

CITY OF HEATH, TEXAS

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED SEPTEMBER 30, 2006

CITY OF HEATH, TEXAS
ANNUAL FINANCIAL REPORT
For The Year Ended September 30, 2006

TABLE OF CONTENTS

	<u>Page</u>	<u>Exhibit</u>
FINANCIAL SECTION		
Independent Auditors' Report on Financial Statements.....	1	
Management's Discussion and Analysis (Required Supplementary Information).....	5	
<u>Basic Financial Statements</u>		
Government-wide Financial Statements:		
Statement of Net Assets.....	13	A-1
Statement of Activities.....	14	A-2
Fund Financial Statements:		
Balance Sheet - Governmental Funds.....	16	A-3
Reconciliation of the Governmental Funds		
Balance Sheet to the Statement of Net Assets.....	19	A-4
Statement of Revenues, Expenditures, and Changes in		
Fund Balances - Governmental Funds.....	20	A-5
Reconciliation of the Statement of Revenues, Expenditures, and Changes in		
Fund Balances of Governmental Funds to the Statement of Activities.....	23	A-6
Statement of Net Assets - Enterprise Fund.....	24	A-7
Statement of Revenues, Expenses, and Changes in		
Fund Net Assets - Enterprise Fund.....	25	A-8
Statement of Cash Flows - Enterprise Fund.....	26	A-9
Notes to the Financial Statements	27	
<u>Required Supplementary Information:</u>		
Budgetary Comparison Schedules:		
General Fund.....	47	B-1
<u>Combining Statements and Budgetary Comparison Schedules as Supplementary Information:</u>		
Special Revenue Funds:		
Combining Balance Sheet - Nonmajor Special Revenue Funds.....	50	D-1
Combining Statement of Revenues, Expenditures and Changes		
in Fund Balances - Nonmajor Special Revenue Funds.....	51	D-2
Budgetary Comparison Schedules:		
H.E.D.C - 4A.....	52	D-3
H.M.B.C. - 4B.....	53	D-4
Debt Service Funds:		
Budgetary Comparison Schedule:		
Debt Service Fund.....	54	D-5

This page is left blank intentionally.

Financial Section

This page is left blank intentionally.

RUTLEDGE CRAIN & COMPANY, PC
CERTIFIED PUBLIC ACCOUNTANTS

2401 Garden Park Court, Suite B
Arlington, Texas 76013

INDEPENDENT AUDITORS' REPORT

City Council
City of Heath, Texas
200 Laurence
Heath, Texas

Members of the City Council:

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 Heath, Texas, (the City) as of and for the year ended September 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Heath, Texas' management. Our responsibility is to express an opinion 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Heath, Texas, as of September 30, 2006, 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.

The Management's Discussion and Analysis and budgetary comparison schedules on pages 5 through 10 and page 47 through 48, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Heath, Texas' basic financial statements. The combining financial statements and individual nonmajor fund schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements and individual nonmajor fund schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Rutledge Crain & Company, PC

November 3, 2006

This page is left blank intentionally.

Management's Discussion and Analysis

This page is left blank intentionally.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis provides a narrative overview and analysis of the financial activities of the City of Heath "City" for the fiscal year ended September 30, 2006. We encourage readers to consider the information presented here in conjunction with information furnished in the City's financial statements, which follows this section.

Financial Highlights

- City assets exceeded City liabilities at year end by \$41,713,816 (net assets). Of this amount, \$6,906,985 (unrestricted net assets) may be used to meet the government's ongoing obligations to citizens and creditors.
- Total net assets increased by \$12,389,586 (42%) during the year largely from contributed capital.
- The combined ending fund balances of the City's governmental funds rose by \$296,795 during the year to \$4,828,525 at year end. Increases in the General Fund of \$312,455, Debt Service Fund of \$217,155, and Other Governmental Funds of \$293,685, were partially offset by an intended spend down of fund balance in the Capital Projects Fund.
- The unreserved portion of the General Fund fund balance rose by \$304,825 or 12.6% during the year to \$2,715,760 at year end or 76% of total General Fund expenditures and transfers out.
- Total City debt declined by \$597,754 or 3.9% during the year due to scheduled debt retirements.

Overview of the Financial Statements

The Management Discussion and Analysis is intended to serve as an introduction to the City of Heath's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide Financial Statements. The government-wide financial statements provide a broad overview of the City of Heath's finances in a manner similar to a private-sector business. Two statements, the Statement of Net Assets and the Statement of Activities, provide this financial overview.

- The Statement of Net Assets presents information on all of the City's assets and liabilities with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating. The Statement of Net Assets can be found on page 13.
- The Statement of Activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flow. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). The Statement of Activities can be found on pages 14 and 15.

Both of the government-wide statements distinguish between two types of activities: 1) governmental activities and 2) business-type activities. Governmental activities are basically those activities that are supported by taxes and intergovernmental revenues. Business-type activities are basically those activities that are supported by user fees and charges. Most City services are reported in governmental activities while business-type activities are reported in the Enterprise Fund.

The government-wide financial statements include not only the City of Heath, but also component units: the Heath Economic Development Corporation (HEDC) and Heath Municipal Benefits Corporation (HMBC). Although legally separate, the City is financially accountable for the HEDC and the HMBC.

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

City of Heath, Texas
Management's Discussion and Analysis (continued)
September 30, 2006

1. **Governmental funds.** Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. 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 fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City of Heath maintains six individual governmental funds. Information is presented separately in the Governmental Fund Balance Sheet and in the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances for the General Fund, Capital Improvements Fund and the Debt Service Fund which are considered to be major funds. Data from the other three funds are combined into a single aggregated presentation. Individual fund data for each of the non-major funds is provided in the form of combining statements elsewhere in this report.

2. **Proprietary funds.** The City maintains one proprietary fund: the enterprise fund. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses an enterprise fund to account for its water and sewer operations.

Proprietary funds financial statements provide the same type of information as the government-wide financial statements, only in more detail.

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

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information. Required supplementary information can be found after the notes to the financial statements.

Government-wide Financial Analysis

At the end of fiscal year 2006, the City's net assets (assets exceeding liabilities) totaled \$41,713,816. This analysis focuses on the net assets (Table 1) and changes in net assets (Table 2).

Net Assets. The largest portion of the City's net assets, \$33,448,297 or 80.2%, reflects its investment in capital assets (land, buildings, improvements other than buildings, machinery and equipment, construction in progress), less any related debt used to acquire those assets that is still outstanding. The City uses these assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the City reports its capital assets net of related debt, the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City's net assets, \$1,358,534 or 3.3% represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$6,906,985 or 16.5%, may be used to meet the government's ongoing obligations to citizens and creditors.

**City of Heath, Texas
Management's Discussion and Analysis (continued)
September 30, 2006**

**Table 1
Condensed Statement of Net Assets**

	Governmental Activities		Business-type Activities		Total	
	9/30/06	9/30/05	9/30/06	9/30/05	9/30/06	9/30/05
Current and other assets	\$5,968,469	\$5,520,566	\$4,167,138	\$5,381,671	\$10,135,607	\$10,902,237
Capital assets	24,983,259	16,968,904	23,053,280	20,494,457	48,036,539	37,463,361
Total Assets	30,951,728	22,489,470	27,220,418	25,876,128	58,172,146	48,365,598
Long term liabilities	6,811,408	7,135,974	8,422,611	8,752,528	15,234,019	15,888,502
Other liabilities	535,937	285,111	688,374	2,867,755	1,224,311	3,152,866
Total Liabilities	7,347,345	7,421,085	9,110,985	11,620,283	16,458,330	19,041,368
Net Assets:						
Invested in capital assets, net of related debt	18,837,137	10,468,375	14,611,160	11,724,391	33,448,297	22,192,766
Restricted for debt service	1,347,501	1,270,176	--	--	1,347,501	1,270,176
Restricted for capital projects	11,033	537,392	--	--	11,033	537,392
Excess of restricted assets over restricted liabilities	--	--	--	1,566,904	--	1,566,904
Unrestricted	3,408,712	2,792,442	3,498,273	964,550	6,906,985	3,756,992
Total Net Assets	23,604,383	\$15,068,385	\$18,109,433	\$14,255,845	\$41,713,816	\$29,324,230

Changes in Net Assets. The net assets of the City increased by \$12,389,586 or 42.3% during the fiscal year ending September 30, 2006.

Governmental Activities. Governmental activities increased the City's net assets by \$8,535,998 or 56.6% from the prior year. This increase was primarily the result of capital grants and contributions.

Business-type Activities. Net assets from business-type activities increased by \$3,853,588 or 27% from the prior year. This increase was also largely the result of capital grants and contributions. Increased revenues resulting from both the growth of the customer base and higher levels of water consumption also contributed to the increase.

**City of Heath, Texas
Management's Discussion and Analysis (continued)
September 30, 2006**

Table 2
Changes in Net Assets

	Governmental		Business-type		Total	
	Activities		Activities			
	9/30/06	9/30/05	9/30/06	9/30/05	9/30/06	9/30/05
Revenues:						
Program revenues:						
Charges for services	\$554,712	\$518,594	\$3,288,982	\$2,712,152	\$3,843,694	\$3,230,746
Operating grants	13,926	30,631	--	--	13,926	30,631
Capital grants	8,687,378	1,155,398	3,746,562	3,087,794	12,433,940	4,243,192
General revenues:						0
Ad valorem taxes	2,750,401	2,552,545	--	--	2,750,401	2,552,545
Sales taxes	651,212	553,424	--	--	651,212	553,424
Franchise taxes	508,640	293,995	--	--	508,640	293,995
Alcoholic beverage taxes	3,147	3,533	--	--	3,147	3,533
Miscellaneous	14,984	274,792	39,961	167,088	54,945	441,880
Interest income	248,428	53,469	42,220	41,902	290,648	95,371
Gain on capital assets sale	1,141	64,034	--	--	1,141	64,034
Total revenues	13,433,969	5,500,415	7,117,725	6,008,936	20,551,694	11,509,351
Expenses:						
General government	1,101,712	806,768	--	--	1,101,712	806,768
Highways and streets	1,228,466	856,215	--	--	1,228,466	856,215
Parks	190,621	192,694	--	--	190,621	192,694
Building inspection	279,651	174,864	--	--	279,651	174,864
Municipal court	115,321	105,945	--	--	115,321	105,945
Public safety	1,705,415	1,640,083	--	--	1,705,415	1,640,083
Economic development	227	2,698	--	--	227	2,698
Economic opportunity	127	2,998	--	--	127	2,998
Interest and fiscal charges	276,431	278,350	--	--	276,431	278,350
Water and sewer operation	--	--	3,264,137	2,771,907	3,264,137	2,771,907
Total expenses	4,897,971	4,060,615	3,264,137	2,771,907	8,162,108	6,832,522
Increase in net assets	8,535,998	1,439,800	3,853,588	3,237,029	12,389,586	4,676,829
Net assets - October 1	15,068,385	13,628,585	14,255,845	11,018,816	29,324,230	24,647,401
Net assets - September 30	<u>\$23,604,383</u>	<u>\$15,068,385</u>	<u>\$18,109,433</u>	<u>\$14,255,845</u>	<u>\$41,713,816</u>	<u>\$29,324,230</u>

Government-Wide Financial Analysis

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

As of the end of the current fiscal year, the City's governmental funds reported combined fund balances of \$4,828,525.

**City of Heath, Texas
Management's Discussion and Analysis (continued)
September 30, 2006**

The General Fund is the main operating fund of the City. At the end of the current fiscal year, unreserved fund balance was \$2,715,760. During the current fiscal year, the fund balance of the General Fund increased by \$312,455. Key factors of the increase are as follows:

- Property and sales tax revenue increased from the previous year by \$294,959.
- Interest income increased by \$150,762.

The fund balance in the Total Nonmajor Governmental Funds increased by \$293,685 mostly due to restrained expenditures.

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

General Fund Budgetary Highlights. In fiscal 2006, there were no changes from the initially approved budget at the beginning of the fiscal year and the final budget for the end of the fiscal year. Actual expenditures were 5.7% more than budgeted and actual revenues exceeded budgeted revenues by 21.6%

Capital Assets and Debt Administration

Capital Assets. The City's investment in capital assets for its governmental and business-type activities as of September 30, 2006, amounts to \$48,036,539 (net of accumulated depreciation). The investment in capital assets includes land, buildings, improvements other than buildings, machinery and equipment, and construction in progress. The total increase in the City's investment in capital assets for the current year was 28.2%.

Table 3

Capital Assets at Year-end

Net of Accumulated Depreciation

Asset	Governmental Activities		Business-type Activities		Total	
	9/30/06	9/30/05	9/30/06	9/30/05	9/30/06	9/30/05
Land	\$2,832,651	\$2,832,651	\$ --	\$ --	\$2,832,651	\$2,832,651
Buildings	1,237,900	1,302,895	185,704	195,487	1,423,604	1,498,382
Improvements	1,233,967	657,125	21,133,829	17,704,078	22,367,796	18,361,203
Infrastructure	18,710,780	11,633,982	--	--	18,710,780	11,633,982
Machinery & equipment	913,961	542,251	16,048	22,450	930,009	564,701
Construction in progress	54,000	--	1,717,699	2,572,442	1,771,699	2,572,442
	<u>\$24,983,259</u>	<u>\$16,968,904</u>	<u>\$23,053,280</u>	<u>\$20,494,457</u>	<u>\$48,036,539</u>	<u>\$37,463,361</u>

Debt administration. At the end of the current fiscal year, the City of Heath had total bonded debt outstanding of \$14,903,476.

**City of Heath, Texas
Management's Discussion and Analysis (continued)
September 30, 2006**

Table 4
Outstanding Bonded Debt at Year End

Type of Debt	Governmental Activities		Business-type Activities		Total	
	9/30/06	9/30/05	9/30/06	9/30/05	9/30/06	9/30/05
General Obligation	\$2,340,000	\$2,495,000	\$ --	\$ --	\$2,340,000	\$2,495,000
Contract Revenue Bonds	-	-	973,236	1,006,566	973,236	1,006,566
Certificates of Obligation	4,142,500	4,258,750	7,532,500	7,831,250	11,675,000	12,090,000
Deferred Discount	(21,144)	(22,586)	(63,616)	(67,750)	(84,760)	(90,336)
	<u>\$6,461,356</u>	<u>\$6,731,164</u>	<u>\$8,442,120</u>	<u>\$8,770,066</u>	<u>\$14,903,476</u>	<u>\$15,501,230</u>

The City maintains favorable ratings from bond rating agencies. The City's General Obligation and Certificates of Obligation ratings are as follows:

	Moody's <u>Investors Service</u>	<u>Fitch</u>
General obligation bonds	A3	A+
Certificates of obligation	A3	A+

Additional information on the City's long-term debt can be found in the notes to the financial statements.

Economic Factors and Next Years's Budgets and Rates

The City continues to experience steady growth as evidenced by the more than 100 residential building permits issued in fiscal 2006. Accompanying the building activity was an increase of \$115 million or 14.5% in the assessed valuation of taxable property. There was a 5% estimated population growth during fiscal 2006. This steady growth trend is expected to continue into fiscal 2007 and impacted the development of the fiscal 2007 budget.

Fiscal 2007 General Fund revenues and expenditures are budgeted to increase by 5% and 56% respectively over budgeted fiscal 2006 revenues and expenditures. The City intends to utilize designated fund balance to fund street improvements. Growth in our revenue base will also be utilized to offset the growing demand for services.

Fiscal 2007 Water and Sewer Fund operating revenues and expenses are budgeted consistent with fiscal 2006 levels.

The City maintained the same ad valorem tax rate for the fifteenth consecutive year. While the tax rate remained unchanged, overall tax revenues increased due to new development and increases in appraised values of existing properties.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, City of Heath, 200 Laurence Drive, Heath, Texas, 75032.

Basic Financial Statements

This page is left blank intentionally.

CITY OF HEATH, TEXAS
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2006

	Governmental Activities	Business-type Activities	Total
ASSETS			
<i>Cash and cash equivalents</i>	\$ 256,703	\$ --	\$ 256,703
<i>Investments</i>	6,544,673	353,005	6,897,678
Receivables (net of allowances for uncollectibles):			
<i>Taxes</i>	82,346	--	82,346
<i>Accounts</i>	240,514	671,302	911,816
<i>Special assessments</i>	241,056	31,482	272,538
<i>Intergovernmental</i>	175,775	--	175,775
<i>Internal balances</i>	(2,084,711)	2,084,711	--
<i>Prepaid items</i>	7,630	--	7,630
<i>Inventories</i>	--	6,138	6,138
Restricted assets:			
<i>Cash and cash equivalents</i>	--	244,236	244,236
<i>Investments</i>	405,790	657,595	1,063,385
<i>Deferred charges</i>	98,693	118,669	217,362
Capital assets (net of accumulated depreciation):			
<i>Land</i>	2,832,651	--	2,832,651
<i>Buildings</i>	1,237,900	185,704	1,423,604
<i>Improvements other than buildings</i>	1,233,967	21,133,829	22,367,796
<i>Infrastructure</i>	18,710,780	--	18,710,780
<i>Machinery and equipment</i>	913,961	16,048	930,009
<i>Construction in progress</i>	54,000	1,717,699	1,771,699
Total Assets	30,951,728	27,220,418	58,172,146
LIABILITIES			
<i>Accounts payable</i>	31,868	384,485	416,353
<i>Accrued liabilities and other payables</i>	88,995	37,813	126,808
<i>Due to other governments</i>	9,284	--	9,284
Liabilities payable from restricted assets	405,790	266,076	671,866
Noncurrent liabilities:			
<i>Due within one year</i>	487,259	325,071	812,330
<i>Due in more than one year</i>	6,324,149	8,097,540	14,421,689
Total Liabilities	7,347,345	9,110,985	16,458,330
NET ASSETS			
<i>Invested in Capital Assets, Net of Related Debt</i>	18,837,137	14,611,160	33,448,297
Restricted For:			
<i>Debt Service</i>	1,347,501	--	1,347,501
<i>Capital Projects</i>	11,033	--	11,033
<i>Unrestricted</i>	3,408,712	3,498,273	6,906,985
Total Net Assets	\$ 23,604,383	\$ 18,109,433	\$ 41,713,816

The accompanying notes are an integral part of this statement.

CITY OF HEATH, TEXAS
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2006

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
PRIMARY GOVERNMENT:				
Expenditures:				
Governmental Activities:				
<i>Administration</i>	1,101,712	21,512	--	--
<i>Highways and streets</i>	1,228,466	27,253	--	8,532,358
<i>Parks</i>	190,621	4,463	4,207	155,020
<i>Building inspection</i>	279,651	276,066	--	--
<i>Municipal court</i>	115,321	5,609	--	--
<i>Public safety</i>	1,705,415	219,809	9,719	--
<i>Economic development and assistance</i>	227	--	--	--
<i>Economic opportunity</i>	127	--	--	--
<i>Interest and fiscal charges</i>	276,431	--	--	--
Total expenditures	<u>4,897,971</u>	<u>554,712</u>	<u>13,926</u>	<u>8,687,378</u>
Business-type Activities:				
Water and Sewer	3,264,137	3,288,982	--	3,746,562
Total Primary Government	<u>\$ 8,162,108</u>	<u>\$ 3,843,694</u>	<u>\$ 13,926</u>	<u>\$ 12,433,940</u>

General Revenues:
Property Taxes
Sales Taxes
Franchise Taxes
Alcoholic Beverage Taxes
Miscellaneous
Unrestricted Investment Earnings
Gain on Sale of Capital Assets
Total General Revenues
Change in Net Assets
Net Assets - Beginning
Net Assets - Ending

The accompanying notes are an integral part of this statement.

Net (Expense) Revenue and Changes in Net Assets

<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
(1,080,200)		(1,080,200)
7,331,145		7,331,145
(26,931)		(26,931)
(3,585)		(3,585)
(109,712)		(109,712)
(1,475,887)		(1,475,887)
(227)		(227)
(127)		(127)
(276,431)		(276,431)
<u>4,358,045</u>		<u>4,358,045</u>
--	\$ 3,771,407	3,771,407
<u>4,358,045</u>	<u>3,771,407</u>	<u>8,129,452</u>
2,750,401	--	2,750,401
651,212	--	651,212
508,640	--	508,640
3,147	--	3,147
14,984	39,961	54,945
248,428	42,220	290,648
1,141	--	1,141
<u>4,177,953</u>	<u>82,181</u>	<u>4,260,134</u>
8,535,998	3,853,588	12,389,586
15,068,385	14,255,845	29,324,230
<u>\$ 23,604,383</u>	<u>\$ 18,109,433</u>	<u>\$ 41,713,816</u>

CITY OF HEATH, TEXAS

BALANCE SHEET - GOVERNMENTAL FUNDS

SEPTEMBER 30, 2006

	General Fund	Capital Improvements Fund
ASSETS		
<i>Cash and cash equivalents</i>	\$ 750	\$ --
<i>Investments</i>	5,347,400	665,286
Receivables (net of allowances for uncollectibles):		
<i>Taxes</i>	65,844	--
<i>Accounts</i>	5,352	--
<i>Special assessments</i>	--	--
<i>Intergovernmental</i>	99,895	--
<i>Due from other funds</i>	--	--
<i>Prepaid items</i>	7,630	--
Restricted assets:		
<i>Investments</i>	405,790	--
Total Assets	<u>\$ 5,932,661</u>	<u>\$ 665,286</u>
LIABILITIES AND FUND BALANCES		
Liabilities:		
<i>Accounts payable</i>	\$ 31,868	\$ --
<i>Accrued liabilities and other payables</i>	55,557	--
<i>Due to other governments</i>	9,284	--
<i>Due to other funds</i>	2,649,278	654,253
Liabilities payable from restricted assets		
<i>Impact fees payable</i>	162,000	--
<i>Street escrow funds</i>	243,790	--
<i>Deferred revenue</i>	57,494	--
Total Liabilities	<u>3,209,271</u>	<u>654,253</u>
Fund balances:		
Reserved for:		
<i>Reserved for prepaid items</i>	7,630	--
<i>Debt service</i>	--	--
Unreserved, reported in:		
<i>General fund</i>	1,215,760	--
<i>General fund, designated for streets</i>	1,500,000	--
<i>Special revenue funds</i>	--	--
<i>Capital projects funds</i>	--	11,033
Total fund balances	<u>2,723,390</u>	<u>11,033</u>
Total Liabilities and Fund Balances	<u>\$ 5,932,661</u>	<u>\$ 665,286</u>

The accompanying notes are an integral part of this statement.

Debt Service Fund	Other Governmental Funds	Total Governmental Funds
\$ 63,265	\$ 192,689	\$ 256,704
531,986	--	6,544,672
16,502	--	82,346
--	--	5,352
241,056	--	241,056
--	75,880	175,775
494,693	724,127	1,218,820
--	--	7,630
--	--	405,790
<u>\$ 1,347,502</u>	<u>\$ 992,696</u>	<u>\$ 8,938,145</u>
\$ --	\$ --	\$ 31,868
--	--	55,557
--	--	9,284
--	--	3,303,531
--	--	162,000
--	--	243,790
246,096	--	303,590
<u>246,096</u>	<u>--</u>	<u>4,109,620</u>
--	--	7,630
1,101,406	--	1,101,406
--	--	1,215,760
--	--	1,500,000
--	992,696	992,696
--	--	11,033
<u>1,101,406</u>	<u>992,696</u>	<u>4,828,525</u>
<u>\$ 1,347,502</u>	<u>\$ 992,696</u>	<u>\$ 8,938,145</u>

This page is left blank intentionally.

CITY OF HEATH, TEXAS

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
SEPTEMBER 30, 2006

Total fund balances - governmental funds balance sheet	\$ 4,828,525
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not reported in the funds.	24,983,259
Property taxes receivable unavailable to pay for current period expenditures are deferred in the funds.	64,874
Payables for bond principal which are not due in the current period are not reported in the funds.	(6,461,356)
Payables for capital leases which are not due in the current period are not reported in the funds.	(217,853)
Payables for bond interest which are not due in the current period are not reported in the funds.	(33,438)
Payables for compensated absences which are not due in the current period are not reported in the funds.	(132,199)
Other long-term assets are not available to pay for current-period expenditures and are deferred in the funds.	98,693
Court fines receivable unavailable to pay for current period expenditures are deferred in the funds.	5,352
Franchise taxes receivable unavailable to pay for current period expenditures are not accrued in the funds.	235,162
Assessments receivable unavailable to pay for current period expenditures are deferred in the funds.	233,364
	<hr/>
Net assets of governmental activities - statement of net assets	\$ <u>23,604,383</u>

The accompanying notes are an integral part of this statement.

CITY OF HEATH, TEXAS

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS FOR THE YEAR ENDED SEPTEMBER 30, 2006

	General Fund	Capital Improvements Fund
Revenues:		
<i>Taxes</i>	\$ 2,978,615	\$ --
<i>Licenses and permits</i>	287,814	--
<i>Intergovernmental</i>	119,913	--
<i>Charges for services</i>	49,073	--
<i>Fines</i>	97,706	--
<i>Special assessments</i>	--	--
<i>Interest</i>	179,932	32,886
<i>Miscellaneous</i>	183,052	--
Total revenues	<u>3,896,105</u>	<u>32,886</u>
Expenditures:		
Current:		
<i>Administration</i>	1,074,008	--
<i>Highways and streets</i>	273,730	--
<i>Parks</i>	149,324	--
<i>Building inspection</i>	300,154	--
<i>Municipal court</i>	112,883	--
<i>Public safety</i>	1,674,692	--
<i>Economic development and assistance</i>	--	--
<i>Economic opportunity</i>	--	--
Capital outlay	--	559,245
Debt service:		
<i>Principal</i>	--	--
<i>Interest and fiscal charges</i>	--	--
Total expenditures	<u>3,584,791</u>	<u>559,245</u>
 Excess (deficiency) of revenues over (under) expenditures	 311,314	 (526,359)
Other financing sources (uses):		
<i>Sale of capital assets</i>	1,141	--
Total other financing sources (uses)	<u>1,141</u>	<u>--</u>
 Net change in fund balances	 312,455	 (526,359)
 Fund balances, October 1	 2,410,935	 537,392
Fund balances, September 30	<u>\$ 2,723,390</u>	<u>\$ 11,033</u>

The accompanying notes are an integral part of this statement.

Debt Service Fund	Other Governmental Funds	Total Governmental Funds
\$ 559,005	\$ 325,474	\$ 3,863,094
--	--	287,814
--	--	119,913
--	--	49,073
--	--	97,706
112,192	--	112,192
51,452	12,104	276,374
--	--	183,052
<u>722,649</u>	<u>337,578</u>	<u>4,989,218</u>
--	--	1,074,008
--	--	273,730
--	--	149,324
--	--	300,154
--	--	112,883
--	--	1,674,692
--	227	227
--	127	127
--	--	559,245
252,000	19,250	271,250
253,494	24,289	277,783
<u>505,494</u>	<u>43,893</u>	<u>4,693,423</u>
217,155	293,685	295,795
--	--	1,141
<u>217,155</u>	<u>293,685</u>	<u>296,936</u>
884,251	699,011	4,531,589
<u>\$ 1,101,406</u>	<u>\$ 992,696</u>	<u>\$ 4,828,525</u>

This page is left blank intentionally.

CITY OF HEATH, TEXAS

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2006

Net change in fund balances - total governmental funds	\$ 296,936
Amounts reported for governmental activities in the statement of activities ("SOA") are different because:	
Capital outlays are not reported as expenses in the SOA.	537,053
The depreciation of capital assets used in governmental activities is not reported in the funds.	(1,059,605)
Donations of capital assets increase net assets in the SOA but not in the funds.	8,536,906
Certain property tax revenues are deferred in the funds. This is the change in these amounts this year.	13,802
Repayment of bond principal is an expenditure in the funds but is not an expense in the SOA.	271,250
Repayment of capital lease principal is an expenditure in the funds but is not an expense in the SOA.	49,341
Bond issuance costs and similar items are amortized in the SOA but not in the funds	(9,357)
(Increase) decrease in accrued interest from beginning of period to end of period	1,353
Compensated absences are reported as the amount earned in the SOA but as the amount paid in the funds.	5,418
Certain assessment revenues are deferred in the funds. This is the change in these amounts this year.	(144,686)
Revenues in the SOA for court fines not providing current financial resources are not reported in the funds.	1,084
Revenues in the SOA for franchise taxes not providing current financial resources are not reported in the funds.	<u>36,503</u>
Change in net assets of governmental activities - statement of activities	<u>\$ 8,535,998</u>

The accompanying notes are an integral part of this statement.

CITY OF HEATH, TEXAS

STATEMENT OF NET ASSETS

ENTERPRISE FUND

SEPTEMBER 30, 2006

	Enterprise Fund <u>Water and Sewer Fund</u>
ASSETS	
Current assets:	
<i>Investments</i>	\$ 353,005
Receivables (net of allowances for uncollectibles):	
<i>Accounts</i>	671,302
<i>Special assessments</i>	31,482
<i>Due from other funds</i>	2,084,711
<i>Inventories</i>	6,138
Total current assets	<u>3,146,638</u>
Restricted assets:	
<i>Cash and cash equivalents</i>	244,235
<i>Investments</i>	657,595
Total restricted assets	<u>901,830</u>
<i>Deferred charges</i>	118,669
Capital assets:	
<i>Buildings</i>	215,224
<i>Improvements other than buildings</i>	24,658,229
<i>Machinery and equipment</i>	78,877
<i>Construction in progress</i>	1,717,699
<i>Accumulated depreciation</i>	(3,616,749)
Total capital assets (net of accumulated depreciation)	<u>23,053,280</u>
Total Assets	<u>27,220,417</u>
LIABILITIES	
Current liabilities:	
<i>Accounts payable</i>	384,484
<i>Accrued liabilities and other payables</i>	37,813
<i>Compensated liabilities</i>	13,821
<i>Combination tax and revenue bonds - current portion</i>	311,250
Total current liabilities	<u>747,368</u>
Liabilities payable from restricted assets:	
<i>Impact fees payable</i>	184,586
<i>Instalment sales contract - current portion</i>	33,330
<i>Accrued interest payable</i>	48,160
Total liabilities payable from restricted assets:	<u>266,076</u>
Noncurrent liabilities:	
<i>Combination tax and revenue bonds</i>	7,157,634
<i>Instalment sales contract</i>	939,906
Total noncurrent liabilities:	<u>8,097,540</u>
Total Liabilities	<u>9,110,984</u>
NET ASSETS	
<i>Invested in capital assets, net of related debt</i>	14,611,160
<i>Restricted for excess of restricted assets over restricted liabilities</i>	634,920
<i>Unrestricted</i>	2,863,353
Total Net Assets	<u>\$ 18,109,433</u>

The accompanying notes are an integral part of this statement.

CITY OF HEATH, TEXAS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES
 IN FUND NET ASSETS - ENTERPRISE FUND
 FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Enterprise Fund Water and Sewer Fund
OPERATING REVENUES:	
<i>Water sales</i>	\$ 2,139,730
<i>Sewer charges</i>	571,109
<i>Sanitation charges</i>	319,397
<i>Taps fees, penalty and other</i>	258,746
Total Operating Revenues	<u>3,288,982</u>
OPERATING EXPENSES:	
<i>Personal services - salaries and wages</i>	331,543
<i>Supplies and services</i>	134,654
<i>Operational costs</i>	1,619,755
<i>Materials & equipment</i>	220,895
<i>Depreciation and amortization</i>	593,357
Total Operating Expenses	<u>2,900,204</u>
Operating Income (Loss)	<u>388,778</u>
NON-OPERATING REVENUES (EXPENSES):	
<i>Other income</i>	39,961
<i>Interest revenue</i>	42,220
<i>Interest expense</i>	(363,933)
Total Non-operating Revenues (Expenses)	<u>(281,752)</u>
Net Income (Loss) before Transfers and Capital Contributions	<u>107,026</u>
TRANSFERS AND CAPITAL CONTRIBUTIONS:	
<i>Capital contributions</i>	3,746,562
Change in net assets	<u>3,853,588</u>
Net assets, October 1	14,255,845
Net assets, September 30	<u>\$ 18,109,433</u>

The accompanying notes are an integral part of this statement.

CITY OF HEATH, TEXAS

STATEMENT OF CASH FLOWS

ENTERPRISE FUND

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Enterprise Fund <u>Water and Sewer Fund</u>
Cash Flows from Operating Activities:	
<i>Cash Received from Customers</i>	\$ 3,182,161
<i>Cash Payments to Employees for Services</i>	(333,514)
<i>Cash Payments to Other Suppliers for Goods and Services</i>	(2,312,013)
Net Cash Provided (Used) by Operating Activities	<u>536,634</u>
Cash Flows from Non-capital Financing Activities:	
<i>Paid to other funds</i>	(2,084,711)
Net Cash Provided (Used) for Capital & Related Financing Activities	<u>(2,084,711)</u>
Cash Flows from Capital and Related Financing Activities:	
<i>Principal and Interest Paid</i>	(676,384)
<i>Acquisition or Construction of Capital Assets</i>	(3,100,991)
<i>Impact Fees Received</i>	1,922,438
Net Cash Provided (Used) for Capital & Related Financing Activities	<u>(1,854,937)</u>
Cash Flows from Investing Activities:	
<i>Interest and Dividends on Investments</i>	42,220
Net Cash Provided (Used) for Investing Activities	<u>42,220</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>(3,360,794)</u>
Cash and Cash Equivalents at Beginning of Year	
<i>Cash</i>	964,351
<i>Investments</i>	2,476
<i>Restricted Cash</i>	2,088,972
<i>Restricted Investments</i>	1,559,830
	<u>4,615,629</u>
Cash and Cash Equivalents at End of Year	
<i>Investments</i>	353,005
<i>Restricted Cash</i>	244,235
<i>Restricted Investments</i>	657,595
	<u>\$ 1,254,835</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating Income (Loss)	\$ 388,778
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities	
<i>Depreciation and amortization</i>	593,357
<i>Other Income</i>	39,961
Change in Assets and Liabilities:	
<i>Decrease (Increase) in Receivables</i>	(154,117)
<i>Decrease (Increase) in Assessments</i>	7,335
<i>Decrease (Increase) in Due from other Governments</i>	23,213
<i>Decrease (Increase) in Inventories</i>	1,775
<i>Increase (Decrease) in Accounts Payable</i>	(322,661)
<i>Increase (Decrease) in Accrued Expenses</i>	(34,466)
<i>Increase (Decrease) in Compensated Absences</i>	(1,971)
<i>Increase (Decrease) in Due to other Governments</i>	(4,570)
Total Adjustments	<u>147,856</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ 536,634</u>
Noncash Transactions Affecting Balance Sheet:	
<i>Recognition of Capital Contributions</i>	<u>\$ 3,746,562</u>

The accompanying notes are an integral part of this statement.

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies, methods and procedures adopted by the City of Heath, Texas conform to generally accepted accounting principles (GAAP) as applicable to governments. The following notes to the financial statements are an integral part of the basic financial statements.

A. Reporting Entity

The City, a political subdivision of the state of Texas, is governed by an elected mayor and four City Councilmen which comprise the City Council. The City provides a full range of municipal services including public safety (police and fire), highway and streets, parks and recreation, health and social services, planning and zoning, and general administrative services. In addition, the City provides water and sewer service as a proprietary function of the City.

For financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GAAP. The criteria used are as follows:

Financial Accountability - The primary government is deemed to be financially accountable if it appoints a voting majority of the organization's governing body and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits or impose specific financial burdens on the primary government. Additionally, the primary government may be financially accountable if an organization is fiscally dependent on the primary government regardless of whether the organization has a separately elected governing board, a governing board appointed by a higher level of government or a jointly appointed board.

Blended Component Units

The Heath Economic Development Corporation (HEDC) is governed by a five member board of directors appointed, at will, by the City Council. Although it is legally separate from the City, it is reported as if it was part of the City (blended) since its sole purpose is to act on behalf of the City. HEDC collects a half cent sales tax to support its activities. The City is the primary beneficiary of HEDC's activities. Stand alone financial statements for HEDC as of and for the fiscal year ended September 30, 2006 have not been prepared.

The City of Heath Municipal Benefits Corporation (HMBC) is governed by a five member board of directors appointed, at will, by the City Council. Although it is legally separate from the City, it is reported as if it was part of the City (blended) since its sole purpose is to act on behalf of the City. HMBC collects a half cent sales tax to support its activities. The City is the primary beneficiary of HMBC's activities. Stand alone financial statements for HMBC as of and for the fiscal year ended September 30, 2006 have not been prepared.

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e. the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely, to a significant extent, on fees and charges for support. Likewise, the *primary government* is reported separately from certain legally separate *component units* for which the primary government is financially accountable.

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

Separate financial statements are provided for governmental funds and proprietary funds. Major individual enterprise funds are reported as separate columns in the fund financial statements.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic *resources measurement focus* and the accrual *basis of accounting*, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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

Property taxes and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Sales taxes collected and held by the State and merchants at year end on behalf of the City are also recognized as revenue. Franchise taxes, fines and permits, and miscellaneous revenues are not susceptible to accrual because generally they are not measurable until received in cash.

The City reports the following major governmental funds:

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

The *Capital Improvements Fund* accounts for the acquisition of capital assets or the construction of major capital projects (such as streets and sidewalks) not being financed by proprietary funds.

The *Debt Service Fund* accounts for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

The City reports the following major proprietary fund:

The *Water and Sewer Fund* operates the water distribution system and the wastewater treatment plants, wastewater pumping stations, and collection systems.

Additionally, the City reports the following fund types:

The Special Revenue Funds account for specific revenue sources that are legally restricted to expenditures for specified purposes (not including expendable trusts or major capital projects).

Drainage Fund - accounts for accumulation of assets to fund drainage projects.

H.E.D.C. 4A Sales Tax Revenue Fund - accounts for sales tax monies specifically designated for promoting economic development within the City by developing, implementing, providing, and financing various projects within the City.

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

M.E.B.C. 4B Sales Tax Revenue Fund - accounts for sales tax monies specifically designated for promoting economic development within the City by developing, implementing, providing, and financing park and recreation projects.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

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

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes, miscellaneous revenue, and interest income.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* 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. The principal operating revenues of the Water and Sewer enterprise fund are charges to customers for sales and services. The enterprise utility fund also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for the enterprise fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Assets, Liabilities and Equity

1. Cash and Cash Equivalents

The City's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

2. Investments

State statutes authorize the City to invest in (1) obligations of the United States or its agencies and instrumentalities; (2) direct obligations of the State of Texas or its agencies; (3) other obligations, the principal of and interest on which are unconditionally guaranteed or insured by the State of Texas or the United States; (4) obligations of states, agencies, counties, cities, and other political subdivisions of any state having been rated as to investment quality by a nationally recognized investment rating firm and having received a rating of not less than A or its equivalent; (5) certificates of deposit by state and national banks domiciled in this state that are (A) guaranteed or insured by the Federal Deposit Insurance Corporation, or its successor; or, (B) secured by obligations that are described by (1) - (4); or, (6) fully collateralized direct repurchase agreements having a defined termination date, secured by obligations described by (1), pledged with third party selected or approved by the City, and placed through a primary government securities dealer. Investments are stated at fair value.

3. Receivables and Payables

Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "interfund receivables/payables" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e. the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

All trade receivables are shown net of an allowance for uncollectibles. Trade accounts receivable in excess of 60 days comprise the trade allowance for uncollectibles.

No allowance for uncollectible property taxes has been provided because property taxes attach as an enforceable lien on property for up to 20 years per state statute. Any uncollected taxes at September 30 are recorded as taxes receivable and those which are not expected to be collected within 60 days are recorded as deferred revenue. Anticipated refunds of such taxes are recorded as liabilities and reductions of revenue when they are measurable and their validity seems certain.

The sequence for the levying and collection of property taxes is as follows:

January 1, 2006	Date at which taxable value and exemption status is determined; a tax lien attached to property to secure payments of taxes, penalties, and interest ultimately imposed for the year.
October 1, 2005	Tax assessor mails tax bills by this date or soon thereafter.
February 1, 2006	Unpaid property taxes are declared delinquent and interest and penalties begin accruing.
July 1, 2006	Delinquent taxes incur the maximum penalty and begin to incur additional penalty for attorney fees.

In Texas, county-wide central appraisal districts are required to assess all property within the appraisal district on the basis of 100% of its appraised value and are prohibited from applying any assessment ratios. The value of property within the appraisal district must be reviewed every four years; however, the City, at its own expense, may require an annual review of appraised values. The City or taxpayers may challenge appraised values established by the appraisal district through various appeals, and, if necessary, take legal action. Under this system, the City sets tax rates on City property. However, if the effective tax rate, excluding tax rates for bonds and other contractual obligations, adjusted for new improvements, exceeds the rate for the previous year by more than eight percent, qualified voters of the City may petition for an election to determine whether to limit the tax rate to no more than eight percent above the tax rate of the previous year.

4. Inventories

Inventories on the balance sheet are stated at weighted average cost. Inventory items are recorded as expenditures when used.

5. Restricted Assets

Certain proceeds of Water and Sewer Enterprise Fund revenue bonds, as well as certain resources set aside for their repayment, have been classified as restricted assets because their use is restricted by applicable bond covenants. Certain amounts escrowed by developers are considered restricted until conditions imposed on the amounts are met.

6. Capital assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 (amount not rounded) and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

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

Buildings	20 - 30 years
Improvements other than buildings	20 - 50 years
Machinery and Equipment	3 - 10 years

7. Compensated Absences

Vested or accumulated vacation leave and compensatory time expected to be liquidated with expendable available financial resources are reported as an expenditure and a fund liability of the governmental fund that will pay it. Amounts not expected to be liquidated with expendable available financial resources are reported in the governmental long-term debts. No expenditure is reported for these amounts.

8. Long-term obligations

In the government-wide financial statements, and proprietary fund type in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight line method which approximate the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

9. Fund equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

II. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

A. Explanation of certain differences between the governmental fund balance sheet and the government-wide statement of net assets:

The governmental fund balance sheet includes a reconciliation between *fund balance-total governmental funds* and *net assets – governmental activities* as reported in the government-wide statement of net assets. One element of that reconciliation explains that "Other long-term assets are not available to pay for current-period expenditures and are deferred in the funds." The details of this \$98,693 difference are as follows:

Deferred charges - bonds issuance costs:

City

\$98,693

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

III. DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. At year end, the carrying amount of the City's cash on hand and deposits was \$500,939 (\$244,236 restricted) and the bank balance was \$391,270. All of the bank balance was secured by federal deposit insurance (\$100,000) and collateral pledged by the depository in the City's name (fair value of \$1,220,969) and held by the depository's agent.

Custodial Credit Risk - Investments

For an investment, this is the risk that, in the event of the failure of the counterparty, the government will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All of the City's investments were held by the counter party's agent as of September 30, 2006.

Investments at September 30, 2006 were as follows:

<u>Description</u>	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Weighted Average Maturity (Yrs)</u>
Investments not subject to categorization			
TexPool	\$2,761,408	\$2,761,408	
TexStar	5,199,655	5,199,655	
Local government sponsored investment pool	\$7,961,063	\$7,961,063	0.066

The Texas Local Government Investment Pool ("TexPool") is an external investment pool operated by the Texas Comptroller of Public Accounts and is not SEC registered. The Texas Interlocal Cooperation Act and the Texas Public Funds Investments Act provide for creation of public funds investment pools and permit eligible governmental entities to jointly invest their funds in authorized investments. The State Comptroller has established an advisory board composed both of participants in TexPool and of other persons who do not have a business relationship with TexPool. The Advisory Board members review the investment policy and management fee structure.

The TexStar Participant Services Local Government Investment Pool ("TexStar") is an external investment pool operated by First Southwest Asset Management, Inc. and is not SEC registered. The Texas Interlocal Cooperation Act and the Texas Public Funds Investments Act provide for creation of public funds investment pools and permit eligible governmental entities to jointly invest their funds in authorized investments. The State Comptroller has established an advisory board composed both of participants in TexStar and of other persons who do not have a business relationship with TexStar. The Advisory Board members review the investment policy and management fee structure.

CITY OF HEATH, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006

B. Receivables

Receivables as of September 30, 2006 for the City's individual major funds and nonmajor funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	General	Capital Improvements	Debt Service	Water & Sewer	Nonmajor and Other	Total
Taxes - delinquent	\$65,844	\$ --	\$16,502	\$ --	\$ --	\$82,346
Accounts receivable	\$8,920	\$ --	\$ --	\$680,682	\$ --	\$689,602
Less allowance	(3,568)	--	--	(9,380)	--	(12,948)
Accounts receivable	\$5,352	\$ --	\$ --	\$671,302	\$ --	\$676,654
Special assessments	\$ --	\$ --	\$241,056	\$31,482	\$ --	\$272,538
Intergovernmental	\$99,895	\$ --	\$ --	\$ --	\$75,880	\$175,775

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of *deferred revenue* and *unearned revenue* reported in the governmental funds were as follows:

	Unavailable	Unearned
Delinquent property taxes receivable (General Fund)	\$52,142	\$ --
Delinquent property taxes receivable (Debt Service Fund)	\$12,732	--
Fines receivable (General Fund)	5,352	--
Assessments receivable (Debt Service Fund)	233,364	--
Total deferred/unearned revenue for governmental funds	\$303,590	\$ --

CITY OF HEATH, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006

C. Capital assets

Capital asset activity for the year ended September 30, 2006:

Primary Government

	Balance 9/30/05	Additions	Retirements	Completed Construction	Balance 9/30/06
GOVERNMENTAL ACTIVITIES:					
Capital assets, not being depreciated:					
Land	\$2,832,651	\$ --	\$ --	\$ --	\$2,832,651
Construction in progress	--	54,000	--	--	54,000
Total capital assets not being depreciated	<u>2,832,651</u>	<u>54,000</u>	<u>--</u>	<u>--</u>	<u>2,886,651</u>
Capital assets, being depreciated:					
Buildings	1,673,100	--	--	--	1,673,100
Improvements other than buildings	697,285	623,898	--	--	1,321,183
Infrastructure	19,684,677	7,913,008	--	--	27,597,685
Machinery and equipment	882,268	483,053	(150,672)	--	1,214,649
Total capital assets being depreciated	<u>22,937,330</u>	<u>9,019,959</u>	<u>(150,672)</u>	<u>--</u>	<u>31,806,617</u>
Less accumulated depreciation for:					
Buildings	(370,205)	(64,995)	--	--	(435,200)
Improvements other than buildings	(40,160)	(47,057)	--	--	(87,217)
Infrastructure	(8,050,695)	(836,210)	--	--	(8,886,905)
Machinery and equipment	(340,017)	(111,343)	150,672	--	(300,688)
Total accumulated depreciation	<u>(8,801,077)</u>	<u>(1,059,605)</u>	<u>150,672</u>	<u>--</u>	<u>(9,710,010)</u>
Total capital assets being depreciated, net	<u>14,136,253</u>	<u>7,960,354</u>	<u>--</u>	<u>--</u>	<u>22,096,607</u>
Governmental activities capital assets, net	<u>\$16,968,904</u>	<u>\$8,014,354</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$24,983,258</u>

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

	Balance 9/30/05	Additions	Retirements	Completed Construction	Balance 9/30/06
BUSINESS-TYPE ACTIVITIES:					
Capital assets, not being depreciated:					
Land	\$ --	\$ --	\$ --	\$ --	\$ --
Construction in progress	2,572,442	770,502	--	(1,625,244)	1,717,700
Total capital assets not being depreciated	2,572,442	770,502	--	(1,625,244)	1,717,700
Capital assets, being depreciated:					
Buildings	215,224	--	--	--	215,224
Improvements other than buildings	20,702,495	2,330,490	--	1,625,244	24,658,229
Machinery and equipment	78,877	--	--	--	78,877
Total capital assets being depreciated	20,996,596	2,330,490	--	1,625,244	24,952,330
Less accumulated depreciation for:					
Buildings	(19,737)	(9,783)	--	--	(29,520)
Improvements other than buildings	(2,998,417)	(525,983)	--	--	(3,524,400)
Machinery and equipment	(56,427)	(6,402)	--	--	(62,829)
Total accumulated depreciation	(3,074,581)	(542,168)	--	--	(3,616,749)
Capital assets being depreciated, net	17,922,015	1,788,322	--	1,625,244	21,335,581
Business type activities capital assets, net	\$20,494,457	\$2,558,824	\$ --	\$ --	\$23,053,281

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities:

Administration	\$28,806
Highways and streets	870,349
Parks	40,070
Building inspections	7,523
Municipal court	2,076
Public safety	110,781
Total depreciation expense - governmental activities	<u>\$1,059,605</u>

Business-type activities:

Water and sewer - depreciation	<u>\$542,168</u>
--------------------------------	------------------

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

Construction commitments

The City has active construction projects as of September 30, 2006. The projects include waste water system improvements.

Project	Spent to Date	Remaining Commitment
Governmental Capital Assets		
Cove ridge, Rush Creek, FM 114	\$54,000	\$31,000
Pavement Management System	--	127,942
Total Governmental Capital Assets	54,000	158,942
Business-type Capital Assets		
Demolition wastewater treatment plants	\$ --	\$80,000
Gravity sewer improvements	853,965	--
Water storage facility	863,734	142,831
Total Business-type	1,717,699	222,831
	\$1,771,699	\$381,773

The commitment for the street systems and the pavement management system are being financed by street impact fees.

The commitments for sewer system improvements and demolition of wastewater treatment plants are being financed by revenue bonds and impact fees. The commitment for the water storage facility is being financed by revenue instalment sales contracts.

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

D. Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of September 30, 2006, is as follows:

<u>Fund</u>	<u>Receivable</u>	<u>Payable</u>
Major Governmental Funds		
General Fund	\$ --	\$2,649,278
Capital Improvements Fund	--	654,253
Debt Service Fund	494,693	--
Nonmajor Funds		
Drainage Special Revenue	69,874	--
H.E.D.C. Special Revenue	420,361	--
H.M.B.C. Special Revenue	233,892	--
Total Governmental Funds	<u>1,218,820</u>	<u>3,303,531</u>
Business-type Funds		
Water and Sewer	<u>2,084,711</u>	--
	<u>\$3,303,531</u>	<u>\$3,303,531</u>

Interfund receivables arise from covering overdrafts in pooled cash at year end.

E. Goodwill

In the year ended September 30, 2001, the City purchased a private water system serving approximately 620 customers. The total purchase price of \$1,100,000 was financed through the issuance of long-term debt. The City obtained a valuation of the assets purchased, and allocated the purchase price between the value of the system purchased (\$716,115), and goodwill of \$383,885. The goodwill is being amortized over a period of sixty months. A total of \$51,189 was charged to depreciation and amortization during the current year.

F. Long-term debt

The City of Heath issues general obligation bonds, certificates of obligation bonds, contractual obligation bonds, capital leases, and notes to provide funds for the acquisition and construction of major capital facilities. General obligation bonds have been issued for both governmental and business-type activities. These issues are direct obligations and pledge the full faith and credit of the City. During 2004, the City issued \$2,190,000 Combination Tax and Revenue Certificates of Obligation, Series 2004 generally for the purchase of land, construction of streets and park improvements. The Heath Economic Development Corporation and the Heath Municipal Benefits Corporation entered into an agreement with the City to participate in the repayment of \$280,000 and \$450,000 of the debt, respectively.

CITY OF HEATH, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006

General Debt Currently Outstanding:					
Purpose	Original Amount	Year of Issue	Final Maturity	Interest Rate	Balance 9/30/05
Governmental Debt Issues					
General Obligation Bonds:					
Improvements/refunding	\$730,000	2/15/01	2/15/17	4.40%-4.85%	\$730,000
Improvements/refunding	1,835,000	7/07/04	2/15/15	3.68%-3.68%	1,610,000
Total General Obligation Bonds					<u>2,340,000</u>
Certificate of Obligation Bonds:					
Improvements	2,300,000	2/15/01	2/15/22	4.00%-5.00%	2,037,500
Improvements	2,190,000	7/07/04	2/15/24	3.68%-3.68%	2,105,000
Total Certificates of Obligation					<u>4,142,500</u>
Total General Long-Term Debt					<u>6,482,500</u>
Proprietary Debt Issues:					
Contract Revenue Bonds:					
Improvements	1,006,566	6/01/05	6/21/25	3.75%-4.625%	973,236
Certificate of Obligation Bonds:					
Improvements	6,900,000	2/15/01	2/15/22	4.00%-5.00%	6,112,500
Improvements	1,640,000	7/15/04	2/15/16	3.68%-3.68%	1,420,000
Total Certificates of Obligation					<u>7,532,500</u>
Total Proprietary Debt					<u>8,505,736</u>
Total Debt					<u><u>\$14,988,236</u></u>

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

Annual debt service requirements to maturity for general debt:

Year	Governmental Activities		Business-type Activities		Total
	Principal	Interest	Principal	Interest	
2007	\$303,750	\$262,430	\$344,580	\$381,928	\$1,292,688
2008	326,250	250,531	358,747	367,876	1,303,404
2009	355,000	237,608	376,663	352,969	1,322,240
2010	387,500	223,395	385,829	337,189	1,333,913
2011	416,250	207,510	438,746	320,026	1,382,532
2012-2016	2,013,750	1,072,498	2,557,894	1,291,084	6,935,226
2017-2021	1,401,250	827,489	3,377,055	599,926	6,205,720
2022-2024	1,278,750	182,718	666,222	39,838	2,167,528
Total	\$6,482,500	\$3,264,179	\$8,505,736	\$3,690,836	\$21,943,251

DEFEASED DEBT

During 2004, the City defeased the 1996 combination tax and revenue certificates of obligation and the 1993-A combination tax and revenue certificates of obligation by providing resources to purchase U.S. Government, State and Local Series securities that were placed in irrevocable trusts for the purpose of generating resources for all future debt service payments of the refunded debt. At year end the City had \$1,456,000 general obligation defeased debt outstanding.

During 2004, the City also defeased the 1994 NTMWD Installment Sales Contract Revenue bonds by providing resources to purchase U.S. Government, State and Local Series securities that were placed in irrevocable trusts for the purpose of generating resources for all future debt service payments of the refunded debt. At year end the City had \$1,630,000 business type defeased debt outstanding.

CAPITALIZED LEASE OBLIGATIONS

The City has entered into a contract for the lease purchase of a fire truck. Capitalized lease obligations outstanding at year end are as follows:

Purpose	Original Amount	Year of Issue	Final Maturity	Interest Rate	Balance 9/30/06
Capital Lease					
Fire truck (\$296,432)	\$374,440	9/15/04	9/15/10	6.99%	\$217,853

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

Capital lease obligation debt service requirements to maturity are as follows:

Year	Total
2007	\$60,002
2008	60,002
2009	60,002
2010	<u>60,002</u>
Total payments	240,008
Less imputed interest	<u>(22,155)</u>
Total Capital Lease Obligations	<u><u>\$217,853</u></u>

CHANGES IN LONG-TERM LIABILITIES

Long-term liability activity for the year ended September 30, 2005, was as follows:

	Balance 9/30/05	Additions	Retirements	Balance 9/30/06	Due Within One Year
Governmental activities:					
General obligation bonds	\$2,495,000	\$ --	(\$155,000)	\$2,340,000	\$165,000
Certificates of obligation	4,258,750	--	(116,250)	4,142,500	138,750
Less deferred discount	<u>(22,586)</u>	--	1,442	<u>(21,144)</u>	--
Total bonds payable	6,731,164	--	(269,808)	6,461,356	303,750
Capital lease obligations	267,194	--	(49,341)	217,853	51,310
Compensated absences	<u>137,616</u>	90,122	(95,539)	<u>132,199</u>	132,199
Total long-term liabilities	<u><u>\$7,135,974</u></u>	<u><u>\$90,122</u></u>	<u><u>(\$414,688)</u></u>	<u><u>\$6,811,408</u></u>	<u><u>\$487,259</u></u>
Business-type activities:					
Certificates of obligation	\$7,831,250	\$ --	(\$298,750)	\$7,532,500	\$311,250
Less deferred discount	<u>(67,750)</u>	--	4,134	<u>(63,616)</u>	--
Total bonds payable	7,763,500	--	(294,616)	7,468,884	311,250
Contract revenue bonds	1,006,566	--	(33,330)	973,236	33,330
Compensated absences	<u>15,792</u>	14,493	(16,464)	<u>13,821</u>	13,821
Total long-term liabilities	<u><u>\$8,785,858</u></u>	<u><u>\$14,493</u></u>	<u><u>(\$344,410)</u></u>	<u><u>\$8,455,941</u></u>	<u><u>\$358,401</u></u>

For the governmental activities, claims and judgements and compensated absences are generally liquidated by the general fund. The government-wide statement of activities includes \$33,330 of the long-term liabilities due within one year for business-type activities in "liabilities payable from restricted assets." The remaining amount of \$314,542 is displayed as "noncurrent liabilities, due within one year on that same statement.

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

IV. OTHER INFORMATION

A. Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; injuries to employees; employee health benefits; natural disasters; and claims of various nature. The City participates in the Texas Municipal League Intergovernmental Risk Pool (the Pool) which provides protection for risks of loss. Premiums are paid to the Pool which retains the risk of loss beyond the City's policy deductibles. Any losses reported but unsettled or incurred and not reported, are believed to be insignificant to the City's basic financial statements. For the last three years, there have been no significant reductions of insurance coverage or insurance settlements in excess of insurance coverage. Any losses reported but unsettled or incurred and not reported, are believed to be insignificant to the City's basic financial statements.

B. Related Party Transaction

The City purchased approximately seventy-five acres of land for future development for \$1,325,000 with the proceeds of a bond issue. The 4B corporation, a blended component unit of the City, acquired twenty-five acres of this land for a price not to exceed \$450,000. The purchase price is being paid to the City through annual debt service payments made by the 4B corporation on the bonds issued to purchase the land. The total amount paid by the 4B corporation on debt service in the current year was \$27,368.

The 4A corporation paid \$16,172 in the current year for debt service related to street maintenance.

The president of the local branch of the City's depository is a board member of the 4B and 4A component units.

C. North Texas Municipal Water District (the District)

The district is a conservation and reclamation district and political subdivision of the State of Texas, created and functioning under Chapter 62, Acts of 1951, 52nd Legislature, Regular Session, as amended, originally compiled as Vernon's Article 8270-141 (the "Act"), pursuant to Article 16, Section 59 of the Texas Constitution. The District comprises all of the territory of its member cities, viz., Garland, Princeton, Plano, Mesquite, Wylie, Rockwall, Farmersville, McKinney, Richardson, Forney and Royse City (the "Member Cities"). The District was created for the purpose of providing a source of water supply for municipal, domestic and industrial use and for the treatment, processing and transportation of such water to its Member Cities, and to its other customers located in North Central Texas, all within the Dallas Standard Metropolitan Statistical Area.

Under the Act, including specifically Section 27 thereof, and under the Constitution and Statutes of the State of Texas, the District has broad powers to (1) impound, control, store, preserve, treat, transmit and use storm and flood water, the water of rivers and streams and underground water, for industrial and commercial uses and purposes and all other beneficial uses and purposes; and (2) collect, transport, process, treat, dispose of, and control all municipal, domestic, industrial or commercial waste whether in fluid, solid or composite state, including specifically the control, abatement or reduction of all types of pollution. The City retains no ongoing financial interest, equity investments and/or responsibilities for the District other than the contractual arrangements discussed more fully herein.

The District has a long-term contract with the City to supply sewer treatment. The City contracted with the District to build sewage treatment plants and provide treatment services to the City. Under the terms of the contract, the City's payments, which began when the facilities were first utilized, are equal to the operating and maintenance expenses for the ensuing fiscal year, as shown in the Annual Budget. The contract further provides that the debt service payments would be equal to the principal and/or interest coming due on the bonds on the next succeeding interest payment date, plus the fees and charges of the paying agent and registrar.

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

These contractual obligations have been included as installment sales contract revenue bonds in amounts equal to the bonds outstanding under these agreements. Accordingly, the related sewage treatment facilities have been capitalized and are being depreciated over the estimated life of the facilities. In the year ended September 30, 2004, the outstanding installment sales contract was refunded.

In the fiscal year ended September 30, 2005, the City entered into a contract with the District to construct a water storage facility. Under the terms of the contract, the City's payments, which began when the facilities were first utilized, are equal to the operating and maintenance expenses for the ensuing fiscal year, as shown in the Annual Budget. The contract further provides that the debt service payments would be equal to the principal and/or interest coming due on the bonds on the next succeeding interest payment date, plus the fees and charges of the paying agent and registrar. These contractual obligations have been included as installment sales contract revenue bonds and the related water storage facilities have been capitalized and are being depreciated over the estimated life of the facilities.

Buffalo Creek Wastewater Interceptor System

In January 2004, the Cities of Rockwall and Heath in Rockwall County, and the City of Forney in Kaufman County entered into a contract with the District to provide for the acquisition, construction, improvement, operation, and maintenance of the Regional Buffalo Creek Wastewater Interceptor System (System) for the purpose of providing facilities to adequately receive, transport, treat, and dispose of wastewater. The District will own the System with Rockwall, Heath and Forney as the initial participants. The District issued approximately \$17 million in bonds to construct this new facility in April 2004. Budget calculations for operating costs and debt service for the System on the service commencement date is based on the following estimated flow ratio: City of Rockwall - 78%, the City of Heath - 14%, and the City of Forney - 8%. "Service Commencement Date" means the first date upon which the System is available to treat wastewater from the participants. Heath's long-term commitment to the System's debt service component is approximately \$2.4 million.

The District will send each participant a letter detailing the annual requirement necessary to operate the System each year. The annual requirement budget will include an operation and maintenance component and a bond service component. The budgeting ratio described earlier is only valid for the first year of System operations. In subsequent years, budgets and year-end audits will be based on actual flow ratios. For example, if the flow measurements indicate that 80% of the flow is produced by Rockwall, 15% by Heath and 5% by Forney, then the next year's operating and debt service components would be allocated using a 80/15/5 split. If in the future, additional participants are added, then the flow ratios will be adjusted using the above method.

Construction is underway and the System is nearing completion.

D. Contingent Liabilities and Commitments

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

The City is defendant in a suit brought by certain property owners to enforce certain restrictive covenants on property purchased by the City for a water tower and other municipal uses. The City cross-filed to condemn the outstanding interests. The special commissioners awarded \$331,280 to the property owners. The case has been set for trial and, in the opinion of the City's management, after consultation with the City's attorney, the potential loss on this litigation is expected to be no more than the special commissioners award. The amount awarded, along with related expenses, was charged to the water and sewer fund in 2002. The case was appealed to the Texas supreme court. The appeal was not granted by the supreme court, so the matter is back in the trial court for trial as to the value of the property interests.

There is no other litigation or pending lawsuits which would be significant to the City's financial statements.

CITY OF HEATH, TEXAS

NOTES TO THE FINANCIAL STATEMENTS

September 30, 2006

E. Employees' Retirement System

1. Plan Description

The City provides pension benefits for all of its full-time employees through a nontraditional, joint contributory, hybrid defined benefit plan in the state-wide Texas Municipal Retirement System (TMRS), one of 811 currently administered by TMRS, an agent multiple-employer public employee retirement system. TMRS issues a report on the system as a whole, separate financial statements of the City's plan are not prepared. All assumptions for the December 31, 2005 valuations are contained in the 2005 TMRS Comprehensive Annual Financial Report which can be obtained by writing to P.O. Box 149153, Austin, Texas, 78714-9153.

Benefits depend upon the sum of the employee's contributions to the plan, with interest, and the City-financed monetary credits, with interest. At the date the plan began, the City granted monetary credits for service rendered before the plan began of a theoretical amount equal to two times what would have been contributed by the employee, with interest, prior to establishment of the plan. Monetary credits for service since the plan began are a percent (100%) of the employee's accumulated contributions. In addition, the City can grant as often as annually another type of monetary credit referred to as an updated service credit which is a theoretical amount which, when added to the employee's accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and City matching percent had always been in existence and if the employee's salary had always been the average of his salary in the last three years that are one year before the effective date. At retirement, the benefit is calculated as if the sum of the employee's accumulated contributions with interest and the employer-financed monetary credits with interest were used to purchase an annuity.

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

2. Contributions

The contribution rate for the employees is 7%, and the City matching ratio is currently 2 to 1, both as adopted by the governing body of the City. Under the state law governing TMRS, the actuary annually determines the City contribution rate. This rate consists of the normal cost contribution rate and the prior service contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to the City matching percent, which are the obligation of the City as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the City to each employee at the time his/her retirement becomes effective. The prior service contribution rate amortizes the unfunded (over funded) actuarial liability (asset) over the remainder of the plan's 25-year amortization period. The unit credit actuarial cost method is used for determining the City contribution rate. Both the employees and the City make contributions monthly. Since the City needs to know its contribution rate in advance to budget for it, there is a one-year delay between the actuarial valuation that is the basis for the rate and the calendar year when the rate goes into effect, i.e. December 31, 2005 valuation is effective for rates beginning January 2007.

CITY OF HEATH, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006

	<u>Actuarial Assumptions</u>
Actuarial Cost Method	Unit Credit
Amortization Method	Level Percent of Payroll
Remaining Amortization	25 Years - Open Period
Asset Valuation Method	Amortized Cost
Investment Rate of Return	7%
Projected Salary Increases	None
Includes Inflation At	3.5%
Cost of Living Adjustments	None

Schedule of Actuarial Liabilities and Funding Progress

Actuarial Valuation Date	<u>12/31/05</u>	<u>12/31/04</u>	<u>12/31/03</u>
Actuarial Value of Asset	\$1,317,007	\$1,264,068	\$995,552
Actuarial Accrued Liabilities	\$1,814,345	\$1,718,652	\$1,493,269
Percentage Funded	72.6%	73.5%	66.7%
Unfunded (Over-funded) Actuarial	\$497,338	\$454,584	\$497,717
Annual Covered Payroll	\$1,701,288	\$1,286,948	\$1,147,714
UAAL as a Percentage of Covered Payroll	29.2%	35.3%	43.4%
Net Pension Obligation (NPO)	\$ --	\$ --	\$ --
Annual Pension Cost:			
Annual Required Contribution (ARC)	214,783	192,486	123,208
Interest on NPO	--	--	--
Adjustment to the ARC	--	--	--
	<u>214,783</u>	<u>192,486</u>	<u>123,208</u>
Contributions Made (100%)	214,783	192,486	123,208
Increase in NPO	<u>--</u>	<u>--</u>	<u>--</u>
NPO at the End of Period	<u>\$ --</u>	<u>\$ --</u>	<u>\$ --</u>

F. Concentrations of Credit Risk

Taxes receivable are due from citizens and businesses within the City's boundaries. Risk of loss is immaterial due to wide dispersion of receivables and because of policies which address procedures for filing property tax liens.

Accounts receivable are due from citizens and businesses within the City's boundaries. Risk of loss is immaterial due to wide dispersion of receivables and because of policies which address collection procedures for past due accounts.

Required Supplementary Information

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

This page is left blank intentionally.

CITY OF HEATH, TEXAS
GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED SEPTEMBER 30, 2006

EXHIBIT B-1

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
<i>Taxes</i>	\$ 2,711,258	\$ 2,711,258	\$ 2,978,615	\$ 267,357
<i>Licenses and permits</i>	239,250	239,250	287,814	48,564
<i>Intergovernmental</i>	112,000	112,000	119,913	7,913
<i>Charges for services</i>	23,300	23,300	49,073	25,773
<i>Fines</i>	75,000	75,000	97,706	22,706
<i>Interest</i>	28,000	28,000	179,932	151,932
<i>Miscellaneous</i>	16,500	16,500	183,052	166,552
Total revenues	<u>3,205,308</u>	<u>3,205,308</u>	<u>3,896,105</u>	<u>690,797</u>
Expenditures:				
Current:				
<i>Administration</i>	827,806	827,806	1,074,008	(246,202)
<i>Highways and streets</i>	349,470	349,470	273,730	75,740
<i>Parks</i>	187,618	187,618	149,324	38,294
<i>Building inspection</i>	281,185	281,185	300,154	(18,969)
<i>Municipal court</i>	105,017	105,017	112,883	(7,866)
<i>Public safety</i>	1,640,089	1,640,089	1,674,692	(34,603)
Total expenditures	<u>3,391,185</u>	<u>3,391,185</u>	<u>3,584,791</u>	<u>(193,606)</u>
Excess (deficiency) of revenues over (under) expenditures	(185,877)	(185,877)	311,314	497,191
Other financing sources (uses):				
<i>Sale of capital assets</i>	--	--	1,141	1,141
Total other financing sources (uses)	<u>--</u>	<u>--</u>	<u>1,141</u>	<u>1,141</u>
Net change in fund balances	(185,877)	(185,877)	312,455	498,332
Fund balances, October 1	<u>2,410,935</u>	<u>2,410,935</u>	<u>2,410,935</u>	<u>--</u>
Fund balances, September 30	<u>\$ 2,225,058</u>	<u>\$ 2,225,058</u>	<u>\$ 2,723,390</u>	<u>\$ 498,332</u>

CITY OF HEATH, TEXAS

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

September 30, 2006

(Unaudited)

Budgetary Information

The official budget was prepared using generally accepted accounting principals for adoption by the General Fund, H.E.D.C. 4A Special Revenue Fund, the H.M.B.C. 4B Special Revenue Fund, and the Debt Service Fund. The following procedures are followed in establishing the budgetary data reflected in the Basic Financial Statements:

1. Prior to the beginning of the fiscal year, the City prepares a budget for the next succeeding fiscal year. The operating budget includes proposed expenditures and the means of financing them.
2. A meeting of the City Council is then called for the purpose of adopting the proposed budget. At least three days' prior to a meeting a public notice of the meeting must have been given.
3. Prior to the start of the fiscal year, the budget is legally enacted through passage of a resolution by the City Council.

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

*Combining Statements and Budget Comparisons
as Supplementary Information*

This supplementary information includes financial statements and schedules not required by the Governmental Accounting Standards Board, nor a part of the basic financial statements, but are presented for purposes of additional analysis.

CITY OF HEATH, TEXAS
 COMBINING BALANCE SHEET
 NONMAJOR SPECIAL REVENUE FUNDS
 SEPTEMBER 30, 2006

	Drainage Special Revenue	H.E.D.C. 4A	H.M.B.C. 4B	Total Nonmajor Special Revenue Funds (See Exhibit A-3)
ASSETS				
<i>Cash and cash equivalents</i>	\$ 26,891	\$ --	\$ 165,798	\$ 192,689
Receivables (net of allowances for uncollectibles):				
<i>Intergovernmental</i>	--	37,940	37,940	75,880
<i>Due from other funds</i>	69,874	420,361	233,892	724,127
Total Assets	<u>\$ 96,765</u>	<u>\$ 458,301</u>	<u>\$ 437,630</u>	<u>\$ 992,696</u>
FUND BALANCES				
<i>Unreserved</i>	\$ 96,765	\$ 458,301	\$ 437,630	\$ 992,696
Total fund balances	<u>96,765</u>	<u>458,301</u>	<u>437,630</u>	<u>992,696</u>
Total Fund Balances	<u>\$ 96,765</u>	<u>\$ 458,301</u>	<u>\$ 437,630</u>	<u>\$ 992,696</u>

CITY OF HEATH, TEXAS

COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
NONMAJOR SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Drainage Special Revenue	H.E.D.C. 4A	H.M.B.C. 4B	Total Nonmajor Special Revenue Funds (See Exhibit A-5)
Revenues:				
<i>Taxes</i>	\$ --	\$ 162,737	\$ 162,737	\$ 325,474
<i>Interest</i>	2,033	5,031	5,040	12,104
Total revenues	<u>2,033</u>	<u>167,768</u>	<u>167,777</u>	<u>337,578</u>
Expenditures:				
Current:				
<i>Economic development and assistance</i>	--	227	--	227
<i>Economic opportunity</i>	--	--	127	127
Debt service:				
<i>Principal</i>	--	7,150	12,100	19,250
<i>Interest and fiscal charges</i>	--	9,021	15,268	24,289
Total expenditures	<u>--</u>	<u>16,398</u>	<u>27,495</u>	<u>43,893</u>
Net change in fund balances	2,033	151,370	140,282	293,685
Fund balances, October 1	94,732	306,931	297,348	699,011
Fund balances, September 30	<u>\$ 96,765</u>	<u>\$ 458,301</u>	<u>\$ 437,630</u>	<u>\$ 992,696</u>

CITY OF HEATH, TEXAS

EXHIBIT C-3

H.E.D.C - 4A

SPECIAL REVENUE FUND

BUDGETARY COMPARISON SCHEDULE

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
<i>Taxes</i>	\$ 127,500	\$ 127,500	\$ 162,737	\$ 35,237
<i>Interest</i>	1,500	1,500	5,031	3,531
Total revenues	<u>129,000</u>	<u>129,000</u>	<u>167,768</u>	<u>38,768</u>
Expenditures:				
Current:				
<i>Economic development and assistance</i>	7,350	7,350	227	7,123
Debt service:				
<i>Principal</i>	3,350	3,350	7,150	(3,800)
<i>Interest and fiscal charges</i>	3,267	3,267	9,021	(5,754)
Total expenditures	<u>13,967</u>	<u>13,967</u>	<u>16,398</u>	<u>(2,431)</u>
Net change in fund balances	115,033	115,033	151,370	36,337
Fund balances, October 1	306,931	306,931	306,931	--
Fund balances, September 30	<u>\$ 421,964</u>	<u>\$ 421,964</u>	<u>\$ 458,301</u>	<u>\$ 36,337</u>

CITY OF HEATH, TEXAS

EXHIBIT C-4

H.M.B.C. - 4B

SPECIAL REVENUE FUND

BUDGETARY COMPARISON SCHEDULE

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
<i>Taxes</i>	\$ 127,500	\$ 127,500	\$ 162,737	\$ 35,237
<i>Interest</i>	1,500	1,500	5,040	3,540
Total revenues	<u>129,000</u>	<u>129,000</u>	<u>167,777</u>	<u>38,777</u>
Expenditures:				
Current:				
<i>Economic opportunity</i>	6,700	6,700	127	6,573
Debt service:				
<i>Principal</i>	5,900	5,900	12,100	(6,200)
<i>Interest and fiscal charges</i>	5,950	5,950	15,268	(9,318)
Total expenditures	<u>18,550</u>	<u>18,550</u>	<u>27,495</u>	<u>(8,945)</u>
Net change in fund balances	110,450	110,450	140,282	29,832
Fund balances, October 1	297,348	297,348	297,348	--
Fund balances, September 30	<u>\$ 407,798</u>	<u>\$ 407,798</u>	<u>\$ 437,630</u>	<u>\$ 29,832</u>

CITY OF HEATH, TEXAS
DEBT SERVICE FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED SEPTEMBER 30, 2006

EXHIBIT C-5

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
<i>Taxes</i>	\$ 562,750	\$ 562,750	\$ 559,005	\$ (3,745)
<i>Special assessments</i>	--	--	112,192	112,192
<i>Interest</i>	2,000	2,000	51,452	49,452
Total revenues	<u>564,750</u>	<u>564,750</u>	<u>722,649</u>	<u>157,899</u>
Expenditures:				
Debt service:				
<i>Principal</i>	311,341	311,341	252,000	59,341
<i>Interest and fiscal charges</i>	289,186	289,186	253,494	35,692
Total expenditures	<u>600,527</u>	<u>600,527</u>	<u>505,494</u>	<u>95,033</u>
Net change in fund balances	(35,777)	(35,777)	217,155	252,932
Fund balances, October 1	884,251	884,251	884,251	--
Fund balances, September 30	<u>\$ 848,474</u>	<u>\$ 848,474</u>	<u>\$ 1,101,406</u>	<u>\$ 252,932</u>