

**City of Hernando, Mississippi
Audited Financial Statements
For the Year Ended September 30, 2010**

City of Hernando, Mississippi
Audited Financial Statements
For the Year Ended September 30, 2010

TABLE OF CONTENTS

Independent Auditors' Report	1
Management's Discussion and Analysis	3
Financial Statements	13
Statement of Net Assets	14
Statement of Activities.....	15
Balance Sheet – Governmental Funds	16
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	17
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds.....	18
Reconciliation of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	19
Statement of Net Assets – Proprietary Fund	20
Statement of Revenues, Expenses and Changes in Net Assets – Proprietary Fund.....	21
Statement of Cash Flows – Proprietary Fund	22
Notes to Financial Statements	23
Required Supplementary Information	33
Budgetary Comparison Schedule – General Fund	34
Supplementary Information	35
Schedule of Expenditures of Federal Awards	36
Surety Bond Coverage	37
Additional Auditors' Reports	39
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	40
Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133	42
Independent Auditors' Report on Compliance with State Laws and Regulations.....	44
Schedule of Findings and Questioned Costs	45



WILLIAMS • PITTS • BEARD, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

DANNY L. WILLIAMS
JERRY W. PITTS
REBECCA A. BEARD
KRISTOPHER A. WHITTEN

2042 McIngvale Road, Suite A
Hernando, MS 38632

(662) 429-4436
FAX: (662) 429-4438
www.williamsandpitts.com

INDEPENDENT AUDITORS' REPORT

Mayor and Board of Aldermen
City of Hernando
Hernando, Mississippi

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Hernando, Mississippi ("the City") as of and for the year ended September 30, 2010, which collectively comprise the City's financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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, business-type activities, each major fund, and the aggregate remaining fund information of the City as of September 30, 2010, and the respective changes in financial position, and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 25, 2010 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any

assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. The schedule of expenditures and federal awards is the responsibility of management and was derived from and related directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole. The accompanying supplemental information on surety bond coverage is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Williams, Pitts & Beard, PLLC

Williams, Pitts & Beard, PLLC
Hernando, Mississippi
February 25, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited

This Discussion and Analysis of the City of Hernando's financial performance provides an overall review of the City's financial activities for the year ended September 30, 2010. The intent of this discussion and analysis is to look at the City's financial performance as a whole. Readers should also review the basic financial statements to enhance their understanding of the City's financial performance.

This discussion complies with the "Required Supplementary Information" specified in the Governmental Accounting Standards Board's (GASB) Statement No. 34 – Basic Financial Statements – and Management's Discussion and Analysis (MD&A) for State and Local Governments issued in June 1999, in order to give the reader a clear understanding of the financial activities that occurred during the fiscal year.

The statements presented in this audit consist of two types:

- Government-wide financial statements are prepared using the modified accrual basis of accounting and include all assets and liabilities of the City of Hernando as a whole. These statements provide an overall view of Hernando's finances. The Statement of Net Assets is found on page 14 of the audit report.
- In the Statement of Activities, the City's activities are reported as (1) Governmental Activities; which includes: administration, ambulance, fire, park, planning, police, and street departments, (2) Business-type Activities; which includes: water, sewer, and sanitation. This statement shows the revenues, expenses, and net assets. The Statement of Activities is found on page 15.

Fund Financial Statements – A fund is a self-balancing set of accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Hernando, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into two categories – Governmental Funds and Proprietary Funds.

Governmental Funds – Governmental funds are used to account for essentially the functions reported as governmental activities in the governmental –wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Non-financial assets such as governmental buildings, roads, parkland and long-term liabilities such as bonds payable or long-term liabilities that will not be paid with current assets are excluded. Such information may be useful in evaluating a government's near-term financing requirements.

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

City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited

The City maintains several governmental funds. Information presented separately in the Governmental Funds Balance Sheet (page 16) and in the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances for the General Fund and Capital Projects Fund which are considered to be major funds. All other Governmental Funds are combined into a single amount listed as Other Governmental Funds. The basic governmental funds financial statements can be found on pages 16-19.

Proprietary Funds – The City maintains one proprietary fund, which is an enterprise fund. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City of Hernando uses enterprise funds to account for its Water, Sewer, and Sanitation operations.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statement provides separate information for the Water, Sewer, and Sanitation funds since they are considered major funds of the City. The combining proprietary fund financial statements can be found on pages 20-22 of this report.

Notes to the Financial Statements- The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 23-32 of this report.

BRIEF DISCUSSION OF BASIC FINANCIAL STATEMENTS

Net assets and net assets by category may serve over time as a useful indicator of a government's financial position. The assets of the City of Hernando, Mississippi exceeded its liabilities at September 30, 2010 by \$12,288,884 or 74%. The majority of the City's net assets are invested in capital assets, net of related debt and unrestricted assets and may be used to meet the government's ongoing obligations to citizens and creditors in accordance with the City's fund designation and fiscal policies. The remaining \$927,743 is restricted for specific purposes. Unrestricted net assets decreased by \$505,401, restricted assets decreased in the amount of \$494,040, and invested in capital assets increased by \$998,972.

As of the close of the current fiscal year the City of Hernando's governmental funds reported combined ending fund balances of \$1,862,435 and a total liabilities and fund balances combined of \$6,551,467.

City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited

CONDENSED COMPARATIVE FINANCIAL STATEMENTS

The City's combined net assets in 2010 decreased .004% from a year ago. The combined net assets decreased from \$12,289,353 in 2009 to \$12,288,884 in 2010, which is a decrease of \$469.

NET ASSETS (IN THOUSANDS)						
	2010	2009			2010	2009
	Governmental Activities (All other funds)	Governmental Activities (All other funds)	2010 Business Type Activities (Utility Fund)	2009 Business Type Activities (Utility Fund)	Total	Total
<u>ASSETS</u>						
Current and Other Assets	\$ 6,755	\$ 7,802	\$ 1,082	\$ 1,250	\$ 7,837	\$ 9,052
Capital Assets, Net	12,223	11,965	8,860	8,802	21,083	20,767
TOTAL ASSETS	18,978	19,767	9,942	10,052	28,920	29,819
<u>LIABILITIES</u>						
Current and Other Liabilities	4,629	4,883	499	499	5,128	5,382
Long Term Liabilities:						
Due Within One Year	474	468	203	215	678	683
Due in More than One Year	8,853	9,294	1,973	2,171	10,826	11,465
TOTAL LIABILITIES	13,956	14,645	2,675	2,885	16,632	17,530
<u>NET ASSETS</u>						
Invest in Capital Assets Net of Debt	3,302	2,576	6,763	6,491	-	-
Restricted:						
Capital Projects	573	967	-	-	573	967
Prepaid Expenses	291	390	-	-	292	390
Debt Services	62	64	-	-	63	64
Unrestricted	792	1124	503	677	1,295	1,801
TOTAL NET ASSETS	\$ 5,023	\$ 5,122	\$ 7,266	\$ 7,167	\$12,288	\$12,289

Net assets of the City's governmental activities decreased by 2% (\$5,121,422 in 2009, compared to \$5,021,966). Unrestricted net assets – the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements - changed from \$1,123,950 at 9-30-09 to \$792,150 at the end of this year which is a decrease of 29.3%.

Net assets of the City's business type activities (utility fund) increased by 1.38% (\$7,167,931 compared to \$7,266,918). Unrestricted net assets changed from \$677,066 at 9-30-09 to \$503,465 at the end of this year, which is a decrease of 25.64%.

City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited

ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATION

The City of Hernando has not seen the growth this year that it has had during the previous years due to the economy, although the growth has increased slowly over the prior year. The City's revenues have increased in sales tax, and building permits, but decreased in police fines. In order to continue to furnish the quality services to the citizens, Hernando has been fortunate to receive grants and loans for projects such as water improvements, sewer extension, parks, and drainage improvements. The City has had to decrease capital expenditures and operating expenses, and has used surplus funds to continue to provide the necessary services to operate within the budget for year ending 9-30-10 due to the economy.

ANALYSIS OF BALANCES AND TRANSACTIONS OF INDIVIDUAL FUNDS

The largest portion of the City of Hernando's assets can be found in fixed assets such as land, buildings, equipment, and infrastructure. Capital assets used in governmental activities are not financial resources but are used to provide services.

The Statement of Net Assets looks at the City as a whole. The following table provides a summary and comparison of the City's net assets for Governmental Activities, Business Type Activities and the two combined per year.

	2009 Governmental Activities	2010 Governmental Activities	2009 Business- Type Activities	2010 Business- Type Activities	2009 Total	2010 Total
Revenues						
Taxes - Property	\$3,971,850	\$3,846,037	\$ 6,047	\$ -	\$ 3,977,897	\$ 3,846,037
Sales and Use	2,533,495	2,561,593	-	-	2,533,495	2,561,593
Other	443,801	386,150	-	-	443,801	386,150
Intergovernmental	175,425	176,622	-	-	175,425	176,622
Charges for services	892,473	869,563	3,132,460	3,431,794	4,024,933	4,301,357
Interest	67,373	5,459	2,686	1,232	70,059	6,691
Grants	794,439	565,867	-	216,759	794,439	782,626
Interfund transfers	(736,816)	(363,972)	736,816	363,972	-	-
Miscellaneous	122,011	138,625	4,629	6,595	126,640	145,220
Sale of assets	30,700	20,888	18,833	5,916	49,533	26,804
Total revenues	8,294,751	8,206,832	3,901,471	4,026,268	7,376,850	7,149,117
Total expenses	(8,616,574)	(8,306,288)	(3,725,076)	(3,927,281)	(7,522,251)	(7,149,586)
Change in net assets	(321,796)	(99,456)	176,395	98,987	(145,401)	(469)
Net assets-beginning of year	5,662,493	5,121,422	7,170,866	7,167,931	12,833,359	12,289,353
Prior Period Adjustment	(219,275)	-	(179,330)	-	(398,605)	-
Net assets-end of year	<u>\$5,121,422</u>	<u>\$5,021,966</u>	<u>\$7,167,931</u>	<u>\$7,266,918</u>	<u>\$12,289,353</u>	<u>\$12,288,884</u>

City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited

BUDGETARY ANALYSIS

The City of Hernando's budget is prepared according to Mississippi law and is based on accounting for certain transactions on a basis of cash receipts, disbursements, and encumbrances. The most significant budgeted fund is the General Fund. The Budgetary Analysis can be found on page 34.

During the fiscal year ending 9-30-10, the City amended its budget two times. The total dollar amount of the budget for all funds was decreased in the amount of \$584,709, which was in the General Fund, Culture and Recreation Fund, ARRA – American Recovery & Reinvestment Fund, and Utility Fund. The amendment was necessary in the General Fund due to the move of ARRA funding and expenditures to a separate fund for better accountability. Sales tax and police fines were reduced to account for the overestimate of revenues. Ambulance collections, permit fees, prior year taxes and Public Utility taxes were increased based on current collections. Revenues and expenses for safe routes to school and MDOT Street Improvement funds were removed because it will not be received in this fiscal year. Several expense items were reduced including Street Personnel Services, Police Personnel Services and Police Capital Outlay due to over projecting the cost. Other expense items were increased to account for matching funds to purchase a generator and sirens. There was also an unexpected expense for: a Public Safety Computer program, replaced appliances in the Fire Department, and the ambulance equipment was more than was budgeted. Contingency was increased in the amount the city was reimbursed for a car. The amendments in ARRA Fund were to separate from the General Fund for better accountability of revenue and expenses. The amendments in the Culture & Recreation Fund are necessary to account for a grant not budgeted and increased surplus funds that were under estimated. Several expense items were increased including utilities, community garden, and contingency. The Utility Fund Amendment is the result of increased revenues for the NRCS projects and DCRUA that were not budgeted in the revenue. The loan proceeds were decreased because the city did not get funded by DEQ. Surplus was reduced because it was overestimated and sale of surplus equipment and recycling fees were increased. The expenses for the NRCS project were increased, while the expenses for the DEQ project were removed. Revenue and expenses were increased for the recycling grant and the equipment that was to be purchased with this grant. Also, contingency was increased.

All budget amendments must be approved by the Mayor and Board of Aldermen. If the amendment exceeds 10% of the original budget then the amendment must be published in a local newspaper.

The fund balance at the beginning of the year was \$1,330,800 for the General Fund and at the end of the year (GAAP basis) was \$744,531, which was a decrease of \$586,269. The most significant revenues in the General Fund are derived from ad-valorem taxes, sales taxes, franchise taxes, building permit fees, police fines, and ambulance fees.

The revenue budgeted for the Business-Type Fund (Utility Fund) is derived from the sale of water and for services provided such as sanitary sewer and sanitation.

City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited

CAPITAL ASSETS AND LONG TERM DEBT ACTIVITY

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. A comparison of these assets are shown as follows:

<u>Description</u>	<u>FYE 9-30-09</u>	<u>FYE 9-30-10</u>	<u>Difference</u>
Land	\$ 565,425	\$ 565,425	\$ -
Buildings and improvements	5,634,371	5,627,896	(6,475)
Equipment	1,959,709	2,003,721	44,012
Vehicles	939,978	920,923	(19,055)
Infrastructure	7,274,650	7,733,325	458,675
Construction in progress	34,374	49,818	15,444
Improvements other than buildings	196,411	351,630	155,219
Accumulated depreciation	(4,639,959)	(5,029,129)	(389,170)
	\$11,964,959	\$ 12,223,609	\$ 258,650

Changes in General Fixed Assets can be found on page 28 and 29. In the category of Governmental Activities capital assets, net, increased from \$11,964,959 at 9-30-09 to \$12,223,609 at 9-30-10. This is an increase of \$258,650 after depreciation. The primary increase in capital assets occurred in improvements, equipment, construction in progress, and infrastructure. In the category of Business-type Activities capital assets, net, increased from \$8,802,137 at 9-30-09 to \$8,860,099 at 9-30-10. This is an increase of \$57,962 after depreciation. The primary increase in capital assets in this category occurred in vehicles, sewer and water system improvements, and equipment. During the past year, the city completed Lee Summit Park, MDOT project, Lambert/Green T Sewer, and NRCS drainage projects.

General Long-Term Debt is located on pages 30-32. As of September 30, 2010, the City had \$8,740,000 in outstanding General Obligation Bonds and \$2,109,597 in notes payable. The City issued \$5,000,000 in General Obligation Bonds in FYE 9-30-07. The bond funds have been used for infrastructure improvements such as Old Highway 51 Sewer Project, Nesbit Sewer Extension Project Phase II, Green T Water Improvement Project for fire protection, lift station upgrades, and completing the Gale Center Phase II renovations which included a court clerks office's, courtroom, and community center. The long-term debt is low interest loans from the State of Mississippi for water and sewer improvements.

INFRASTRUCTURE ACTIVITY

Over the past few years, the City has applied for state funding to improve the City water system and sanitary sewer system. The DWSIRLF loan application included major water projects for the city that would be completed in five phases. At this time, Hernando has received three DWSIRLF loans and has completed an application to apply for the fourth loan, which would construct a new above ground water tank and improve water lines among other things. The water improvements have included a new well, water tank, and larger water mains. Capital Improvement Projects completed during 2010 are the Natural Resources Conservation Services (NRCS) Drainage Project (paid with NRCS funds), the Lee's Summit Park (paid with grant funds), and the Commerce Street Paving Project (paid with MDOT/ARRA funds). For the year 2011, our capital improvement projects currently under construction are the Hernando/Southaven Sewer Project and Lambert Subdivision Sewer Project.

City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited

CURRENTLY KNOWN FACTS

Hernando has been growing at a very rapid pace; according to the Census in 1990, the population was 3,200, in 2000 the population was 6,812, and currently the population in 2010 is 14,090. In 2010 the City assessed value of property increased 2.19% and the sales tax revenue held steady over the prior year. Residential and commercial building permits have slowed but the City of Hernando is steadily growing. People are continuing to move to Hernando as shown by the increased number of utility customers. Over the past year the City has added 119 sewer customers, and 93 water customers. Since FYE 9-30-2000 the City has added 2,583 sewer customers, and 1,656 water customers. We have two rural water systems that also provide water inside the corporate limits of Hernando, which is the reason there are more sewer customers than water. Over the last few years, the Mississippi Department of Environmental quality has mandated that Hernando and the other cities in DeSoto County improve the level of sewage treatment. This mandate is in place to protect our environment and our groundwater. In order to satisfy this mandate more cost effectively, the cities joined with the county to create the DeSoto County Regional Utility Authority (DCRUA). Over the past two years the City of Hernando entered into an agreement with the City of Southaven to construct a sewer main on the east side of I-55 from Southaven to Hernando and then connect into the DCRUA main. This main will sewer annexed areas and future developments.

Our Park and Recreation facilities have grown from three parks to eight facilities. Each year we try to improve our facilities as funds become available either from tax revenues, grants, or donations. We have a community garden at the Gale Center that is open to the public and a farmers market on the square where the public can purchase home grown items. Our park facilities include community center, tennis courts, basketball courts, football fields, and soccer fields, exercise equipment, walking trails, pavilions and playgrounds. We have made an effort to have facilities and programs to accommodate all ages. This year Hernando was again given the "Playful City USA" designation. We are one of 118 cities from across the country and the first city in Mississippi to receive this prestigious award. Hernando received a \$50,000 grant from Blue Cross Blue Shield for receiving the "Healthiest Hometown" Award, and a \$10,000 donation last year which will be used to resurface the running & walking track at Hernando Sports Park.

Hernando has been promoting a healthier city by improving and extending the sidewalks, and adding walking and biking trails on the streets. We have been approved to receive a grant to install more sidewalks in school areas to give children a safe way to walk to school.

The City must continue to furnish quality services such as water, sewer, garbage collection, fire, police, and ambulance. These services are not without a price and the City has had to be innovative to fund these services and keep the City financially stable. This year we purchased very little equipment and tried to live within our means.

Hernando has tried to keep the property taxes at a reasonable rate, while continuing to provide the needed services. From 1988 to 1990, the millage for ad-valorem tax was 28.5, and in 1990, the millage was increased to 29.5. In the budget year 2001-2002, the millage for ad-valorem taxes was increased from 29.5 mills to 31.75 and this year the millage has remained the same. The taxes are distributed to the General Fund, Municipal Bond and Interest Fund, Library Fund, and the Park Fund. The General Fund is the main fund of the city, which provides for Administration, Fire, Police, Planning, Ambulance, and Court. The Municipal Bond and Interest Fund is to pay General Obligation Bond payments and fees. Library Fund provides funding for the Hernando Library. The Park Fund is used to pay for improvements in the park, cemetery maintenance, and beautification of the City.

**City of Hernando, Mississippi
Management's Discussion and Analysis
For the Year Ended September 30, 2010
Unaudited**

CONTACT:

This financial report is designed to provide our citizens, taxpayers, creditors, and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have any questions about this report or need additional financial information contact the City Clerk, at 475 West Commerce Street, Hernando, MS 38632 or by telephone at 662-429-9092.

(This page left blank intentionally)

FINANCIAL STATEMENTS

City of Hernando, Mississippi
Statement of Net Assets
September 30, 2010

	<u>Governmental</u> <u>Activities</u>	<u>Business-Type</u> <u>Activities</u>	<u>Total</u>
Assets			
Cash and cash equivalents	\$ 1,110,747	\$ -	\$ 1,110,747
Accounts receivable, net of allowance for doubtful accounts of \$790,210	269,772	592,833	862,605
Property tax receivable	3,755,510	-	3,755,510
Intergovernmental receivable	368,566	-	368,566
Grants receivable	-	116,251	116,251
Prepaid expense	291,613	45,901	337,514
Internal balances	(40,611)	40,611	-
Restricted assets:			
Customer deposits	-	286,863	286,863
Cash in bank	682,056	-	682,056
Capital lease receivable	153,950	-	153,950
Bond issue costs, net	163,450	-	163,450
Capital assets, net of accumulated depreciation	12,223,609	8,860,099	21,083,708
Total Assets	18,978,662	9,942,558	28,921,220
Liabilities			
Accounts payable	253,501	85,831	339,332
Accrued expenses	436,618	51,150	487,768
Retainage payable	-	5,925	5,925
Customer deposits	-	356,221	356,221
Deferred revenue	3,909,460	-	3,909,460
Escrow deposit	29,423	-	29,423
Long-term liabilities			
Due within one year:			
Capital debt	474,012	203,911	677,923
Due in more than one year:			
Capital debt	8,447,524	1,892,735	10,340,259
Non-capital debt	406,158	79,867	486,025
Total Liabilities	13,956,696	2,675,640	16,632,336
Net Assets			
Invested in capital assets, net of related debt	3,302,073	6,763,453	10,065,526
Restricted:			
Capital projects	573,538	-	573,538
Prepaid expenses	291,613	-	291,613
Debt service	62,592	-	62,592
Unrestricted	792,150	503,465	1,295,615
Total Net Assets	\$ 5,021,966	\$ 7,266,918	\$ 12,288,884

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Statement of Activities
For the Year Ended September 30, 2010

	Program Revenues				Net (Expenses) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental Activities							
General government	\$ 1,602,733	\$ 181,680	\$ 140,536	\$ 15,000	\$ (1,265,517)	\$ -	\$ (1,265,517)
Public safety	5,363,433	203,099	65,510	-	(5,094,824)	-	(5,094,824)
Public works	425,056	-	-	184,821	(240,235)	-	(240,235)
Culture and recreation	461,029	96,485	160,000	-	(204,544)	-	(204,544)
Health and welfare	112,059	388,299	-	-	276,240	-	276,240
Interest on long-term debt	341,978	-	-	-	(341,978)	-	(341,978)
Total Governmental Activities	8,306,288	869,563	366,046	199,821	(6,870,858)	-	(6,870,858)
Business-Type Activities							
Water	1,475,288	755,080	-	-	-	(720,208)	(720,208)
Sewer	1,370,157	1,968,814	-	216,759	-	815,416	815,416
Sanitation	1,023,601	707,900	-	-	-	(315,701)	(315,701)
Interest on long-term debt	58,235	-	-	-	-	(58,235)	(58,235)
Total Business-Type Activities	3,927,281	3,431,794	-	216,759	-	(278,728)	(278,728)
Total Government	\$ 12,233,569	\$ 4,301,357	\$ 366,046	\$ 416,580	\$ (6,870,858)	\$ (278,728)	\$ (7,149,586)

General Revenues

Property taxes	3,846,037	-	3,846,037
Intergovernmental	176,622	-	176,622
Sales tax	2,561,593	-	2,561,593
Other taxes	386,150	-	386,150
Interest	5,459	1,232	6,691
Miscellaneous	138,625	6,595	145,220
Transfers other funds	(363,972)	363,972	-
Sale of assets	20,888	5,916	26,804
Total General Revenues	6,771,402	377,715	7,149,117
Change in Net Assets	(99,456)	98,987	(469)

Net Assets-Beginning of Year

Net Assets-End of Year

5,121,422	7,167,931	12,289,353
\$ 5,021,966	\$ 7,266,918	\$ 12,288,884

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Balance Sheet - Governmental Funds
September 30, 2010

	<u>General Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Assets			
Cash and cash equivalents	\$ 816,517	\$ 294,230	\$ 1,110,747
Property tax receivable	3,755,510	-	3,755,510
Intergovernmental receivable	368,168	398	368,566
Other receivables	-	380	380
Prepaid expenses	60,932	230,681	291,613
Due from other funds	179,795	8,850	188,645
Restricted cash	-	682,056	682,056
Capital lease receivable	-	153,950	153,950
Total Assets	<u>\$ 5,180,922</u>	<u>\$ 1,370,545</u>	<u>\$ 6,551,467</u>
Liabilities			
Accounts payable	\$ 193,687	\$ 59,814	\$ 253,501
Accrued expenses	259,375	8,017	267,392
Due to other funds	227,819	1,437	229,256
Deferred revenue	3,755,510	153,950	3,909,460
Escrow deposit	-	29,423	29,423
Total Liabilities	<u>4,436,391</u>	<u>252,641</u>	<u>4,689,032</u>
Fund Balances			
Reserved for:			
Capital projects	-	573,538	573,538
Prepaid expenses	60,932	230,681	291,613
Debt service	-	62,592	62,592
Unreserved, reported in:			
General Fund	683,599	-	683,599
Special Revenue Funds	-	251,093	251,093
Total Fund Balances	<u>744,531</u>	<u>1,117,904</u>	<u>1,862,435</u>
Total Liabilities and Fund Balances	<u>\$ 5,180,922</u>	<u>\$ 1,370,545</u>	<u>\$ 6,551,467</u>

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets
September 30, 2010

Total Fund Balance - Governmental Funds \$ 1,862,435

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:

Land	565,425	
Buildings and improvements	5,627,896	
Equipment	2,003,721	
Vehicles	920,923	
Infrastructure	7,733,325	
Construction in progress	49,818	
Improvements other than buildings	351,630	
Accumulated depreciation	<u>(5,029,129)</u>	
		12,223,609

Bonds issued by the City have associated costs that are paid from current available financial resources in the funds. However, these costs are deferred on the Statement of Net Assets. 163,450

Other assets are not available to pay for current period expenditures and, therefore, are deferred in the funds. 269,391

Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

Notes payable	(130,826)	
General obligation and revenue bonds	(8,740,000)	
Compensated absences	(406,158)	
Accrued interest	(169,226)	
Capital leases payable	<u>(50,709)</u>	
		<u>(9,496,919)</u>

Net Assets of Governmental Activities \$ 5,021,966

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds
For the Year Ended September 30, 2010

	<u>General Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Revenues			
General property taxes	\$ 3,071,725	\$ 1,160,462	\$ 4,232,187
Intergovernmental	2,738,215	-	2,738,215
Licenses and permits	181,680	-	181,680
Charges for services	325,255	96,485	421,740
Fines and forfeitures	203,099	-	203,099
Interest	2,793	2,666	5,459
Miscellaneous	97,694	40,931	138,625
Total Revenues	<u>6,620,461</u>	<u>1,300,544</u>	<u>7,921,005</u>
Expenditures			
General government	1,334,425	-	1,334,425
Public safety	5,179,693	15,510	5,195,203
Public works	250,397	-	250,397
Culture and recreation	-	409,106	409,106
Health and welfare	92,705	15,134	107,839
Capital outlay	398,878	482,995	881,873
Debt service:			
Principal	34,129	433,606	467,735
Interest	2,037	339,941	341,978
Total Expenditures	<u>7,292,264</u>	<u>1,696,292</u>	<u>8,988,556</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(671,803)</u>	<u>(395,748)</u>	<u>(1,067,551)</u>
Other Financial Sources			
Grant revenue	69,046	481,821	550,867
Sale of assets	1,488	19,400	20,888
Interfund transfers	-	(363,972)	(363,972)
Contributed capital	15,000	-	15,000
Total Other Financing Sources	<u>85,534</u>	<u>137,249</u>	<u>222,783</u>
Net Change in Fund Balances	(586,269)	(258,499)	(844,768)
Fund Balance - Beginning of Year	<u>1,330,800</u>	<u>1,376,403</u>	<u>2,707,203</u>
Fund Balance - End of Year	<u>\$ 744,531</u>	<u>\$ 1,117,904</u>	<u>\$ 1,862,435</u>

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Reconciliation of Revenues, Expenditures and Changes in
Fund Balances of Governmental Funds to the Statement of Activities
For the Year Ended September 30, 2010

Net Change in Fund Balances - Total Governmental Funds	\$ (844,768)
<p>Amounts reported for governmental activities in the Statement of Activities are different because:</p>	
<p>Governmental funds report capital outlays as expenditures. However, in the Statements of Activities, the cost of those material assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays of \$671,110 exceeded depreciation expense of \$408,225 in the current period.</p>	262,885
<p>Debt proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the Statement of Net Assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. This is the amount by which repayments \$467,735 exceed amortization expense \$11,298.</p>	456,437
<p>Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. Those amounts by which the (increase) decrease consist of are as follows:</p>	
Disposal of capital asset	(4,235)
Compensated absences payable	<u>(32,818)</u>
	(37,053)
<p>Some revenues will not be collected for several months after year-end. They are not considered available resources in the governmental funds.</p>	<u>63,043</u>
Change in Net Assets of Governmental Activities	<u><u>\$ (99,456)</u></u>

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Statement of Net Assets – Proprietary Fund
September 30, 2010

	Utility Fund
Assets	
Current Assets	
Accounts receivable , net of allowance for doubtful accounts of \$107,124	\$ 592,833
Grant receivable	116,251
Prepaid expenses	45,901
Due from other funds	40,699
Total Current Assets	795,684
Noncurrent Assets	
Restricted assets:	
Customer deposits	286,863
Capital assets, net of accumulated depreciation	8,860,099
Total Noncurrent Assets	9,146,962
Total Assets	\$ 9,942,646
Liabilities and Net Assets	
Current Liabilities	
Accounts payable	\$ 85,831
Accrued expenses	51,150
Retainage payable	5,925
Due to other funds	88
Total Current Liabilities	142,994
Current Liabilities Payable From Restricted Assets:	
Customer deposits	356,221
Long-term liabilities due within one year:	
Capital debt	203,911
Total Current Liabilities Payable From Restricted Assets	560,132
Long-Term Liabilities Due in More Than One Year:	
Capital debt	1,892,735
Non-capital debt	79,867
Total Long-Term Liabilities	1,972,602
Total Liabilities	2,675,728
Net Assets	
Invested in capital assets, net of related debt	6,763,453
Unrestricted	503,465
Total Net Assets	7,266,918
Total Liabilities and Net Assets	\$ 9,942,646

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Statement of Revenues, Expenses and
Changes in Net Assets – Proprietary Fund
For the Year Ended September 30, 2010

	<u>Utility Fund</u>
Operating Revenues	
Sewer sales	\$ 1,968,814
Water sales	755,080
Sanitation sales	707,900
Miscellaneous	<u>6,595</u>
Total Operating Revenues	<u>3,438,389</u>
Operating Expenses	
Cost of sales	1,302,189
Personnel	1,113,643
Depreciation and amortization	541,719
Material and supplies	170,265
Repairs and maintenance	550,388
Other	<u>190,842</u>
Total Operating Expenses	<u>3,869,046</u>
Operating Income	<u>(430,657)</u>
Non-Operating Revenues (Expenses)	
Grant proceeds	216,759
Interest income	1,232
Interest expense	(58,235)
Interfund transfers	363,972
Sale of assets	<u>5,916</u>
Total Non-Operating Revenues (Expenses)	<u>529,644</u>
Change in Net Assets	98,987
Net Assets - Beginning of Year	<u>7,167,931</u>
Net Assets - End of Year	<u><u>\$ 7,266,918</u></u>

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Statement of Cash Flows – Proprietary Fund
For the Year Ended September 30, 2010

	<u>Utility Fund</u>
Cash Flows From Operating Activities	
Cash received from customers	\$ 3,322,573
Cash payments for goods and services	(2,246,918)
Cash payments to employees	<u>(1,104,918)</u>
Net Cash Provided By (Used In) Operating Activities	<u>(29,263)</u>
Cash Flows From Non-Capital Financing Activities	
Interfund transfers	354,313
Net Cash Provided By (Used In) Non-Capital Financing Activities	<u>354,313</u>
Cash Flows From Capital and Related Financing Activities	
Payments for capital acquisitions	(599,681)
Proceeds from sale of assets	5,916
Customer deposits	21,588
Grant proceeds	100,508
Principal payments on debt	(214,626)
Interest payments on debt	<u>(58,235)</u>
Net Cash Provided By (Used In) Capital and Related Financing Activities	<u>(744,530)</u>
Cash Flows From Investing Activities	
Interest on investments	1,232
Net Cash Provided By (Used In) Investing Activities	<u>1,232</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(418,248)
Cash and Cash Equivalents - Beginning of Year	<u>705,111</u>
Cash and Cash Equivalents - End of Year	<u><u>\$ 286,863</u></u>
Reconciliation of Operating Income to Net Cash	
Provided By (Used In) Operating Activities	
Operating Income	\$ (430,657)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:	
Depreciation and amortization	541,719
(Increase) decrease in customer receivables	(112,739)
(Increase) decrease in prepaid items	(11,936)
Increase (decrease) in accounts payable	3,241
Increase (decrease) in accrued expenses	(30,464)
Increase (decrease) in retainage payable	5,925
Increase (decrease) in accrued compensated absences	<u>5,648</u>
Total adjustments	<u>401,394</u>
Net Cash Provided By (Used In) Operating Activities	<u><u>\$ (29,263)</u></u>

The accompanying notes are an integral part of the financial statements.

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General Statement

The City of Hernando (“the City”) was incorporated in 1866. The City operates under the Board of Aldermen-Mayor form of government and provides the following services; public safety, public works, culture and recreation, public improvements, planning and zoning, and general administrative services.

The financial statements of the City have been prepared in conformity with generally accepted accounting principles (“GAAP”) as applied to governmental units. The Governmental Accounting Standards Board (“GASB”) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the more significant polices.

Financial Reporting Entity

These financial statements present all the accounts of the City. There are no component units as defined by GASB Statement 14, *The Financial Reporting Entity*.

Basis of Presentation

The government-wide financial statements (Statement of Net Assets and the Statement of Activities) report information on all the activities of the City. The effect of interfund activity, within the governmental and business-type activities columns, has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

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

Fund Financial Statements

The City segregated transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Separate statements are presented for governmental and proprietary activities. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

Governmental funds are those funds through which most governmental functions typically are financed. The measurement focus of governmental funds is on the sources, uses and balance of current financial resources. The City has presented the following major governmental fund:

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

General Fund:

The General Fund is the main operating fund of the City. This fund is used to account for all financial resources not accounted for in other funds. All general tax revenues and other receipts that are not restricted by law or contractual agreement to some other fund are accounted for in this fund. General operating expenditures, fixed charges and capital improvement costs that are not paid through other funds are paid from the General Fund.

Proprietary Funds

All proprietary funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. The accounting objectives are determinations of net income, financial position, and cash flow. All assets and liabilities are included on the Statement of Net Assets. FASB pronouncements issued subsequent to November 30, 1989 that conflict with GASB pronouncements have not been followed, as permitted under GASB No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that use Proprietary Fund Accounting*. The City has presented the following major proprietary funds:

Utility Fund:

The Utility Fund is used to account for the provision of water, sewer and sanitation services to the residents of the City. Activities of the fund include administration, operations and maintenance of the water and sewer system and sanitation services, as well as billing and collection activities. The fund also accounts for the accumulation of resources for, and the payment of, long-term debt principal and interest for water, sewer and sanitation debt. All costs are financed through charges to utility customers with rates reviewed regularly and adjusted if necessary to ensure integrity of the funds.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Operating expenses for the proprietary funds include the cost of personal and contractual services, supplies and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditure are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The government-wide statements and fund financial statements for proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus means all assets and liabilities (whether current or non-current) are included on the Statement of Net Assets and the operating statements present increases (revenues) and decreases (expenses) in net total assets. Under the accrual basis of accounting, revenues are recognized when earned, including unbilled water, sewer and sanitation services which are accrued. Expenses are recognized at the time the liability is incurred.

Governmental fund financial statements are reported using the current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual; i.e., when they both become measurable and available. "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

soon enough thereafter to be used to pay liabilities of the current period. The City considers property taxes as available if they are collected within 60 days after year-end. A one-year availability period is used for recognition of all other governmental fund revenues. Expenditures are recognized when the related fund liability is incurred. However, debt service expenditures, except for interest payable accrued at the debt issuance date for which cash is received with the debt proceeds, as well as expenditures related to compensated absences are recorded only when payment has matured and will be payable shortly after year-end.

The revenues susceptible to accrual are property taxes, franchise fees, licenses, charges for services, interest income and intergovernmental revenues. Sales taxes collected and held by the state at year-end on behalf of the government are also recognized as revenue. All other governmental fund revenues are recognized when received, as they are deemed immaterial.

Budgets and Budgetary Accounting

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

The City Charter establishes the fiscal year as the twelve-month period beginning October 1. The departments submit to the City Clerk a budget of estimated expenditures for the ensuing fiscal year after which the City Clerk submits a budget of estimated expenditure and revenues to the Mayor and Board of Aldermen by August 1.

Upon receipt of the budget estimates, the Board of Aldermen holds a public hearing on the proposed budget. Information about the budget ordinance is then published in the official newspaper of the City.

At the September board meeting, the budget is legally enacted through passage of ordinance. The City Clerk is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the Board of Aldermen.

The actual receipts and disbursements are accumulated each month and compared to the budgeted amounts and reviewed by the Mayor and Board of Aldermen. Any revisions on the budget during the year are approved by the Board of Aldermen.

Cash and Cash Equivalents

For the purpose of the Statement of Net Assets, "Cash and cash equivalents" includes all demand, savings accounts, and certificates of deposits of the City. For the purpose of the proprietary fund Statement of Cash Flows, "Cash and cash equivalents" include all demand and savings accounts, and certificates of deposit or short-term investments with an original maturity of three months or less.

Prepaid Expenses

Prepaid balances are for payments made by the City in the current year to provide services occurring in the subsequent fiscal year, and the reserve for prepaid expenses in the governmental funds has been recorded to signify that a portion of fund balance is not available for other subsequent expenditures.

Interfund Transactions and Balances

Transactions between funds that are representative of short-term lending/borrowing arrangements and transactions that have not resulted in the actual transfer of cash at the end of the fiscal year are referred to as "Due to/from other

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

funds.” Noncurrent portions of interfund receivables and payables are reported as “Advances to/from other funds.” Advances between funds, when reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources. Interfund receivables and payable between funds within governmental activities are eliminated in the Statement of Net Assets. Any outstanding balances between the governmental activities and business type activities are reported in the government-wide financial statements as “Internal balances.”

Restricted Assets

Proprietary fund assets required to be held and/or used as specified in bond indentures, bond resolutions, trustee agreements, board resolutions and donor specifications have been reported as restricted assets. When both restricted and non-restricted assets are available for use, the policy is to use restricted assets first.

Capital Assets and Depreciation

Capital assets, which include property, plant, equipment, and infrastructure assets, are reported in the applicable governmental or business-type activities columns in the government-wide financial statements and in the fund financial statements for proprietary funds. All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are capitalized at estimated fair market value on the date donated.

Depreciation of capital assets is computed and recorded by the straight-line method. Estimated useful lives of the various classes of depreciable capital assets are as follows:

- Buildings - 20 to 50 years
- Improvements/infrastructure - 5 to 50 years
- Equipment - 2 to 15 years

Compensated Absences

The City has adopted a policy of compensation for accumulated unpaid employee personal leave. No payment is authorized for accrued major medical leave. Accounting principles generally accepted in the United States of America require accrual of accumulated unpaid employee benefits as long-term liabilities in the government-wide financial statements and proprietary fund financial statements. In fund financial statements, governmental funds report the compensated absence liability payable only if the payable has matured, for example an employee resigns or retires.

Nature and Purpose of Reservations and Designations of Fund Equity

The financial statements report reservations of fund balance for amounts that are not available for appropriation or legally restricted by outside parties for use for a specific purpose. Following are descriptions of fund reserves used by the City:

Reserved for capital projects – An account that represents a portion of the fund balance which is legally restricted and not available for spending for any other purpose than the capital project for which is it restricted.

Reserved for prepaid expenses – An account that represents a portion of the fund balance which indicates that prepaid items do not represent available spendable resources even though they are a component of net assets.

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

Reserved for debt service – An account that represents a portion of the fund balance which is legally restricted and not available for spending for any other purpose than the debt instrument for which it is restricted.

Net Assets

Net assets are the difference between assets and liabilities. Net assets “Invested in capital assets, net of related debt” are capital assets, less accumulated depreciation and any outstanding debt related to the acquisition, construction or improvement of those assets. Net assets are reported as “Restricted” when there are legal limitations imposed on their use by City legislation or external restrictions by other governments, creditors or grantors.

Property Tax Revenues

Restrictions associated with property tax levies vary with the statutory authority. The amount of increase in certain property taxes is limited by state law. Generally, this restriction provides that these tax levies shall produce no more than 110% of the amount which resulted from the assessments of the previous year.

The Board of Alderman, each year at a meeting in September, levies property taxes for the ensuing fiscal year which begins on October 1. Real property taxes become a lien on January 1 of the current year, and personal property taxes become a lien on March 1 of the current year. Taxes on both real and personal property, however, are due on or before February 1 of the next succeeding year. Taxes on motor vehicles and mobile homes become a lien are due in the month that coincides with the month of the original purchase.

Accounting principles generally accepted in the United States of America require property taxes to be recognized at the levy date if measurable and available. All property taxes are recognized as revenue in the year for which they are levied. Motor vehicle and mobile home taxes do not meet the measurability and collectability criteria for property tax recognition because the lien and due date cannot be established until the date of the original purchase occurs.

NOTE B – CASH AND CASH EQUIVALENTS

The collateral for public entities’ deposits in financial institutions are held in the name of the State Treasurer under a program established by the Mississippi State Legislature and is governed by Section 27-105-5, Miss. Code Ann. (1972). Under this program, the entity’s funds are protected through a collateral pool administered by the State Treasurer. Financial institutions holding deposits of public funds must pledge securities as collateral against those deposits. In the event of failure of a financial institution, securities pledged by that institution would be liquidated by the State Treasurer to replace the public deposits not covered by the Federal Depository Insurance Corporation (“FDIC”).

Custodial credit risk is the risk that, in the event of a financial institutions failure, the City’s deposits might not be recovered. The City does not have a deposit policy for custodial credit risk. As of September 30, 2010, the City’s bank balance was not exposed to custodial credit risk.

As of September 30, 2010, the carrying amount of the City’s deposits was \$2,079,666 and the bank balances totaled \$2,170,490. Of the bank balances, \$500,000 was insured by federal deposit insurance and \$1,670,490 was covered by pooled and/or pledged collateral.

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

NOTE C - INTERGOVERNMENTAL RECEIVABLES

Intergovernmental receivables consist of sales tax and franchise tax.

	<u>General Fund</u>
Ad valorem	\$ 56,835
Franchise and sales tax	311,731
Total	<u>\$ 368,566</u>

NOTE D – CAPITAL ASSETS

	<u>Balance at 9/30/2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Adjustments</u>	<u>Balance at 9/30/2010</u>
Governmental Activities					
Capital assets, not being depreciated:					
Land	\$ 565,425	\$ -	\$ -	\$ -	\$ 565,425
Construction in progress	34,374	15,444	-	-	49,818
Total capital assets, not being depreciated:	<u>599,799</u>	<u>15,444</u>	<u>-</u>	<u>-</u>	<u>615,243</u>
Capital assets, being depreciated:					
Buildings and improvements	5,634,371	-	-	(6,475)	5,627,896
Infrastructure	7,274,650	462,910	(4,235)	-	7,733,325
Equipment	1,959,709	37,537	-	6,475	2,003,721
Vehicles	939,978	-	(19,055)	-	920,923
Improvements other than buildings	196,411	155,219	-	-	351,630
Total capital assets, being depreciated:	<u>16,005,119</u>	<u>655,666</u>	<u>(23,290)</u>	<u>-</u>	<u>16,637,495</u>
Less accumulated depreciation for:					
Buildings and improvements	(1,154,624)	(113,916)	-	-	(1,268,540)
Infrastructure	(1,202,405)	(130,759)	-	-	(1,333,164)
Equipment	(1,566,319)	(56,922)	-	-	(1,623,241)
Vehicles	(700,672)	(92,563)	19,055	-	(774,180)
Improvements other than buildings	(15,939)	(14,065)	-	-	(30,004)
Total Accumulated Depreciation	<u>(4,639,959)</u>	<u>(408,225)</u>	<u>19,055</u>	<u>-</u>	<u>(5,029,129)</u>
Total Capital Assets, Being Depreciated, Net	<u>11,365,160</u>	<u>247,441</u>	<u>(4,235)</u>	<u>-</u>	<u>11,608,366</u>
Governmental Activities Capital Assets, Net	<u>\$ 11,964,959</u>	<u>\$ 262,885</u>	<u>\$ (4,235)</u>	<u>\$ -</u>	<u>\$ 12,223,609</u>
Business-Type Activities					
Capital assets, not being depreciated:					
Construction in progress	1,479,370	\$ 370,872	\$ (1,730,954)	\$ -	\$ 119,288
Total Capital Assets, Not Being Depreciated:	<u>1,479,370</u>	<u>370,872</u>	<u>(1,730,954)</u>	<u>-</u>	<u>119,288</u>
Capital assets, being depreciated:					
Infrastructure	10,940,630	1,904,406	-	-	12,845,036
Equipment	1,261,803	11,860	-	-	1,273,663
Vehicles	387,066	43,497	-	-	430,563
Total Capital Assets, Being Depreciated:	<u>12,589,499</u>	<u>1,959,763</u>	<u>-</u>	<u>-</u>	<u>14,549,262</u>
Less accumulated depreciation for:					
Infrastructure	(4,074,793)	(417,981)	-	-	(4,492,774)
Equipment	(863,871)	(104,951)	-	-	(968,822)
Vehicles	(328,068)	(18,787)	-	-	(346,855)
Total Accumulated Depreciation	<u>(5,266,732)</u>	<u>(541,719)</u>	<u>-</u>	<u>-</u>	<u>(5,808,451)</u>
Total Capital Assets, Being Depreciated, Net	<u>7,322,767</u>	<u>1,418,044</u>	<u>-</u>	<u>-</u>	<u>8,740,811</u>
Business-Type Activities Capital Assets, Net	<u>\$ 8,802,137</u>	<u>\$ 1,788,916</u>	<u>\$ (1,730,954)</u>	<u>\$ -</u>	<u>\$ 8,860,099</u>

No interest was capitalized during the year due to immateriality.

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

A summary of depreciation expense by function is as follows:

Governmental Activities:	
General Government	\$ 25,727
Public Safety	166,939
Public Works	174,646
Culture and Recreation	37,089
Health and Wellness	<u>3,824</u>
Total Governmental Activities Depreciation Expense	<u>\$ 408,225</u>
Business-Type Activities:	
Water	<u>\$ 541,719</u>
Total Business-Type Activities Depreciation Expense	<u>\$ 541,719</u>

Commitments under construction at September 30, 2010 are summarized as follows:

<u>Project</u>	<u>Contract Amount</u>	<u>Remaining Balance</u>	<u>Fund</u>
Lambert Subdivision Sewer	\$ 116,530	\$ 36,675	General Obligation Debt
Hernando/Southaven Sewer	10,000	7,900	Utility

NOTE E - INTERFUND TRANSACTIONS

Interfund transactions are for the payment of monthly claims, and to provide funds for debt service and capital outlay. All transfers were routine and consistent with the activities of the fund, and all interfund balances are expected to be repaid within a year. The following is a summary of interfund transactions and balances as of September 30, 2010:

	<u>Due from</u>	<u>Due to</u>
Major Funds:		
General fund	\$ 179,795	\$ 227,819
Utility fund	40,699	88
Nonmajor funds	<u>8,850</u>	<u>1,437</u>
Total Funds	<u>\$ 229,344</u>	<u>\$ 229,344</u>
	<u>Transfer in</u>	<u>Transfer out</u>
Major Funds:		
Nonmajor funds	\$ -	\$ (363,972)
Utility fund	<u>363,972</u>	<u>-</u>
Total Funds	<u>\$ 363,972</u>	<u>\$ (363,972)</u>

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

NOTE F - LONG-TERM DEBT

Long-term debt activity for the year ended September 30, 2010 was as follows:

	<u>Balance at 9/30/2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at 9/30/2010</u>	<u>Amounts Due Within One Year</u>
Governmental Activities:					
General obligation bonds payable	\$ 9,140,000	\$ -	\$ 400,000	\$ 8,740,000	\$ 410,000
Notes payable	164,432	-	33,606	130,826	35,369
Leases payable	84,838	-	34,129	50,709	28,643
Compensated absences payable	373,340	32,818	-	406,158	-
Governmental Activities Long-Term Liabilities	<u>\$ 9,762,610</u>	<u>\$ 32,818</u>	<u>\$ 467,735</u>	<u>\$ 9,327,693</u>	<u>\$ 474,012</u>
Business-Type Activities:					
Notes payable	\$ 2,108,932	\$ -	\$ 130,161	\$ 1,978,771	\$ 133,565
Leases payable	202,340	-	84,465	117,875	70,346
Compensated absences payable	74,219	5,648	-	79,867	-
Business-Type Activities Long-Term Liabilities	<u>\$ 2,385,491</u>	<u>\$ 5,648</u>	<u>\$ 214,626</u>	<u>\$ 2,176,513</u>	<u>\$ 203,911</u>

General obligation bonds are direct obligations and pledge the full faith and credit of the City. General obligation bonds outstanding as of September 30, 2010 are as follows:

<u>Description</u>	<u>Interest Rate</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount</u>	
				<u>Issued</u>	<u>Outstanding</u>
2003	Various	4/1/2003	4/1/2023	\$ 2,000,000	\$ 1,490,000
2003	Various	10/1/2003	10/1/2023	3,500,000	2,750,000
2007	Various	5/31/2007	5/1/2027	5,000,000	4,500,000
				<u>\$ 10,500,000</u>	<u>\$ 8,740,000</u>

Notes payable as of September 30, 2010 are as follows:

<u>Description</u>	<u>Interest Rate</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount</u>	
				<u>Issued</u>	<u>Outstanding</u>
Dept. of Econ. and Community Dev. - Industrial Building	4.00%	6/30/1997	4/1/2014	\$ 450,000	\$ 130,826
Dept. of Econ. and Community Dev. - Sewer Cap Loan	3.00%	10/31/2002	10/31/2021	288,000	180,897
State of Mississippi - DWSIRLF	3.00%	2/10/2002	10/10/2021	752,086	477,289
State of Mississippi - DWSIRLF	3.00%	2/10/2003	9/10/2022	391,232	266,191
Dept. of Environ. Quality - Water Pollution Control	1.75%	6/1/2003	1/1/2023	508,741	340,363
Dept. of Econ. and Community Dev. - Sewer Cap Loan	2.00%	2/1/2005	2/1/2025	237,400	180,059
Dept. of Econ. and Community Dev. - Sewer Cap Loan	3.00%	11/1/2005	11/1/2025	191,116	161,016
State of Mississippi - DWSIRLF	4.00%	5/1/2006	2/1/2026	233,505	372,956
Total				<u>\$ 3,052,080</u>	<u>\$ 2,109,597</u>

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

The aggregate maturities of general obligation bonds, revenue bonds, and loans for the years subsequent to September 30, 2010 are as follows:

Year ending September 30	Governmental Fund		Enterprise Fund	
	Principal	Interest	Principal	Interest
2010	\$ 445,369	\$ 344,462	\$ 133,565	\$ 49,857
2011	466,810	323,254	137,093	46,328
2012	493,310	301,632	140,718	42,702
2013	494,958	280,191	144,443	38,978
2014	495,379	258,842	148,271	34,877
2015-2019	2,825,000	985,138	802,553	114,553
2020-2024	2,930,000	402,830	449,855	23,568
2025-2029	720,000	41,420	22,273	257
Total	\$ 8,870,826	\$ 2,937,769	\$ 1,978,771	\$ 351,120

Future minimum capital lease payments and the net present value of these minimum lease payments as of September 30, 2010 were as follows:

Year Ending September 30	General Fund		Enterprise Fund	
	Principal	Interest	Principal	Interest
2010	\$ 28,643	\$ 1,156	\$ 70,346	\$ 2,694
2011	22,066	283	40,893	794
2012	-	-	6,636	36
Total	\$ 50,709	\$ 1,439	\$ 117,875	\$ 3,524

Legal debt margin. The City is subject to the limitations of indebtedness prescribed by Section 21-33-303, Miss. Code Ann. (1972). No municipality may issue bonds secured by a pledge of its full faith and credit in an amount which, when added to the then outstanding bond indebtedness of such municipality, would exceed the 15% and 20% tests prescribed in Section 21-33-303. These percentages are applied to the assessed value of the taxable property within such municipality, with certain types of bond issues being excluded from the authorized debt limit tests. Presented in the schedule below are the calculations of the applicable statutory debt limitations and the resulting margin for further debt in the amount of \$9,723,156 (the smaller of the two computed margins) as of September 30, 2010.

	15% Test	20% Test
Assessed value as of September 30, 2010:		
\$123,087,704 times applicable percentage	\$ 18,463,156	\$ 24,617,541
Less present debt subject to debt limits as of September 30, 2010:		
Total bonds outstanding (excluding proprietary)	<u>(8,740,000)</u>	<u>(8,740,000)</u>
Margin for additional debt	<u>\$ 9,723,156</u>	<u>\$ 15,877,541</u>

In December 2007, the City entered into an agreement with the City of Southaven, Mississippi whereby the City of Southaven will design and construct a sewer system ("the Hurricane Creek Project") by which it will collect and transport wastewater through the City of Hernando to the DeSoto County Regional Utility Authority's sewer system for treatment and disposal. Upon completion, the City of Hernando will operate and maintain the sewer line. Further, the City has agreed to pay the City of Southaven \$1,000,000 over seven years to reimburse the City of Southaven for its portion of the construction costs.

City of Hernando, Mississippi
Notes to Financial Statements
For the Year Ended September 30, 2010

The City will make the first annual payment to the City of Southaven within sixty days of completion of the project, and then annually on October 1. The project has not substantially begun as of September 30, 2010. Certain costs have been incurred by the City of Hernando, as shown in Note D as commitments under construction. These costs are related to the City's independent oversight of the project and are not related to the \$1,000,000 that will be payable to the City of Southaven.

NOTE G – DEFINED BENEFIT PENSION PLAN

Plan Description. The City contributes to the Public Employees' Retirement System of Mississippi ("PERS"), a cost-sharing multiple-employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by state law and may be amended only by the State of Mississippi Legislature. PERS issues a publicly available financial report that includes financial statements and required supplementary information. That information may be obtained by writing to Public Employee Retirement System, PERS Building, 429 Mississippi Street, Jackson, MS 39201-1005 or by calling (601) 359-3589 or 1-800-444 PERS.

Funding Policy. PERS members are required to contribute 7.25% of their annual covered salary and the City of Hernando is required to contribute at an actuarially determined rate. At September 30, 2010, the current rate is 12% of annual covered payroll. The contribution requirements of PERS members are established and may be amended only by the State of Mississippi Legislature. The City of Hernando's contributions to PERS for the years ending September 30, 2010, 2009 and 2008 were \$600,890, \$588, 356, and \$548,849 respectively, equal to the required contributions for each year.

NOTE H – RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. This exposure is covered by purchase of commercial insurance.

NOTE I – LITIGATION

The City is subject to various legal proceedings in various stages of litigation, the outcome of which is not determinable at this time. Management of the City and its legal counsel do not anticipate that there will be a material effect on the financial statements as a result of the cases presently in progress.

NOTE J – SUBSEQUENT EVENTS

Subsequent events have been evaluated by the City through February 25, 2010 which is the date the financial statements were available to be issued.

In November 2010, the City entered into an agreement with the Mississippi Department of Health for a Drinking Water Systems Improvement Revolving Fund loan for up to \$2,385,000, payable over 20 years at 2% interest, for an elevated water tank and improvements to the water plant and lines.

In December 2010 the City obtained a tax anticipation loan for up to \$1,200,000 at 1.10% interest to be repaid on or before March 31, 2011. The City borrowed \$575,000, and as of the date of this report, the loan has been repaid in full.

REQUIRED SUPPLEMENTARY INFORMATION

City of Hernando, Mississippi
Budgetary Comparison Schedule – General Fund
For the Year Ended September 30, 2010

	Budgeted Amounts		Actual Amounts Budgetary Basis	Variance with Final Budget
	Original	Final		
Revenues				
General property taxes	\$ 2,554,874	\$ 3,169,874	\$ 3,071,725	\$ (98,149)
Intergovernmental	3,978,600	2,694,500	2,719,952	25,452
Licenses and permits	524,300	136,500	181,680	45,180
Charges for services	260,000	275,800	325,255	49,455
Fines and forfeitures	304,000	219,000	203,099	(15,901)
Interest	-	5,000	2,793	(2,207)
Miscellaneous	92,000	85,000	128,126	43,126
Total Revenues	7,713,774	6,585,674	6,632,630	46,956
Expenditures				
General government	1,309,249	1,497,925	1,348,783	149,142
Public safety	5,923,253	5,400,369	5,179,693	220,676
Public works	312,465	307,865	250,397	57,468
Health and welfare	-	149,066	92,705	56,361
Capital outlay	1,312,640	442,382	383,878	58,504
Debt service	36,167	36,167	36,166	1
Total Expenditures	8,893,774	7,833,774	7,291,622	542,152
Excess (Deficiency) of Revenues				
Over (Under) Expenditures	(1,180,000)	(1,248,100)	(658,992)	589,108
Other Financing Sources (Uses)				
Grant revenue	-	68,100	69,046	946
Contributed capital	-	-	15,000	15,000
Sale of assets	-	-	1,488	1,488
Total Other Financing Sources (Uses)	-	68,100	85,534	17,434
Net Change in Fund Balances	\$ (1,180,000)	\$ (1,180,000)	(573,458)	\$ 606,542
Fund Balance - Beginning of Year			1,330,800	
Fund Balance - End of Year			757,342	
Adjustments to Conform with GAAP:				
Revenues			(12,169)	
Expenditures			(642)	
Fund Balance - End of Year (GAAP Basis)			\$ 744,531	

SUPPLEMENTARY INFORMATION

City of Hernando, Mississippi
Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2010

<u>Federal Grantor/ Pass through Grantor/ Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Number</u>	<u>Federal Expenditures</u>
<u>U.S. Department of Agriculture</u>			
Passed through Natural Resources Conservation Service			
Emergency Watershed Protection Program	10.923	68-4423-10-1950	\$ 15,525
Emergency Watershed Protection Program	10.923	68-4423-10-1951	24,735
Emergency Watershed Protection Program	10.923	68-4423-10-1961	75,991
Total U.S. Department of Agriculture			<u>116,251</u>
<u>U.S. Department of Housing and Urban Development</u>			
Passed through Mississippi Development Authority			
* Home Investment Partnerships Program	14.239	1220-M08-SG-280-912	127,000
Total U.S. Department of Housing and Urban Development			<u>127,000</u>
<u>U.S. Department of Transportation</u>			
Passed through Mississippi Department of Transportation			
* ARRA - Highway Planning and Construction	20.205	105652-70100 ARRA	170,883
Passed through Mississippi Department of Wildlife, Fisheries, and Parks			
Recreational Trails Program	20.219	28-RTP-0146	100,000
Passed through Mississippi Office of Highway Safety			
State and Community Highway Safety	20.600	10-PT-286-1	48,677
Total U.S. Department of Transportation			<u>319,560</u>
Total All Federal Awards			<u>\$ 562,811</u>

* Denotes Major Federal Program

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the City under programs of the federal government for the year ended September 30, 2010. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of the City, it is not intended to and does not present the financial position, changes in net assets or cash flows of the City.

Note 2. Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the modified accrual basis of accounting.

City of Hernando, Mississippi
Surety Bond Coverage
September 30, 2010

Surety bonds in force at September 30, 2010 were as follows:

Name	Position	Insurance Company	Bond
Willis W. Johnson	Mayor	Travelers Casualty and Surety Co.	\$100,000
Sonny Bryant	Alderman	Brierfield Insurance Co.	\$100,000
Gary N. Higdon	Alderman	Brierfield Insurance Co.	\$100,000
Jeff Hobbs	Alderman	Brierfield Insurance Co.	\$100,000
Sam Lauderdale	Alderman	Brierfield Insurance Co.	\$100,000
Marcus Manning	Alderman	Brierfield Insurance Co.	\$100,000
Andrew Miller	Alderman	Brierfield Insurance Co.	\$100,000
James P. Tipton, Jr	Alderman	Brierfield Insurance Co.	\$100,000
Jannett P. Riley	City Clerk	Travelers Casualty and Surety Co.	\$50,000
Cassandra E. Perry	Court Clerk	Travelers Casualty and Surety Co.	\$50,000
Ruthie Dearth	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
Kristin Dugan	Planning Clerk	Travelers Casualty and Surety Co.	\$50,000
Gwen P. House	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
Dot Hughes	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
Robbin Luttrell	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
Marty Pickard	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
Donna Riales	Deputy Court Clerk	Travelers Casualty and Surety Co.	\$50,000
Denise Stringfellow	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
Katie Subia	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
Debra Tipton	Deputy Clerk	Travelers Casualty and Surety Co.	\$50,000
James M. Riley	Police Chief	Travelers Casualty and Surety Co.	\$50,000
Lee Hodge	Police Captain	Travelers Casualty and Surety Co.	\$50,000
Tara Davis	Policeman	Travelers Casualty and Surety Co.	\$50,000
Dewayne Williams	Park Director	Travelers Casualty and Surety Co.	\$50,000
Melissa Zizmann	Asst. Park Director	Travelers Casualty and Surety Co.	\$50,000

(This page left blank intentionally)

ADDITIONAL AUDITORS' REPORTS



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

Mayor and Board of Aldermen
City of Hernando
Hernando, Mississippi

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hernando, Mississippi ("the City") as of and for the year ended, September 30, 2010, which collectively comprise the City's basic financial statements and have issued our report thereon dated February 25, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weakness and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the Schedule of Findings and Questioned Costs as 10-1 through 10-4 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the Schedule of Findings and Questioned Costs as 10-5 to be a significant deficiency.

Compliance and Other Matters

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

The City's responses to the findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Board of Aldermen, others within the entity, and the Mississippi State Department of Audit and is not intended to be and should not be used by anyone other than those specified parties.

Williams, Pitts & Beard, PLLC

Williams, Pitts and Beard, PLLC

Hernando, Mississippi

February 25, 2011



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT
AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Mayor and Board of Aldermen
City of Hernando
Hernando, Mississippi

Compliance

We have audited the City of Hernando, Mississippi's ("the City") compliance with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2010. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City's compliance with those requirements.

In our opinion, the City complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2010.

Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

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

Williams, Pitts & Beard, PLLC

Williams, Pitts & Beard, PLLC
Hernando, Mississippi
February 25, 2011



WILLIAMS • PITTS • BEARD, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

DANNY L. WILLIAMS
JERRY W. PITTS
REBECCA A. BEARD
KRISTOPHER A. WHITTEN

2042 McIngvale Road, Suite A
Hernando, MS 38632

(662) 429-4436
FAX: (662) 429-4438
www.williamsandpitts.com

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
WITH STATE LAWS AND REGULATIONS**

Mayor and Board of Aldermen
City of Hernando, Mississippi

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hernando, Mississippi ("the City") as of and for the year ended September 30, 2010, and have issued our report thereon dated February 25, 2011. We have conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*.

As required by the state legal compliance audit program prescribed by the Office of the State Auditor, we have also performed procedures to test compliance with certain state laws and regulations. However, providing an opinion on compliance with state laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of those procedures and our audit of the general purpose financial statement disclosed no material instances of noncompliance with state laws and regulations.

This report is intended for the information of the City's management and the Office of the State Auditor and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Williams, Pitts & Beard, PLLC

Williams, Pitts & Beard, PLLC
Hernando, Mississippi
February 25, 2011

City of Hernando, Mississippi
Schedule of Findings and Questioned Costs
September 30, 2010

Section 1: Summary of Auditor's Results

Financial Statements:

1.	Type of auditor's report issued on the financial statements	Unqualified
2.	Material noncompliance relating to the financial statements	No
3.	Internal control over financial reporting:	
	a. Material weakness(es) identified?	Yes
	b. Significant deficiency(ies) identified that are not considered to be material weaknesses?	No

Federal Awards:

4.	Type of auditor's report issued on compliance for major federal programs	Unqualified
5.	Internal control over major programs:	
	a. Material weakness(es) identified?	No
	b. Significant deficiency(ies) identified that are not considered to be material weaknesses	No
6.	Any audit finding(s) reported as required by OMB Circular A-133?	No
7.	Federal programs identified as major programs:	
	a. ARRA-Highway Planning and Construction	CFDA #20.205
	b. Home Investment Partnership Program	CFDA #14.239
8.	The dollar threshold used to distinguish between types A and type B programs:	\$300,000
9.	Auditee qualified as a low-risk auditee?	No
10.	Prior fiscal year audit finding(s) and questioned cost relative to federal awards which would require the auditee to prepare a summary schedule of prior audit findings as discussed in Section _____.315(b) of OMB Circular A-133?	No

City of Hernando, Mississippi
Schedule of Findings and Questioned Costs
September 30, 2010

Section 2: Financial Statements Findings

Material Weaknesses

10-1 Criteria: Part of effective internal controls over financial reporting is the ability to properly produce financial statements in accordance with generally accepted accounting principles. Management is responsible for ensuring that all items are reported correctly on the City's financial statements.

Condition: The City incorrectly recorded audit adjustments from the prior year audit.

Effect: An audit adjustment of \$395,915 was required to correctly record audit adjustments from the prior year. The entries were improperly recorded to the current year income statement, instead of fund balance.

Recommendation: Management should ensure that post closing entries are recorded in fund balance.

Response: Auditors instructing bookkeeper, in the past, to key nothing to fund balance unless instructed by the auditors has been a misunderstanding.

10-2 Criteria: Part of effective internal controls over financial reporting is the ability to properly produce financial statements in accordance with generally accepted accounting principles. Management is responsible for ensuring that all items are reported correctly on the City's financial statements.

Condition: The City does not calculate Utility Fund depreciation expense.

Effect: The external auditors must compute depreciation expense for the Utility Fund.

Recommendation: Management should prepare depreciation expense schedules for all funds.

Response: Although we have been adding utility assets to the depreciation schedule since 2005, we have not received a copy of the complete Utility Fund's schedule to add items older than 2005.

10-3 Criteria: Cash on hand related to customer deposits must be designated as "restricted" cash. Management is responsible for ensuring that all funds are correctly segregated for the City.

Condition: The City had customer deposits in the Utility Fund totaling \$356,221 as of September 30, 2010. Total cash in the Utility Fund at September 30, 2010 was \$286,863. There is not enough cash available to "restrict" to cover the balance of customer deposits.

Effect: The City would be unable to refund all of their customers' deposits if necessary.

Recommendation: Management should develop internal controls to properly segregate restricted cash when necessary, and monitor the cash balances to ensure all customer deposits are covered by restricted cash balances.

Response: Management is expecting NRCS funding for the depleted cash due to NRCS project. Management will be looking at better ways to track cash flow in order to avoid this situation in the future.

City of Hernando, Mississippi
Schedule of Findings and Questioned Costs
September 30, 2010

10-4 Criteria: Part of effective internal controls over financial reporting is the ability to properly produce financial statements in accordance with generally accepted accounting principles. Management is responsible for ensuring that all items are reported correctly on the City's financial statements.

Condition: The City did not record a grant receivable totaling \$116,251 as of September 30, 2010.

Effect: An audit adjustment of \$116,251 was recorded to appropriately report grant revenue and grants receivable as of September 30, 2010.

Recommendation: Management should review for any potential receivables at year-end.

Response: The following statement out of the Mississippi Municipal Audit & Accounting Guide was misunderstood. We understood for this to be receivables and disbursements not only disbursements.

Section 21-35-23, Miss. Code Ann. (1972), allows disbursements made within 30 days after September 30 to be charged back to the budget for fiscal year ending on September 30. This provision applies to obligations incurred prior to the end of the fiscal year ending September 30 and intended (appropriated) to be paid from that fiscal year's budget. To qualify for this charge back, the claim for payment [Section 21-39-9, Miss. Code Ann. 1972] must be approved and the check for payment dated no later than October 30.

If for some reason budgeted obligations cannot be paid by October 30, the next year's budget should be revised [Section 21-35-25, Miss. Code Ann.1972] to provide for the payment after October 30. As a result of not charging the prior year's budget with this expenditure, additional cash should be available in the prior year's ending cash to be carried over to the new year's budget (beginning cash balance). This cash may be recognized to increase the new years beginning cash to fund the budget revision.

10-5 Criteria: Part of effective internal controls over financial reporting is the ability to properly produce financial statements in accordance with generally accepted accounting principles. Management is responsible for ensuring that all items are reported correctly on the City's financial statements.

Condition: The City recorded \$75,000 in contributions and grants as a liability to "reserve" the funds for future use.

Effect: The City's revenues were understated and not in compliance with generally accepted accounting principles.

Recommendation: Management should reserve net assets or segregate the receipt of the funds from operating cash with either a separate bank account or a separate account in the general ledger.

Response: The City has already made plans to segregate the funds and it will be corrected by the audit 2011.

Section 3: Federal Award Findings and Questioned Costs.

The results of our tests did not disclose any findings and questioned costs related to federal awards.