.

The City reports the following major enterprise fund:

Enterprise Fund. This fund accounts for the activities of City-owned utilities which provide water, sewer and sanitation services to the community.

In addition, the City reports the following non-major fund types:

Other Governmental Funds include the Special Revenue Funds and Capital Project Funds.

Special Revenue Funds account for proceeds for specifc revenues that are legally restricted to expenditures for a specified purpose.

Capital Projects Funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Internal Service Funds: These funds are used to account for revenues and expenses related to services provided to parties inside the City. These funds facilitate distribution of support costs to the users of support services on a cost-reimbursement basis. Because the principal users of the internal services are the City's governmental activities, this fund type is included in the "Governmental Activities" column of the government-wide financial statements.

Agency Funds: These funds are contributions by employees as additional savings and are held in a purely custodial capacity (assets equal liabilities). Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments. These funds are reported in the fiduciary fund financial statements. Because their assets are held in a trustee or agent capacity and are not available to support City programs, these funds are not included in the government-wide statements.

c. Measurement Focus, Basis of Accounting

Government-wide and Proprietary Fund Financial Statements: These financial statements are reported using the economic resources measurement focus. The government-wide and proprietary fund financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements, and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Fund Financial Statements: Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The City considers all revenues reported in the governmental funds to be available if the revenues are collected within sixty days after year-end. Revenues from local sources consist primarily of property taxes. Property tax revenues and revenues received from the State are recognized under the susceptible-to-accrual concept. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are

recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Under GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," all proprietary funds will continue to follow Financial Accounting Standards Board (FASB) standards issued on or before November 30, 1989. However, from that date forward, proprietary funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements), or 2) continuing to follow new FASB pronouncements unless they conflict with GASB guidance. The City has chosen not to apply future FASB standards.

3. Financial Statement Amounts

a. Cash and Cash Equivalents

For purposes of the statement of cash flows, highly liquid investments are considered to be cash equivalents if they have a maturity of three months or less when purchased.

b. Property Taxes

Property taxes are levied by October 1 on the assessed value listed as of the prior January 1 for all real and business personal property in conformity with Subtitle E, Texas Property Tax Code. Taxes are due on receipt of the tax bill and are delinquent if not paid before February 1 of the year following the year in which imposed. On January 1 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed. Property tax revenues are considered available (1) when they become due or past due and receivable within the current period and (2) when they are expected to be collected during a 60-day period after the close of the fiscal year. Where property taxes are levied to service Enterprise Fund debt, revenue is recognized when due, net of amounts estimated to be uncollectible. Delinquent taxes are prorated between the General and Enterprise Funds based on rates adopted for the year of the levy.

Allowances for uncollectible tax receivables within the General Fund are based upon historical experience in collecting property taxes. Uncollectible personal property taxes are periodically reviewed and written off, but the City is prohibited from writing off real property taxes without specific statutory authority from the Texas Legislature.

c. Inventories and Prepaid Items

The City records purchases of supplies as expenditures, utilizing the purchase method of accounting for inventory.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

d. Capital Assets

Purchased or constructed capital assets are reported at cost or estimated historical cost. Donated fixed assets are recorded at their estimated fair value at the date of the donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. A capitalization threshold of $5,000 is used.

Major general infrastructure assets such as land and buildings for which historic cost data are available, are reported under the City's general capitalization policy. The City has elected not to report major general infrastructure assets such as roads and bridges retroactively. Future acquisitions of such assets will be reported under the City's general capitalization policy.

Capital assets are being depreciated using the straight-line method over the following estimated useful lives:

Asset Class	Estimated Useful Lives (Years)
Buildings	30-50
Infrastructure	30-50
Land Improvements	20-30
Vehicles	4-10
Machinery & Equipment	5-15

e. Receivable and Payable Balances

The City believes that sufficient detail of receivable and payable balances is provided in the financial statements to avoid the obscuring of significant components by aggregation. Therefore, no disclosure is provided which disaggregates those balances.

There are no significant receivables which are not scheduled for collection within one year of year end.

f. Compensated Absences

Employees in permanent positions are eligible for vacation benefits, either as time off with pay or as terminal in cases of separation from City employment. The liabilities for unused vacation time are recorded in the Enterprise Fund and governmental activities column of the government wide statements.

Permanent employees accumulate sick leave indefinitely. However, no terminal pay is authorized for unused sick leave for terminating employees.

g. Interfund Activity

Interfund activity results from loans, services provided, reimbursements or transfers between funds. Loans are reported as interfund receivables and payables as appropriate and are subject to elimination upon consolidation. Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures or expenses. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers In and Transfers Out are netted and presented as a single "Transfers" line on the government-wide statement of activities. Similarly, interfund receivables and payables are netted and presented as a single "Internal Balances" line on the government-wide statement of net assets.

h. Use of Estimates

The preparation of financial statements in conformity with GAAP requires the use of management's estimates. Accordingly, actual results could differ from those estimates.

i. Fund Balances - Governmental Funds

Fund balances of the governmental funds are classified as follows:

Nonspendable Fund Balance - represents amounts that cannot be spent because they are either not in spendable form (such as inventory or prepaid insurance) or legally required to remain intact (such as notes receivable or principal of a permanent fund).

Restricted Fund Balance - represents amounts that are constrained by external parties, constitutional provisions or enabling legislation.

Committed Fund Balance - represents amounts that can only be used for a specific purpose because of a formal action by the City's governing board. Committed amounts cannot be used for any other purpose unless the governing board removes those constraints by taking the same type of formal action. Committed fund balance amounts may be used for other purposes with appropriate due process by the governing board. Commitments are typically done through adoption and amendment of the budget. Committed fund balance amounts differ from restricted balances in that the constraints on their use do not come from outside parties, constitutional provisions, or enabling legislation.

Assigned Fund Balance - represents amounts which the City intends to use for a specific purpose, but that do not meet the criteria to be classified as restricted or committed. Intent may be stipulated by the governing board or by an official or body to which the governing board delegates the authority. Specific amounts that are not restricted or committed in a special revenue, capital projects, debt service or permanent fund are assigned for purposes in accordance with the nature of their fund type or the fund's primary purpose. Assignments within the General Fund conveys that the intended use of those amounts is for a specific purpose that is narrower than the general purposes of the City itself.

Unassigned Fund Balance - represents amounts which are unconstrained in that they may be spent for any purpose. Only the General Fund reports a positive unassigned fund balance. Other governmental funds might report a negative balance in this classification because of overspending for specific purposes for which amounts had been restricted, committed or assigned.

When an expenditure is incurred for a purpose for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds.

4. Encumbrance Accounting

Encumbrances for goods or purchased services are documented by purchase orders or contracts. Under Texas law, appropriations lapse at September 30, and encumbrances outstanding at that time are to be either canceled or appropriately provided for in the subsequent year's budget. The City had no outstanding end-of-year encumbrances.

5. New Pronouncement

In July 2011, the GASB issued GASB Statement No. 63 to provide a new statement of net position to report all assets, deferred outflow of resources, liabilities, deferred inflows of resources and net position (which is the net residual amount of the other elements). The Statement is effective for periods beginning after December 15, 2011 and requires that deferred outflows of resources and deferred inflows of resources be reported separately from assets and liabilities. The Statement also amends certain provisions of GASB Statement 34 and related pronouncements to reflect the residual measure in the statement of financial position as net position, rather than net assets. The GASB also issued GASB Statement No. 65 in April 2012 (effective for periods beginning after December 15, 2012) to limit the recognition of deferred outflows and deferred inflows of resources to those instances specifically identified in authoritative GASB pronouncements. Together these statements will affect the City's reporting of its governmental activities on the government-wide statements as of and for the year ended September 30, 2013, although the impact of applying the statements is not known at this time.

B. Compliance and Accountability

1. Finance-Related Legal and Contractual Provisions

In accordance with GASB Statement No. 38, "Certain Financial Statement Note Disclosures," violations of finance-related legal and contractual provisions, if any, are reported below, along with actions taken to address such violations:

For the year ended September 30, 2012, the City overexpended all functional areas of the General Fund and in total. The City will be more diligent in monitoring its actual expenditures compared to the City's adopted budget during the year.

2. Deficit Fund Balance or Fund Net Assets of Individual Funds

At September 30, 2012, the City did not have any funds with deficit fund balances or net assets.

C. Deposits and Investments

The City's funds are required to be deposited and invested under the terms of a depository contract. The depository bank deposits for safekeeping and trust with the City's agent bank approved pledged securities in an amount sufficient to protect City funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation (FDIC) insurance.

Cash Deposits:

At September 30, 2012, the carrying amount of the City's deposits (cash, certificates of deposit, and interest-bearing savings accounts included in temporary investments) was $5,902,815 and the bank balance was $5,885,107. The City's cash deposits at September 30, 2012, and during the year ended September 30, 2012, were entirely covered by FDIC insurance or by pledged collateral held by the City's agent bank in the City's name.

The BDC deposits funds in an interest-bearing checking account and certificate of deposit. The carrying amount of the BDC's bank accounts at September 30, 2012 was $493,604. Amounts not covered by FDIC insurance were collateralized by pledged securities as of September 30, 2012.

Investments:

The City is required by Government Code Chapter 2256, The Public Funds Investment Act, to adopt, implement, and publicize an investment policy. That policy must be written; primarily emphasize safety of principal and liquidity; address investment diversification, yield, and maturity and the quality and capability of investment management; and include a list of the types of authorized investments in which the investing entity's funds may be invested; and the maximum allowable stated maturity of any individual investment owned by the entity.

The Public Funds Investment Act (Act) requires an annual audit of investment practices. Audit procedures in this area conducted as a part of the audit of the basic financial statements disclosed that in the areas of investment practices, management reports and establishment of appropriate policies, the City adhered to the requirements of the Act. Additionally, investment practices of the City were in accordance with local policies.

The Act determines the types of investments which are allowable for the City. These include, with certain restrictions, (1) obligations of the U.S. Treasury, certain U.S. agencies, and the State of Texas, (2) certificates of deposit, (3) certain municipal securities, (4) money market savings accounts, (5) repurchase agreements, (6) bankers acceptances, (7) mutual funds, (8) investment pools, (9) guaranteed investment contracts, and (10) common trust funds.

The City's general policy is to report money market investments and short-term participating interest-earning investment contracts at amortized cost and to report nonparticipating interest-earning investment contracts using a cost-based measure. However, if the fair value of an investment is significantly affected by the impairment of the credit standing of the issuer or by other factors, it is reported at fair value. All other investments are reported at fair value unless a legal contract exists which guarantees a higher value. The term "short-term" refers to investments which have a remaining term of one year or less at time of purchase. The term "nonparticipating" means that the investment's value does not vary with market interest rate changes. Nonnegotiable certificates of deposit are examples of nonparticipating interest-earning investment contracts.

The City's investments at September 30, 2012 are shown below. Those investments which are evidenced by securities that exist in physical or book entry form are as follows:

Investment - City of Vernon	Fair Value	Weighted Maturity (Days)
Money Market accounts	$ 5,629,643	1

The BDC's investments at September 30, 2012 are shown below. Those investments which are evidenced by securities that exist in physical or book entry form are as follows:

Investments - Component Unit	Fair Value	Weighted Maturity (Days)
Money Market account	$ 240,669	1
Certificate of deposit	252,935	1,162
	$ 493,604	

D. Receivables

Receivables and related allowances for uncollectibles consisted of the following items on September 30, 2012.

	Gross Receivable	Allowance	Net Receivable
General Fund:			
Ambulance billings	$ 1,109,468	$ 867,009	$ 242,459
Ad valorem taxes	151,634	52,624	99,010
Sales taxes	313,351	--	313,351
Accounts	104,491	--	104,491
Other Governmental Funds:			
Accounts	40,254	--	40,254
Enterprise Fund:			
Ad valorem taxes	3,312	3,172	140
Utility billings	1,026,536	547,432	479,104
Accounts	20,473	--	20,473

E. Notes Receivable

The BDC has been issued a series of five $50,000 individual notes from Tangarie Alternative Power, LLC (Tangarie) as part of Tangarie's relocation to Vernon, Texas. The notes are interest-free and matured from January 2012 through May 2012. As of September 30, 2012, all of the notes were in default; consequently, an allowance for uncollectibles of $186,605 was established. The carrying value of the notes receivable at September 30, 2012 is as follows:

Notes receivable	$ 250,000
Allowance for uncollectibles	186,605
Notes receivable, net of allowance for uncollectibles	$ 63,395

F. Capital Assets

Capital asset activity for the period ended September 30, 2012 was as follows:

	Beginning Balances	Increases	Decreases	Ending Balances
Governmental activities:				
Capital assets not being depreciated:				
Land	$ 981,029	$ --	$ --	$ 981,029
Construction in Progress	338,531	1,370,267	1,708,798	--
Total capital assets not being depreciated	1,319,560	1,370,267	1,708,798	981,029
Capital assets being depreciated:				
Buildings and improvements	2,274,550	--	--	2,274,550
Infrastructure	521,703	1,708,798	--	2,230,501
Equipment, furniture, fixtures, etc.	1,520,985	331,854	--	1,852,839
Vehicles	2,452,343	51,296	--	2,503,639
Total capital assets being depreciated	6,769,581	2,091,948	--	8,861,529
Less accumulated depreciation for:				
Buildings and improvements	571,062	54,638	--	625,700
Infrastructure	561	21,704	--	22,265
Equipment, furniture, fixtures, etc.	809,590	114,343	--	923,933
Vehicles	1,147,877	203,804	--	1,351,681
Total accumulated depreciation	2,529,090	394,489	--	2,923,579
Total capital assets being depreciated, net	4,240,491	1,697,459	--	5,937,950
Governmental activities capital assets, net	$ 5,560,051	$ 3,067,726	$ 1,708,798	$ 6,918,979

Depreciation was charged to departments as follows:

General Government	$ 15,544
Public Safety	288,894
Public Works	64,253
Cemetery and Parks	25,798
	$ 394,489

	Beginning Balances	Increases	Decreases	Ending Balances
Business-type activities:				
Capital assets not being depreciated:				
Land	$ 721,690	$ --	$ --	$ 721,690
Construction in progress	25,273	3,200	12,800	15,673
Total capital assets not being depreciated	746,963	3,200	12,800	737,363
Capital assets being depreciated:				
Buildings and improvements	27,376,072	666,872	--	28,042,944
Equipment, furniture, fixtures, etc.	1,080,059	159,295	--	1,239,354
Vehicles	287,872	48,398	28,763	307,507
Total capital assets being depreciated	28,744,003	874,565	28,763	29,589,805
Less accumulated depreciation for:				
Buildings and improvements	8,254,075	617,181	--	8,871,256
Equipment, furniture, fixtures, etc.	757,344	48,787	--	806,131
Vehicles	225,914	28,489	28,763	225,640
Total accumulated depreciation	9,237,333	694,457	28,763	9,903,027
Total capital assets being depreciated, net	19,506,670	180,108	--	19,686,778
Business-type activities capital assets, net	$ 20,253,633	$ 183,308	$ 12,800	$ 20,424,141

Depreciation was charged to departments as follows:

Water	$ 404,302
Sewer	285,947
Sanitation	4,208
	$ 694,457

	Beginning Balances	Increases	Decreases	Ending Balances
Business Development Corporation				
Capital assets not being depreciated:				
Land	$ 99,092	$ --	$ --	$ 99,092
Total capital assets not being depreciated	99,092	--	--	99,092
Capital assets being depreciated:				
Buildings and improvements	585,149	--	--	585,149
Equipment, furniture, fixtures, etc.	24,730	5,656	--	30,386
Total capital assets being depreciated	609,879	5,656	--	615,535
Less accumulated depreciation for:				
Buildings and improvements	46,608	24,114	--	70,722
Equipment, furniture, fixtures, etc.	24,460	934	--	25,394
Total accumulated depreciation	71,068	25,048	--	96,116
Total capital assets being depreciated, net	538,811	(19,392)	--	519,419
BDC capital assets, net	$ 637,903	$ (19,392)	$ --	$ 618,511

G. Interfund Balances and Activity

1. Due To and From Other Funds

Balances due to and due from other funds at September 30, 2012 consisted of the following:

Due To Fund	Due From Fund	Amount	Purpose
General Fund	Enterprise Fund	$ 2,778	Short-term loan
Other Governmental Funds	Enterprise Fund	357	Short-term loan
Enterprise Fund	General Fund	3,277	Short-term loan
	Total	$ 6,412	

All amounts due are scheduled to be repaid within one year.

2. Transfers To and From Other Funds

Transfers to and from other funds at September 30, 2012 consisted of the following:

Transfers To	Transfers From	Amount	Reason
General Fund	Enterprise Fund	$ 1,470,280	Payments in lieu of taxes
General Fund	General Fund	15,500	Main Street operations
General Fund	Other Governmental Funds	50,000	Cemetery maintenance
General Fund	Electric Trust Principal Fund	21,258	Interest transfer
Enterprise Fund	Other Governmental Funds	8,989	Grant expenditures
	Total	$ 1,566,027	

H. Long-Term Obligations

1. Long-Term Obligation Activity

Long-term obligations include debt and other long-term liabilities. Changes in long-term obligations for the period ended September 30, 2012 are as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
Governmental activities:					
Capital leases	$ 1,149,832	$ 327,490	$ 207,837	$ 1,269,485	$ 235,403
Certificates of obligation	1,360,000	--	45,000	1,315,000	45,000
Note payable	--	500,000	--	500,000	--
Compensated absences *	276,684	169,850	179,358	267,176	213,740
Total governmental activities	$ 2,786,516	$ 997,340	$ 432,195	$ 3,351,661	$ 494,143
Business-type activities:					
Revenue bonds	$ 10,155,000	$ 1,850,000	$ 2,650,000	$ 9,355,000	$ 910,000
Premium on revenue bonds	64,260	89,542	2,629	151,173	--
Capital leases	119,417	41,000	44,964	115,453	44,926
Compensated absences *	74,912	41,464	37,491	78,885	47,331
Total business-type activities	$ 10,413,589	$ 2,022,006	$ 2,735,084	$ 9,700,511	$ 1,002,257
Business Development Corporation					
Notes payable	$ 2,630,464	$ 250,000	$ 146,949	$ 2,733,515	$ 147,662
Capital lease	--	5,656	999	4,657	1,823
Total BDC	$ 2,630,464	$ 255,656	$ 147,948	$ 2,738,172	$ 149,485

* - Other long-term liabilities

The funds typically used to liquidate other long-term liabilities in the past are as follows:

Liability	Activity Type	Fund
Compensated absences	Governmental	General Fund
Compensated absences	Business-type	Enterprise Fund

2. Outstanding Bonds

At September 30, 2012, the City had the following bonds outstanding:

Governmental activities:	
Combination Tax and Revenue Certificates of Obligation, Series 2005 due through 2030 with interest rates ranging from 3.75% to 6.75%	$ 1,315,000
Business-type activities:	
General Obligation Refunding Bonds, Series 2004 due through 2016 with interest rates from 3.50% to 4.25%	1,770,000
Tax and Waterworks and Sewer System Surplus Revenue Certificates of Obligation, Series 2009 due through 2036 with interest rates ranging from 3.00% to 5.50%	3,125,000
General Obligation Refunding Bonds, Series 2010 due through 2020 with interest rates from 2.00% to 3.00%	2,610,000

General Obligation Refunding Bonds, Series 2012 due through 2023 with interest rates from 2.00% to 3.00%	1,850,000
Total business-type activities	9,355,000
Total all bonds	$ 10,670,000

3. Debt Service Requirements on Long-Term Bonds

Debt service requirements on long-term bonds at September 30, 2012 are as follows:

	Governmental Activities		
Year Ending September 30,	Principal	Interest	Total
2013	$ 45,000	$ 55,440	$ 100,440
2014	45,000	52,571	97,571
2015	50,000	50,284	100,284
2016	55,000	48,315	103,315
2017	55,000	46,253	101,253
2018-2022	325,000	194,585	519,585
2023-2027	425,000	116,665	541,665
2028-2030	315,000	21,109	336,109
Totals	$ 1,315,000	$ 585,222	$ 1,900,222

	Business-type Activities		
Year Ending September 30,	Principal	Interest	Total
2013	$ 910,000	$ 348,342	$ 1,258,342
2014	940,000	320,262	1,260,262
2015	965,000	290,663	1,255,663
2016	995,000	258,000	1,253,000
2017	610,000	22,069	632,069
2018-2022	2,290,000	860,964	3,150,964
2023-2027	895,000	577,820	1,472,820
2028-2032	860,000	367,676	1,227,676
2033-2036	890,000	101,477	991,477
Totals	$ 9,355,000	$ 3,147,273	$ 12,502,273

4. Capital Leases

Commitments under capitalized lease agreements for facilities and equipment provide for minimum future lease payments as of September 30, 2012 as follows:

Year Ending September 30:	Governmental Activities	Business Type Activities
2013	$ 277,093	$ 48,367
2014	248,357	30,459
2015	231,358	26,067
2016	180,005	8,729
2017	154,877	8,729
2018-2022	218,127	--
2023-2026	172,951	--
Total Minimum Lease Payments	1,482,768	122,351
Less: amount representing interest	(213,283)	(6,898)
Present value of minimum lease payments	$ 1,269,485	$ 115,453

The effective interest rates on capital leases are 2.12% - 11.87%.

Following is a summary of property held subject to capital lease:

	Governmental Activities	Business Type Activities
Machinery & equipment	$ 511,276	$ 138,937
Vehicles	1,411,990	160,819
Less: accumulated depreciation	(533,729)	(162,100)
Net	$ 1,389,537	$ 137,656

5. Note Payable

The City has a note payable to the Waggoner National Bank for $500,000 to fund the balance of the cost to construct the new aquatic center. The note is due in January 2014 and interest is payable annually at 3.75% per annum and is unsecured.

The debt service requirements on the note payable at September 30, 2012 are as follows:

Year Ending September 30,	Principal	Interest	Total
2013	$ --	$ 18,750	$ 18,750
2014	500,000	18,750	518,750
Totals	$ 500,000	$ 37,500	$ 537,500

6. Combined Debt Service Requirements

Debt service requirements on all long-term debt at September 30, 2012 are as follows:

Year Ending	Governmental Activities		
September 30,	Principal	Interest	Total
2013	$ 280,403	$ 115,880	$ 396,283
2014	757,564	107,114	864,678
2015	252,662	78,980	331,642
2016	212,917	70,403	283,320
2017	192,758	63,372	256,130
2018-2022	491,176	246,536	737,712
2023-2027	582,005	132,611	714,616
2028-2030	315,000	21,109	336,109
Totals	$ 3,084,485	$ 836,005	$ 3,920,490

Year Ending	Business-type Activities		
September 30,	Principal	Interest	Total
2013	$ 954,926	$ 351,783	$ 1,306,709
2014	968,600	322,121	1,290,721
2015	990,009	291,721	1,281,730
2016	1,003,370	258,359	1,261,729
2017	618,548	22,250	640,798
2018-2022	2,290,000	860,964	3,150,964
2023-2027	895,000	577,820	1,472,820
2028-2032	860,000	367,676	1,227,676
2033-2036	890,000	101,477	991,477
Totals	$ 9,470,453	$ 3,154,171	$ 12,624,624

7. Refunding

The City refunded certain certificates of obligation by paying them off with the proceeds of new bonds. On September 6, 2012, the City issued General Obligation Refunding Bonds, Series 2012, of $1,850,000 (par value) with interest rates ranging from 2.00% to 3.00%. The debt was issued to refund the Tax and Revenue Certificates of Obligation, Series 2002 with interest rates ranging from 3.75% to 6.75% and a par value of $1,865,000. As a result of the refunding, the City reduced its debt service requirements by $71,179 resulting in an economic gain (difference between the present value of the debt service payments on the old and new debt) of $61,370.

8. Continuing Disclosure

The City has entered into a continuing disclosure undertaking to provide Annual Reports and Material Event Notices to the State Information Depository of Texas, which is the Municipal Advisory Council. This information is required under SEC Rule 15c2-12 to enable investors to analyze the financial condition and operations of the City.

9. BDC Debt

The BDC has notes payable outstanding at September 30, 2012 as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
Waggoner National Bank, Vernon, Texas	$ 336,859	$ --	$ 18,620	$ 318,239	$ 19,436
Texas Leverage Fund (#1)	814,065	--	48,840	765,225	46,114
Texas Leverage Fund (#2)	1,479,540	--	79,489	1,400,051	82,112
Herring Bank	--	250,000	--	250,000	--
Totals	$ 2,630,464	$ 250,000	$ 146,949	$ 2,733,515	$ 147,662

The note payable to the Waggoner National Bank is payable in monthly installments of $2,880 including interest at 4.50% per annum and is secured by real estate. The note matures in February 2025.

The note payable to the Texas Leverage Fund (#1) is payable in monthly installments of $6,215 including interest at 3.25% per annum and is secured by sales tax receipts collected by BDC. The note matures in January 2025.

The note payable to the Texas Leverage Fund (#2) is payable in monthly installments of $10,533 including interest at 3.25% per annum and is secured by sales tax receipts collected by BDC. The note matures in June 2026.

The note payable to Herring Bank is payable in interest only until December 2013 at 3.55% per annum then monthly installments of 240 months until December 2033. The note is secured by a certificate of deposit.

The debt service requirements on the notes payable at September 30, 2012 are as follows:

Year Ending	BDC Note Payable		
September 30,	Principal	Interest	Total
2013	$ 147,662	$ 87,603	$ 235,265
2014	163,650	83,788	247,438
2015	171,546	80,260	251,806
2016	177,509	74,298	251,807
2017	183,681	68,125	251,806
2018-2022	1,018,901	240,132	1,259,033
2023-2027	772,739	64,344	837,083
2028-2032	76,490	10,889	87,379
2033-2034	21,337	508	21,845
Totals	$ 2,733,515	$ 709,947	$ 3,443,462

Commitments under capitalized lease agreements for facilities and equipment provide for minimum future lease payments as of September 30, 2012 as follows:

Year Ending September 30:	Governmental Activities
2013	$ 2,118
2014	2,118
2015	882
Total Minimum Lease Payments	5,118
Less: amount representing interest	(461)
Present value of minimum lease payments	$ 4,657

I. Interest Costs

Interest costs for the year consisted of the following:

	Current Expenditure/ Expense	Capitalized	Total Interest
Governmental Activities	$ 109,256	$ --	$ 109,256
Business-type Activities	227,447	161,169	388,616
	$ 336,703	$ 161,169	$ 497,872
BDC	$ 94,189	$ --	$ 94,189

J. Risk Management

The City is exposed to various risks of loss related to torts, theft, damage or destruction of assets, errors and omissions, injuries to employees, and natural disasters. During fiscal year 2012, the City obtained general liability coverage at a cost that is considered to be economically justifiable by joining together with other governmental entities in the State as a member of the Texas Municipal League Intergovernmental Risk Pool (TML). TML is a self-funded pool operating as a common risk management and insurance program. The City pays an annual premium to TML for its above insurance coverage. The agreement for the formation of TML provides that TML will be self-sustaining through member premiums and will reinsure through commercial companies for claims in excess of acceptable risk levels; however, each category of coverage has its own level of reinsurance. The City continues to carry commercial insurance for other risks of loss. There were no significant reductions in commercial insurance coverage in the past fiscal year and settled claims resulting from these risks have not exceeded coverage in any of the past three fiscal years.

During the fiscal year ended September 30, 1992, the City began a self-insurance program for workmen's compensation. The Workmen's Compensation Fund, an internal service fund, was established for this program. Under current arrangements, this program is administered by the Texas Municipal League. Stop-loss insurance is carried to cover claims in excess of $250,000 in the aggregate. During the fiscal year ended September 30, 2011, the Workmen's Compensation Fund expended $57,334 for claims, stop-loss insurance premiums, and administrative costs. During the same period, the Fund did not receive any charges and fees from the General Fund, the Enterprise Fund or the Business Development Corporation of Vernon (BDC). Settled claims have not exceeded commercial coverage to date.

When payments are received from the General and Enterprise Funds and the BDC, they are based on estimates of the amounts needed to pay current and prior claims and other expenses, and to establish a reserve for catastrophic losses. The estimates are based on the City's historical cost data. As of September 30, 2012, the reserve was $133,528. The claims payable of $3,790 are based on the requirements of GASB Statement Number 10 which requires that a liability for claims be reported if information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Changes in the claims liability amounts in the fiscal years ended September 30, 2011 and 2012 were:

	Beginning-of-Year Liability	Current-Year Claims and Changes in Estimates	Claims and Expenses Paid	Balance at Year-End
FYE September 30, 2011	$ 22,786	$ 57,334	$ 42,161	$ 37,959
FYE September 30, 2012	$ 37,959	$ (24,195)	$ 9,974	$ 3,790

K. Pension Plan

1. Plan Description

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

TMRS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information (RSI) for TMRS; the report also provides detailed explanations of contributions, benefits, and actuarial methods and assumptions used by TMRS. This report may be obtained by writing TMRS, P.O. Box 149153, Austin, Texas 78714-9153 or by calling 800-924-8677; in addition, the report is available on TMRS' website at www.tmrs.org.

Benefits depend upon the sum of the employee's contributions to the plan, with interest, and the City-financed monetary credits, with interest. 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 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 which 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 contributon 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.

Members can retire at ages 60 and above with 5 or more years of service or with 25 years of service regardless of age. A member is vested after 5 years. The plan provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS and within the actuarial constraints also in the statutes.

2. Contributions

The contribution rate for employees is 7%, and the City ratio is currently 2 to 1, both as adopted by the governing body of the City. Under the state law governing TMRS, the actuary annually determines the City contribution rate. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to the City matching percent, which are the obligation of the City as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the City to each employee at the time his/her retirement becomes effective. The prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the remainder of the plan's 26.3-year amortization period. The projected unit credit actuarial cost method is used for determining the City contribution 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, 2011 valuation is effective for rates beginning January, 2013).

Schedule of Actuarial Liabilities and Funding Progress

Actuarial valuation date		12/31/2011
Actuarial value of assets	$	13,193,445
Actuarial accrued liability	$	18,727,045
Unfunded actuarial accrued liability (UAAL)	$	5,533,600
Funded Ratio		70.5%
Annual covered payroll	$	3,976,783
UAAL as a percentage of covered payroll		139.1%
Net pension obligation (NPO) at the beginning of period	$	--
Annual pension cost		
Annual required contribution (ARC)	$	638,194
Contributions made	$	638,194
NPO at the end of the period	$	--

Two preceding years:		
12/31/10:		
Annual Pension Cost	$	636,382
Percentage of Annual Pension Costs Contributed		100.0%
NPO at the end of the period		--
12/31/09:		
Annual Pension Cost	$	525,853
Percentage of Annual Pension Costs Contributed		100.0%
NPO at the end of the period		--

3. Actuarial Assumptions

Actuarial cost method	Projected Unit Credit
Amortization method	Level Percent of Payroll
Remaining amortization period	26.3 years - closed period
Asset valuation method	10-year Smoothed Market
Investment rate of return	7.0%
Projected salary increases	Varies by age and service
Includes inflation at	3%
Cost of living adjustments	2.1%

A schedule of funding progress is presented as required supplementary information for the Texas Municipal Retirement System. This schedule provides multi-year trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial liability for benefits.

L. Group-Term Life Insurance Plan

The City participates in the cost-sharing multiple-employer defined benefit group-term life insurance plan operated by TMRS known as Supplemental Death Benefits Fund (SDBF). The City elected, by ordinance, to provide group-term 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.

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 contributions, benefits, and actuarial methods and assumptions used by TMRS. This report may be obtained by writing TMRS, P.O. Box 149153, Austin, Texas 78714-9153 or by calling 800-924-8677; in addition, the report is available on TMRS' website at www.tmrs.org.

The death benefit for active employees provides for a lump-sum payment of 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 postemployment benefit" or OPEB.

The City contributes to the SDBF at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. For the months in calendar year 2010, 2011, and 2012, this rate was 0.12%, 0.12%, and 0.11%, respectively. The funding policy for the SDBF program is to assure that adequate resources are available to meet all death benefit payments for the upcoming year; the intent is not to pre-fund retiree life insurance during employees' entire careers.

The City's contribution to the TMRS SDBF for the years ended September 30, 2012, 2011, and 2010 were $5,086, $4,739, and $4,673, respectively, which equaled the required contributions each year.

M. Health Care Coverage

On March 11, 1992, the City began a self-insurance medical program through establishment of the Employee

Benefits Trust Fund, an internal service fund. A contract is in effect with Blue Cross Blue Shield of Texas for the administration of the fund. Stop-loss insurance coverage is carried under which the Employee Benefits Trust Fund pays the first $50,000 of medical expenses per covered person up to an aggregate amount of $812,932 per year. The insurance provider pays amounts in excess of the aforementioned up to $950,000 per covered person or an aggregate amount of $1,000,000. Settled claims have not exceeded commercial insurance coverage as of September 30, 2012. Group life insurance premiums are also paid by the Employee Benefits Trust Fund. During the fiscal year ended September 30, 2012, $763,079 was expended for health benefits, insurance premiums and administrative costs. Charges and fees for the same period amounted to $822,576, including $536,330 from the General Fund, $131,239 from the Enterprise Fund, $141,369 from employee payroll deductions, and $13,638 from the Business Development Corporation of Vernon. These amounts were recorded as current expenditures in the charged funds and component unit.

Both the General and Enterprise Funds and The Business Development Corporation of Vernon participate in the self-insurance program and make payments to the internal service fund based on estimates of the amounts needed to pay current and prior year claims and other expenses, and to establish a reserve for catastrophic losses. The estimates are derived from the City's historical cost experience. At September 30, 2012, the reserve was $1,201,288.

The claims liability of $29,002 is based on the requirements of GASB Statement Number 10 which requires that a liability for claims be reported if information available prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

Changes in the claims liability amounts in the fiscal years ended September 30, 2011 and 2012 were:

	Beginning-of-Year Liability	Current-Year Claims and Changes in Estimates	Claims and Expenses Paid	Balance at Year-End
FYE September 30, 2011	$ 16,221	$ 864,431	$ 860,579	$ 20,073
FYE September 30, 2011	$ 20,073	$ 780,763	$ 771,834	$ 29,002

N. Commitments and Contingencies

1. Litigation

No reportable litigation was pending against the City at September 30, 2012.

2. Federal and State Grants - Compliance Audits

The City participates in grant programs which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the City has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable may be impaired. In the opinion of the City, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying basic financial statements for such contingencies.

3. Unfunded Bonds

The City has the ability to draw down up to $680,000 from the Tax and Waterworks and Sewer System Surplus Revenue Certificates of Obligation, Series 2000.

4. Construction-Related Commitments
   At September 30, 2012, the City had one construction project in process. The total costs of this project was $430,672 and the City has incurred $285,222 through September 30, 2012. The remaining commitment on the project was $145,450 at September 30, 2012.

O. Closure and Postclosure Care Cost

A 1991 U.S. Environmental Protection Agency (EPA) ruling, "Solid Waste Facility Criteria", established closure requirements for municipal solid waste landfills. The EPA ruling also imposes thirty-year post-closure care requirements for landfills accepting solid waste after April 9, 1994. As a result, landfill operators are required to perform certain closing functions and post-closure monitoring and maintenance functions. The Governmental Accounting Standards Board has issued its Statement Number 18 to establish accounting principles for post-closure monitoring and maintenance costs resulting from the EPA ruling.

The City of Vernon, Texas operated a municipal solid waste landfill which stopped accepting solid waste on April 1, 1994. Final cover and capping was completed shortly thereafter, using existing personnel and equipment. Because the landfill was closed prior to April 9, 1994, the City is exempted from the post-closure and maintenance and monitoring requirements of the EPA ruling. Accordingly, these financial statements include no provision for related costs contemplated by GASB Statement Number 18.

P. Going Concern Consideration

At September 30, 2012, the General Fund's total fund balance was $76,621, of which $3,674 was restricted, $72,947 was committed, and there was no unassigned fund balance. During the year ended September 30, 2012, the General Fund's expenditures and other financing uses exceeded the revenues and other financing sources by $434,919. A significant reason for the decrease in fund balance was the completion of the aquatic center in 2011-12 using existing fund balance. However, $500,000 was borrowed from a local financial institution to complete the project and is to be scheduled to be repaid in January 2014.

The City's ability to continue operations is dependent on its ability to increase or maintain revenues and limit expenditures to obtain sufficient cash flow to fund operations, including servicing existing debt. For 2012-13, the City adopted a budget that would add $130,555 to fund balance by September 30, 2013. This was accomplished with no property tax rate increase, additional charges and transfers from the City's Utility Enterprise Fund, and limited capital purchases. The City is continuing to monitor its expenditures and future cuts may be necessary to rebuild its fund balance to an appropriate level.

The accompanying financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Required Supplementary Information

Required supplementary information includes financial information and disclosures required by the Governmental Accounting Standards Board but not considered a part of the basic financial statements.

THE CITY OF VERNON, TEXAS

EXHIBIT B-1

GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED SEPTEMBER 30, 2012

	Budgeted Amounts			Variance with Final Budget Positive
	Original	Final	Actual	(Negative)
Revenue:				
Current ad valorem taxes	$ 1,286,768	$ 1,299,768	$ 1,301,199	$ 1,431
Delinquent ad valorem taxes	55,000	60,000	33,010	(26,990)
Penalties and interest	40,000	40,000	32,645	(7,355)
Franchise and occupation tax	733,000	720,000	655,215	(64,785)
Fines and forfeitures	157,500	167,012	193,384	26,372
Property rentals	12,000	11,430	8,858	(2,572)
Cemetery income	70,000	69,000	65,312	(3,688)
Sales tax	1,193,000	1,190,000	1,178,628	(11,372)
Housing Authority	3,000	3,000	4,663	1,663
Permits	10,000	14,000	15,989	1,989
Plumbing inspection fees	300	100	164	64
Contracts	113,904	103,431	103,312	(119)
Swimming pool	108,941	118,600	73,715	(44,885)
Mixed drink tax	4,000	4,000	2,994	(1,006)
Ambulance service	582,000	556,852	592,683	35,831
Administrative charges to other funds	675,881	675,881	675,881	--
Grants and donations	--	--	22,483	22,483
Interest	11,000	4,800	3,891	(909)
Miscellaneous	100,141	116,025	73,409	(42,616)
Total revenues	5,156,435	5,153,899	5,037,435	(116,464)
Expenditures:				
Current:				
General government	796,835	791,566	840,931	(49,365)
Public safety	3,487,145	3,474,002	3,600,496	(126,494)
Public works	808,261	695,093	822,361	(127,268)
Cemetery and parks	431,248	379,624	455,306	(75,682)
Other	391,264	384,157	403,451	(19,294)
Capital outlay	295,690	552,710	861,800	(309,090)
Debt service:				
Capital lease principal	228,957	210,734	252,837	(42,103)
Capital lease interest	41,022	67,001	104,199	(37,198)
Total expenditures	6,480,422	6,554,887	7,341,381	(786,494)
Excess (deficiency) of revenues (under) expenditures	(1,323,987)	(1,400,988)	(2,303,946)	(902,958)
Other financing sources (uses):				
Transfers in	1,161,588	1,161,588	1,557,037	395,449
Transfers out	(15,500)	(15,500)	(15,500)	--
Debt proceeds	172,500	172,500	327,490	154,990
Sale of surplus equipment	15,200	12,000	--	(12,000)
Total other financing sources (uses)	1,333,788	1,330,588	1,869,027	538,439
Excess of revenues and other financing sources over (under) expenditures and other financing uses	9,801	(70,400)	(434,919)	(364,519)
Fund balances/equity, October 1	511,540	511,540	511,540	--
Fund balances/equity, September 30	$ 521,341	$ 441,140	$ 76,621	$ (364,519)

THE CITY OF VERNON, TEXAS

EXHIBIT B-2

SCHEDULE OF FUNDING PROGRESS
TEXAS MUNICIPAL RETIREMENT SYSTEM
YEAR ENDED SEPTEMBER 30, 2012

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/2009	$ 5,656,030	$ 11,687,775	$ 6,031,745	48.4%	$ 3,728,294	161.8%
12/31/2010	12,243,544	17,533,035	5,289,491	69.8%	3,908,797	135.3%
12/31/2011	13,193,445	18,727,045	5,533,600	70.5%	3,976,783	139.1%

A. Basis of Budgeting

The City of Vernon, Texas (City) budget for the General Fund is prepared and presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP).

B. Budget Process

1. Budgeting

The annual budget is legally adopted for the General Fund and is presented in the accompanying schedule for the General Fund. The following procedures are used in establishing the budgetary data reflected in that schedule:

A. Prior to the beginning of the fiscal year, the City prepares a budget for the next succeeding fiscal year. The operating budget includes proposed expenditures and the means of financing them.

B. A meeting of the City Commission is then called for the purpose of adopting the proposed budget after ten days' public notice of the meeting has been given.

C. Prior to start of the fiscal year, the budget is legally enacted through passage of a resolution by the City Commission.

The budget is prepared and controlled by the Finance Director at the revenue object and expenditure function level.

Once the budget is approved, it can be amended only by approval of a majority of the members of the City Commission. As required by law, such amendments are made before the fact, are reflected in the official minutes of the City Commission and are not made after fiscal year-end. During the year, the budget may be amended as necessary. All budget appropriations lapse at year-end.

2. Expenditures in Excess of Budgeted Amounts

During the year ended September 30, 2012, the City had expenditures in excess of the budgeted amounts in the General Fund as follows:

General government	$	49,365
Public safety		126,494
Public works		127,268
Cemetery and parks		75,682
Other		19,294
Capital outlay		309,090
Debt service - principal		42,103
Debt service - interest charges		37,198
Total	$	786,494