

CITY OF KYLE, TEXAS

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2007

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Kyle adopted a City Charter in October 2000. As a home rule form of government, the City Council determines policy. The City Manager is the Chief Administrator of the City and is appointed by the City Council. The City provides the following services: Public Safety, Street Maintenance, Refuse Collection, Recreation Programs, Municipal Court, Community Development, Public Improvements, Water and Sewer Services and General Administrative Services.

A. Reporting Entity

The accompanying financial statements comply with the provisions of GASB Statements No. 14 and 39, "The Financial Reporting Entity," in that the financial statements include all organizations, activities, functions and component units for which the City (the "primary government") is financially accountable. Financial accountability is defined as the appointment of a voting majority of a legally separate organization's governing body and either (1) the City's ability to impose its will over the organization, or (2) the potential that the organization will provide a financial benefit to or impose a financial burden on the City. There are no component units which satisfy requirements for blending within the City's financial statements or for discrete presentation.

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government. 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 revenue, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenue. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenue* includes 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 revenue are reported instead as *general revenue*.

(continued)

I. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

B. **Government-wide Fund Financial Statements** (Continued)

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

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

Governmental Funds are those through which most governmental functions of the City are financed. The acquisition, use, and balances of the City's expendable financial resources and the related liabilities (except those accounted for in the proprietary fund type) are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination.

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I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

The City reports the following major governmental funds:

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

The Road Improvements Fund – is to account for the accumulation of impact fees for road improvements and expenditures from these resources.

The 2008 Certificates of Obligation Fund – is used to account for purchase and renovation of public facilities that are funded by 2008 certificates of obligation.

The City reports the following major proprietary fund:

The Water and Wastewater Fund – is used to account for the activities necessary for the provisions of water and wastewater services.

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 charges between the City's water and wastewater function and various other functions of the government. Elimination of these charges would distort the direct costs and program revenue 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 revenue. Likewise, general revenue includes all taxes.

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I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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 City's Enterprise Funds are charges to customers for sales and services. Operating expenses for Enterprise Funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

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

D. Assets, Liabilities and Net Assets or Equity

Cash and Cash Equivalents

For purpose of presenting the proprietary fund cash flow statement, cash and cash equivalents include cash demand and time deposits and investments with a maturity date within three months of the date acquired by the City.

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 maturing within one year of date of purchase are stated at cost or amortized cost, all other investments are stated at fair value, which is based on quoted market prices.

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I. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

D. **Assets, Liabilities and Net Assets or Equity** (Continued)

Short-term Interfund Receivables/Payables

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as “due from other funds” or “due to other funds” on the balance sheet. Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as “internal balances.”

Restricted Assets

Certain assets of the Enterprise Fund are classified as restricted assets because their use is restricted for capital improvements.

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. The City defines capital assets 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.

General infrastructure assets acquired prior to October 1, 2004, are not reported in the basic statements. General infrastructure assets include all roads, bridges, and other infrastructure assets acquired subsequent to October 1, 2004.

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.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Property, plant and equipment is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and improvements	25 to 40
Waterworks and sanitation systems	10 to 20
Infrastructure	20
Machinery and equipment	5 to 10

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I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Assets, Liabilities and Net Assets or Equity (Continued)

Compensated Absences

The City permits employees to accumulate earned but unused vacation pay benefits. Certain employees have carried forward unused sick leave benefits. Unused sick leave shall be paid upon termination of employment, except as specifically provided as follows:

1. an employee that terminates employment for any reason other than death, or being granted a retirement or disability allowance by the Texas Municipal Retirement System ("TMRS") or the Social Security Administration ("SSA"), shall not be paid for unused sick leave;
2. an employee having at least 10 years of service with the City who is granted a retirement or a disability allowance by TMRS or SSA, or who dies, is entitled to a partial payment for up to 480 hours of unused sick leave accrued to such employee. The partial payment to the employee or the employee's beneficiary shall be as follows: (A) an amount equal to thirty percent (30%) of the value of such accrued, unused sick leave will be paid for 10 years of service; and (B) the amount to be paid for such unused sick leave shall increase by 2% for each year of service as an employee of the City, if any, in excess of 10 years.

No liability is reported for unpaid accumulated sick leave for the remaining employees. Vacation pay and certain sick leave benefits are accrued when incurred in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. A liability for these amounts is reported in governmental funds only if they have matured for example, as a result of employee resignations and retirements.

Long-term Obligations

In the government-wide financial statements and proprietary fund types 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 approximates the effect 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.

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I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Assets, Liabilities and Net Assets or Equity (Continued)

Long-term Obligations (Continued)

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as 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 are reported as other financing uses. Issuance costs, even if withheld from the actual net proceeds received, are reported as expenditures.

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.

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for the acquisition, construction or improvements of those assets, and adding back unspent proceeds. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislations adopted by the City or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

Estimates

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

II. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

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, “Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds.” The details of this \$32,047,868 difference are as follows:

Certificates of obligation	\$ 17,200,000
Premium on bond issuance	87,661
Refunding bonds	55,000
State infrastructure bank loan	14,000,000
Deferred charge for issuance costs	(430,874)
Accrued interest payable	193,562
Compensated absences	116,243
Deferred interest	<u>826,276</u>
Net adjustment to reduce <i>fund balance - total governmental funds</i> to arrive at <i>net assets - governmental activities</i>	<u>\$ 32,047,868</u>

Explanation of Certain Differences Between the Governmental Fund Statement of Revenue, Expenditures and Changes in Fund Balances and the Government-wide Statement of Activities

The governmental fund statement of revenue, expenditures and changes in fund balances includes a reconciliation between *net changes in fund balances – total governmental fund* and *changes in net assets of governmental activities* as reported in the government-wide statement of activities. One element of that reconciliation explains, “Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.” The details of this \$3,968,989 difference are as follows:

Capital outlay	\$ 4,454,382
Depreciation expense	(612,613)
Disposal of capital assets	<u>127,220</u>
Net adjustment to increase <i>net changes in fund balances - total governmental funds</i> to arrive at <i>changes in net assets of governmental activities</i>	<u>\$ 3,968,989</u>

Another element of that reconciliation states, “The effect of donated capital assets is to increase net assets.” Donations of infrastructure from developers increase net assets in the statement of activities, but do not appear in the governmental funds because they are not financial resources. The adjustment to increase net changes in fund balances – total governmental funds to arrive at changes in net assets of governmental activities is \$603,458.

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II. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS
(Continued)

Explanation of Certain Differences Between the Governmental Fund Statement of Revenue, Expenditures and Changes in Fund Balances and the Government-wide Statement of Activities (Continued)

Another element of that reconciliation states, "Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds." The details of this \$10,838 difference are as follows:

Property taxes	\$ 49,075
Franchise taxes	(38,237)
Net adjustment to increase <i>net changes in fund balances - total governmental funds</i> to arrive at <i>changes in net assets of governmental activities</i>	<u>\$ 10,838</u>

Another element of that reconciliation states, "The issuance of long-term debt (e.g., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. The details of this \$9,246,001 difference are as follows:

Issuance of long-term debt	\$(9,910,000)
Premium on issuance of bonds	(87,661)
Bond issuance cost	266,660
Principal repayments:	
Certificates of obligation	465,000
Refunding bonds	<u>20,000</u>
Net adjustment to decrease <i>net changes in fund balances - total governmental funds</i> to arrive at <i>changes in net assets of governmental activities</i>	<u>\$(9,246,001)</u>

Another element of that reconciliation states that "Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds." The details of this \$369,137 difference are as follows:

Compensated absences	\$ 16,208
Accrued interest	151,240
Amortization of issuance costs	12,413
Deferred interest	<u>189,276</u>
Net adjustment to decrease <i>net changes in fund balances - total governmental funds</i> to arrive at <i>changes in net assets of governmental activities</i>	<u>\$ 369,137</u>

III. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Deficit Fund Equity

The 2008 Certificates of Obligation Capital Projects Fund had a deficit fund balance of \$1,039,194 as of September 30, 2007. The fund incurred expenditures for the purchase of a building. The City plans to issue bonds to cover the expenditures.

IV. DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

As of September 30, 2007, the City had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Weighted Average Maturity</u>
TexPool	\$ 10,349,730	33 days
TexStar	1,866,743	20 days
MBIA Municipal Investors	8,575,394	41 days
Federal Home Loan Securities	1,485,962	01/16/08
Federal Home Loan Mortgage	995,257	30 months
Federal Home Loan Securities	119,914	01/16/08
Federal National Mortgage	501,004	12/29/07

The City's investment pools are 2a7-like pools. A 2a7-like pool is one which is not registered with the Securities and Exchange Commission ("SEC") as an investment company, but nevertheless has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940.

Interest Rate Risk. In accordance with its investment policy, the City manages its exposure to declines in fair market values by limiting the weighted average maturity of its investment portfolio to a maximum of 180 days.

Custodial Credit Risk. 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. State statutes require that all deposits in financial institutions be fully collateralized by U. S. Government obligations or its agencies and instrumentalities or direct obligations of Texas or its agencies and instrumentalities that have a fair value of not less than the principal amount of deposits. As of September 30, 2007, \$764,259 of the City's \$864,259 deposit balance was collateralized with securities held by the pledging financial institution in the City's name. The remaining balance, \$100,000 was covered by FDIC insurance.

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IV. DETAILED NOTES ON ALL FUNDS (Continued)

A. Deposits and Investments (Continued)

Credit Risk. It is the City's policy to limit its investments to investments to investment types with an investment quality rating not less than A or its equivalent by a nationally recognized statistical rating organization. The City's investment pools were rated AAAM by Standard & Poor's Investors Service and government securities were rated AAA by Standard & Poor's Investors Service.

B. Receivables

Receivables as of year-end for the government's individual major funds and nonmajor funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	<u>Governmental Funds</u>		<u>Enterprise Fund</u>	<u>Total</u>
	<u>General</u>	<u>Other</u>	<u>Water and Wastewater</u>	
Receivables:				
Accounts:				
Customers	\$ 146,150	\$ -	\$ 553,036	\$ 699,186
Overpayment to vendor	-	-	335,671	335,671
Taxes:				
Property	99,935	47,416	-	147,351
Sales	395,938	-	-	395,938
Franchise	2,916	-	-	2,916
Occupancy	-	21,146	-	21,146
Gross receivables	644,939	68,562	888,707	1,602,208
Less: allowance for uncollectibles	(14,566)	(1,208)	(72,629)	(88,403)
Net total receivables	<u>\$ 630,373</u>	<u>\$ 67,354</u>	<u>\$ 816,078</u>	<u>\$ 1,513,805</u>

Governmental funds report *deferred revenue* in connection with receivables for revenue that is 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:

	<u>Unavailable</u>	<u>Unearned</u>
Delinquent property taxes receivable (general fund)	\$ 39,042	\$ -
Delinquent property taxes receivable (debt service)	49,915	-
Delinquent property taxes receivable (tax increment investment zone)	<u>54,183</u>	<u>-</u>
Total Governmental Funds	<u>\$ 143,140</u>	<u>\$ -</u>

C. Property Taxes

Property taxes are levied on October 1 on assessed values as of January 1 for all real and personal property located in the City. Taxes are due in January of the following year and become delinquent on February 1. On January 1 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed.

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IV. DETAILED NOTES ON ALL FUNDS (Continued)

C. Property Taxes (Continued)

The appraisal of property within the City is the responsibility of the Hays County Appraisal District. The Appraisal District is required under the Property Tax Code to assess all property within the appraisal district on the basis of 100 percent of its appraised value and is prohibited from applying any assessment ratios. The value of property within the appraisal district must be reviewed at least every five years. The City may challenge appraised values established by the Appraisal District through various appeals and, if necessary, legal action. Under this legislation, the City continues to set tax rates on City property. However, if the effective tax rate, excluding tax rates for bonds and other contractual obligations and adjusted for new improvements, exceeds the rate for the previous year by more than 8 percent, qualified voters of the City may petition for an election to determine whether to limit the tax rate to no more than 8 percent above the tax rate of the previous year.

D. Capital Assets

Capital asset activity for the year ended September 30, 2007, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 1,272,067	\$ 267,565	\$ -	\$ 1,539,632
Construction in progress	10,037	2,016,143	-	2,026,180
Total assets not being depreciated	<u>1,282,104</u>	<u>2,283,708</u>	<u>-</u>	<u>3,565,812</u>
Capital assets, being depreciated:				
Buildings	5,977,128	1,052,316	-	7,029,444
Improvements other than buildings	216,993	160,178	-	377,171
Infrastructure	16,651,323	1,203,211	-	17,854,534
Machinery and equipment	731,609	358,427	80,557	1,009,479
Total capital assets being depreciated	<u>23,577,053</u>	<u>2,774,132</u>	<u>80,557</u>	<u>26,270,628</u>
Accumulated depreciation:				
Buildings	(324,561)	(142,680)	(135,890)	(331,351)
Improvements other than buildings	(42,502)	(28,007)	-	(70,509)
Infrastructure	(256,128)	(340,642)	-	(596,770)
Machinery and equipment	(320,853)	(101,284)	(71,887)	(350,250)
Total accumulated depreciation	<u>(944,044)</u>	<u>(612,613)</u>	<u>(207,777)</u>	<u>(1,348,880)</u>
Total capital assets being depreciated, net	<u>22,633,009</u>	<u>2,161,519</u>	<u>(127,220)</u>	<u>24,921,748</u>
Governmental activities capital assets, net	<u>\$ 23,915,113</u>	<u>\$ 4,445,227</u>	<u>\$ (127,220)</u>	<u>\$ 28,487,560</u>

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IV. DETAILED NOTES ON ALL FUNDS (Continued)

D. Capital Assets (Continued)

	Beginning Balance	Increases	Decreases	Ending Balance
Business-type activities:				
Capital assets, not being depreciated:				
Land	\$ 436,800	\$ 30,600	\$ -	\$ 467,400
Easements	224,535	-	-	224,535
Construction in progress	<u>2,823,977</u>	<u>1,839,935</u>	<u>2,403,220</u>	<u>2,260,692</u>
Total assets not being depreciated	<u>3,485,312</u>	<u>1,870,535</u>	<u>2,403,220</u>	<u>2,952,627</u>
Capital assets, being depreciated:				
Improvements other than buildings	17,043,023	5,080,805	-	22,123,828
Machinery and equipment	<u>620,949</u>	<u>45,661</u>	-	<u>666,610</u>
Total capital assets being depreciated	<u>17,663,972</u>	<u>5,126,466</u>	-	<u>22,790,438</u>
Accumulated depreciation:				
Improvements other than buildings	(3,263,135)	(649,463)	-	(3,912,598)
Machinery and equipment	<u>(384,301)</u>	<u>(64,897)</u>	-	<u>(449,198)</u>
Total accumulated depreciation	<u>(3,647,436)</u>	<u>(714,360)</u>	-	<u>(4,361,796)</u>
Total capital assets being depreciated, net	<u>14,016,536</u>	<u>4,412,106</u>	-	<u>18,428,642</u>
Business-type activities capital assets, net	<u>\$ 17,501,848</u>	<u>\$ 6,282,641</u>	<u>\$ 2,403,220</u>	<u>\$ 21,381,269</u>

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

Governmental activities:	
General government	\$ 99,899
Public safety	82,402
Public works	77,359
Culture and recreation	<u>352,953</u>
Total depreciation expense - governmental activities	<u>\$ 612,613</u>
Business-type activities:	
Water and wastewater	<u>\$ 714,360</u>
Total depreciation expense - business-type activities	<u>\$ 714,360</u>

(continued)

IV. DETAILED NOTES ON ALL FUNDS (Continued)

E. Interfund Receivables, Payables and Transfers

The composition of interfund balances as of September 30, 2007, is as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Nonmajor governmental	\$ 103,685
Nonmajor governmental	Water and wastewater	6,424
General	Water and wastewater	278,150
General	2008 Certificates obligation	<u>1,039,194</u>
Total		<u>\$ 1,427,453</u>

Balances resulted from the time lag between the dates that 1) interfund goods and services are provided on reimbursable expenditures occur, and 2) transactions are recorded in the accounting system, and 3) payments between funds are made.

Interfund transfers during the year ended September 30, 2007, are as follows:

<u>Transfers In</u>	<u>Transfers Out</u>	<u>Amount</u>
General	Water and wastewater	\$ 841,023
Nonmajor governmental	General	702,749
Nonmajor governmental	Water and wastewater	513,837
Nonmajor governmental	Road improvements	35,662

Transfers are used to 1) move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them, 2) move receipts restricted to debt service from the funds collecting the receipts to the Debt Service Fund as debt service payments become due, and 3) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

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IV. DETAILED NOTES ON ALL FUNDS (Continued)

F. Long-term Debt

Changes in Long-term Liabilities

Long-term liability activity for the year ended September 30, 2007, was as follows:

	Balance 09/30/06	Additions	Reductions	Balance 09/30/07	Due Within One Year
<u>Governmental activities:</u>					
Certificates of obligation	\$ 7,755,000	\$ 9,910,000	\$ 465,000	\$ 17,200,000	\$ 480,000
Premium on bond issuance	-	87,661	-	87,661	4,383
Refunding bonds	75,000	-	20,000	55,000	25,000
State infrastructure loan	14,000,000	-	-	14,000,000	588,894
Deferred interest payable	637,000	189,276	-	826,276	674,596
Compensated absences	100,035	16,208	-	116,243	23,249
Total governmental activities	<u>\$ 22,567,035</u>	<u>\$ 10,203,145</u>	<u>\$ 485,000</u>	<u>\$ 32,285,180</u>	<u>\$ 1,796,122</u>
<u>Business-type activities:</u>					
Note payable	\$ 2,366,017	-	\$ 71,701	\$ 2,294,316	\$ 77,259
Compensated absences	8,396	-	-	8,396	1,679
Total business-type activities	<u>\$ 2,374,413</u>	<u>\$ -</u>	<u>\$ 71,701</u>	<u>\$ 2,302,712</u>	<u>\$ 78,938</u>

The General Fund is generally used to liquidate compensated absences for governmental activities.

General Obligation Bonds

The City issues general obligation bonds to provide funds for the acquisition and construction of major capital facilities and to refund previous issues. General obligation bonded debt of the City is as follows:

Governmental Activities:

\$245,000 Combination Tax and Revenue Refunding Bonds - Series 1989, principal due annually in series through 2009, interest due semi-annually at 9.95% to 10.50%.	\$ 55,000
\$1,385,000 Combination Tax and Revenue Certificates of Obligation - Series 2000, principal due annually in series through 2024, interest due semi-annually at 4.85% to 6.75%.	1,220,000
\$5,135,000 Combination Tax and Revenue Certificates of Obligation - Series 2002, principal due annually in series through 2020, interest due semi-annually at 3.00% to 4.75%.	4,425,000
\$2,340,000 Combination Tax and Revenue Certificates of Obligation - Series 2003, principal due annually in series through 2013, interest due semi-annually at 3.68%.	1,645,000
\$9,910,000 Combination Tax and Revenue Certificates of Obligation - Series 2007, principal due annually in series through 2027, interest due semi-annually at 4.00%.	<u>9,910,000</u>
	<u>\$ 17,255,000</u>

(continued)

IV. DETAILED NOTES ON ALL FUNDS (Continued)

F. Long-term Debt (Continued)

State Infrastructure Bank Loan

On February 28, 2005, the City entered into an agreement with the State of Texas, acting by and through the Texas Department of Transportation to construct, maintain, or finance a highway improvement project. On November 16, 2004, the City designated an area within the City known as "Reinvestment Zone Number One" for the purpose of financing the state infrastructure bank loan through collections of property taxes in the reinvestment zone. A state infrastructure bank loan in the amount of \$14,000,000 is due in annual installments of \$1,202,932 through March 17, 2024, with the first payment deferred to March 17, 2008, at an interest rate of 4.55%. As of September 30, 2007, deferred interest payable in the amount of \$826,276 is reported as a long-term liability.

Notes Payable

On February 15, 1999, the City entered an agreement with AquaSource Services and Technologies, Inc. to finance, design, construct, operate, maintain and manage a new wastewater collection and treatment facility. The total cost to the City for the facility is \$2,700,000, which is to be amortized over a 23-year period.

The City would bear the cost of right-of-way acquisitions for the transmission lines and 50 percent of the costs to secure the necessary permits from the TNRCC. AquaSource's compensation consists of a monthly fee of \$20,538 for payment of principal and interest at 7.5% beginning November 1, 2001, and an operating fee that will be determined by multiplying the number of 1,000 gallon units of wastewater effluent treated during the calendar month by the applicable costs per 1,000 gallons as specified in Appendix F of the Agreement. At the end of 23 years of payments, the facilities will become the property of the City without any additional payments. The City will recoup its costs through user charges.

Defeasance of Bonds

In prior years, the City defeased certain certificates of obligation bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and liabilities for the defeased bonds are not included in the City's financial statements. As of September 30, 2007, the City does not have any debt considered defeased and still outstanding.

(continued)

IV. DETAILED NOTES ON ALL FUNDS (Continued)

F. Long-term Debt (Continued)

Debt Service Requirements

Annual debt service requirements to maturity for certificates of obligation and refunding bonds are as follows:

<u>Fiscal Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 505,000	\$ 882,375	\$ 1,387,375
2009	700,000	694,996	1,394,996
2010	835,000	666,436	1,501,436
2011	960,000	633,732	1,593,732
2012	1,005,000	596,792	1,601,792
2013-2017	4,355,000	2,423,078	6,778,078
2018-2022	4,730,000	1,462,425	6,192,425
2023-2026	<u>4,165,000</u>	<u>477,276</u>	<u>4,642,276</u>
Total	<u>\$ 17,255,000</u>	<u>\$ 7,837,110</u>	<u>\$ 25,092,110</u>

Annual debt service requirements for the State Infrastructure Bank Loan is as follows:

<u>Fiscal Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 588,894	\$ 674,596	\$ 1,263,490
2009	615,688	647,801	1,263,489
2010	643,702	619,787	1,263,489
2011	672,991	590,499	1,263,490
2012	703,612	559,878	1,263,490
2013-2017	4,028,419	2,289,026	6,317,445
2018-2022	5,032,164	1,285,281	6,317,445
2023-2026	<u>2,540,806</u>	<u>187,758</u>	<u>2,728,564</u>
Total	<u>\$ 14,826,276</u>	<u>\$ 6,854,626</u>	<u>\$ 21,680,902</u>

Annual debt service requirements to maturity for notes payable are as follows:

<u>Fiscal Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 77,259	\$ 169,200	\$ 246,459
2009	83,248	163,211	246,459
2010	89,700	156,758	246,458
2011	96,653	149,805	246,458
2012	104,145	142,314	246,459
2013-2017	655,077	577,216	1,232,293
2018-2022	951,488	280,805	1,232,293
2023-2026	<u>236,746</u>	<u>9,713</u>	<u>246,459</u>
Total	<u>\$ 2,294,316</u>	<u>\$ 1,649,022</u>	<u>\$ 3,943,338</u>

(continued)

IV. DETAILED NOTES ON ALL FUNDS (Continued)

G. Contingent Arbitrage Liabilities

The City has invested a portion of revenue bond proceeds as a reserve for the retirement of the bonds. Any excess of interest revenue earned on invested proceeds over interest paid on the bonds must be rebated to the federal government every five years.

V. OTHER INFORMATION

A. Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; employee health benefits; and other claims of various natures. The City participates in the Texas Municipal League Intergovernmental Risk Pool. As an insured, the City is not obligated to reimburse the pool for losses. The City has not had any significant reductions in insurance coverage, nor have insurance settlements for the last three fiscal years exceeded insurance coverage. Any losses reported, but unsettled or incurred and not reported, are believed to be insignificant to the City's financial statements.

B. Commitments and Contingencies

The City is defendant in lawsuits occurring in the normal course of business. Although the outcome of these matters is not presently determinable, in the opinion of the City's attorney, their resolution will not have a material adverse effect on the financial condition of the City.

Amounts received or receivable from grantor agencies are subject to audit and adjustment by such agencies. 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.

C. Retirement Plan

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 statewide Texas Municipal Retirement System (TMRS), one of 821 administered by TMRS, an agent multiple-employer public employee retirement system.

All assumptions for the December 31, 2006, valuations are contained in the 2006 TMRS Comprehensive Annual Financial Report, a copy of which may be obtained by writing to P. O. Box 149153, Austin, Texas 78714-9153.

(continued)

V. **OTHER INFORMATION** (Continued)

C. **Retirement Plan** (Continued)

Plan Description (Continued)

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 10 or more years of service or with 20 years of service regardless of age. A member is vested after 10 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.

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 (overfunded) 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, 2006, valuation is effective for rates beginning January 2008).

(continued)

V. **OTHER INFORMATION** (Continued)

C. **Retirement Plan** (Continued)

Contributions (Continued)

Assumptions and Schedule of Actuarial Liabilities and Funding Progress

Actuarial Cost Method	Unit Credit
Amortization Method	Level Percent of Payroll
Remaining Amortization	25 Years - Open Period
Asset Valuation Method	Amortized Cost (GASB-25, paragraphs 36e and 138)

Investment Rate of Return	7%
Projected Salary Increases	None
Includes Inflation at	3.50%
Cost of Living Adjustments	None

Actuarial Valuation Date	12/31/06	12/31/05	12/31/04
Actuarial Value of Assets	\$ 2,423,903	\$ 2,026,094	\$ 1,849,054
Actuarial Accrued Liabilities	2,989,877	2,580,546	2,351,159
Percentage Funded	81.1%	78.5%	78.6%
Unfunded (Overfunded) Actuarial Accrued Liability (UAAL)	565,974	554,452	502,105
Annual Covered Payroll	2,536,750	1,902,879	1,666,751
UAAL as a Percentage of Covered Payroll	22.3%	29.1%	30.1%
Net Pension Obligation (NPO) at the Beginning of Period	-	-	-
Annual Pension Cost:			
Annual Required Contribution (ARC)	179,591	183,831	170,865
Contributions Made	<u>179,591</u>	<u>183,831</u>	<u>170,865</u>
NPO at the End of the Period	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>

D. **Prior Period Adjustment**

In the current year, the City determined developer deposits were misstated in the prior year. An adjustment to beginning fund balance and net assets were made in the amount of \$90,652.

**REQUIRED
SUPPLEMENTARY INFORMATION**

CITY OF KYLE, TEXAS

**SCHEDULE OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL (GAAP BASIS)**

GENERAL FUND

FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES				
Taxes:				
Property	\$ 2,634,866	\$ 1,679,708	\$ 1,729,274	\$ 49,566
Sales	1,723,701	1,813,920	1,916,203	102,283
Franchise	348,464	410,883	420,677	9,794
Fines and forfeitures	510,490	474,451	469,190	(5,261)
Licenses, permits and fees	1,526,313	1,155,419	843,800	(311,619)
Intergovernmental	-	-	57,793	57,793
Charges for services	790,161	815,325	1,202,839	387,514
Investment earnings	189,980	209,225	245,475	36,250
Miscellaneous	8,965	60,382	43,883	(16,499)
Total revenues	<u>7,732,940</u>	<u>6,619,313</u>	<u>6,929,134</u>	<u>309,821</u>
EXPENDITURES				
Current:				
General government	3,469,684	3,224,239	3,532,105	307,866
Public safety	2,055,971	1,942,907	1,994,543	51,636
Public works	690,611	364,858	412,984	48,126
Culture and recreation	1,107,546	1,032,005	1,170,630	138,625
Capital outlay	1,795,576	940,550	1,158,222	217,672
Total expenditures	<u>5,649,704</u>	<u>4,280,320</u>	<u>4,736,379</u>	<u>456,059</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	<u>2,083,236</u>	<u>2,338,993</u>	<u>2,192,755</u>	<u>765,880</u>
OTHER FINANCING SOURCES (USES)				
Transfers in	772,333	984,572	841,023	143,549
Transfers out	(328,548)	(35,000)	(702,749)	667,749
Total other financing sources and uses	<u>443,785</u>	<u>949,572</u>	<u>138,274</u>	<u>811,298</u>
NET CHANGE IN FUND BALANCE	2,527,021	3,288,565	2,331,029	957,536
FUND BALANCE, BEGINNING	3,974,802	3,974,802	3,974,802	-
PRIOR PERIOD ADJUSTMENT	-	-	90,652	(90,652)
FUND BALANCE, ENDING	<u>\$ 6,501,823</u>	<u>\$ 7,263,367</u>	<u>\$ 6,396,483</u>	<u>\$ 957,536</u>

CITY OF KYLE, TEXAS

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

SEPTEMBER 30, 2007

General Budget Policies

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

Annual appropriated budgets are adopted on a basis consistent with generally accepted accounting principles for the General and Debt Service Funds. The City adopts project-length budgets for the Capital Projects and Special Revenue Funds.

The City Manager submits to the Council a proposed budget.

The Council holds a public hearing on the budget submitted and all interested persons are given an opportunity to be heard for or against any item or the amount of any item contained therein.

After the conclusion of the public hearing, the Council may insert new items or may increase or decrease the items of the budget, except items in proposed expenditures fixed by law, but where it increases the total proposed expenditures, it also provides for an increase in the total anticipated revenue to at least equal such total proposed expenditures.

The budget is adopted by a majority vote of the members of the whole Council.

The budget must be adopted not later than the third Thursday of September. Should the council take no final action on or prior to such day, the budget as submitted by the City Manager shall be deemed to have been finally adopted by the Council. The legal level of budgetary control is the fund level.

Budget amounts are as originally adopted prior to the beginning of the year or as amended by the City Council during the year. Supplemental appropriations were not required in the amended budget.

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CITY OF KYLE, TEXAS
COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Special Revenue		
	Recreation Building	Parks	Police Seizure
ASSETS			
Cash and investments	\$ 1,940	\$ 106,032	\$ 22,245
Tax receivable	-	-	-
Due from other funds	-	-	-
	-	-	-
Total assets	\$ 1,940	\$ 106,032	\$ 22,245
LIABILITIES			
Accounts payable	\$ -	\$ 1,209	\$ -
Due to other funds	5,510	-	-
Deferred revenue	-	-	-
	-	-	-
Total liabilities	5,510	1,209	-
FUND BALANCES			
Unreserved, undesignated	(3,570)	104,823	22,245
Total fund balances	(3,570)	104,823	22,245
Total liabilities and fund balances	\$ 1,940	\$ 106,032	\$ 22,245

Special Revenue			Capital Projects			Total Nonmajor Governmental Funds
Hotel Occupancy Tax	Library	Tax Increment Reinvestment Zone	2002 Certificates of Obligation	Street Projects	Debt Service	
\$ 194,880	\$ 134,745	\$ 353,200	\$ 249,972	\$ 312,236	\$ 557,844	\$ 1,933,094
21,146	-	54,183	-	-	46,208	121,537
-	-	-	-	-	6,424	6,424
<u>\$ 216,026</u>	<u>\$ 134,745</u>	<u>\$ 407,383</u>	<u>\$ 249,972</u>	<u>\$ 312,236</u>	<u>\$ 610,476</u>	<u>\$ 2,061,055</u>
\$ -	\$ -	\$ -	\$ 249,972	\$ -	\$ -	\$ 251,181
-	-	-	-	98,175	-	103,685
-	-	54,183	-	-	49,915	104,098
-	-	54,183	249,972	98,175	49,915	458,964
<u>216,026</u>	<u>134,745</u>	<u>353,200</u>	<u>-</u>	<u>214,061</u>	<u>560,561</u>	<u>1,602,091</u>
<u>216,026</u>	<u>134,745</u>	<u>353,200</u>	<u>-</u>	<u>214,061</u>	<u>560,561</u>	<u>1,602,091</u>
<u>\$ 216,026</u>	<u>\$ 134,745</u>	<u>\$ 407,383</u>	<u>\$ 249,972</u>	<u>\$ 312,236</u>	<u>\$ 610,476</u>	<u>\$ 2,061,055</u>

CITY OF KYLE, TEXAS

**COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES**

NONMAJOR GOVERNMENTAL FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Special Revenue		
	Recreation Building	Parks	Police Seizure
REVENUES			
Taxes:			
Property	\$ -	\$ -	\$ -
Occupancy	-	-	-
Fines and forfeitures	-	-	11,634
Contributions	8,100	-	-
Investment earnings	16	10,213	773
Miscellaneous	-	75	102
Total revenues	8,116	10,288	12,509
EXPENDITURES			
Current:			
General government	-	-	-
Public safety	-	-	24,736
Culture and recreation	18,032	6,020	-
Debt service:			
Principal	-	-	-
Interest and fiscal charges	-	-	-
Capital outlay	-	85,166	11,311
Total expenditures	18,032	91,186	36,047
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(9,916)	(80,898)	(23,538)
OTHER FINANCING SOURCES (USES)			
Transfers in	-	-	-
Total other financing sources and uses	-	-	-
NET CHANGE IN FUND BALANCES	(9,916)	(80,898)	(23,538)
FUND BALANCES, BEGINNING	6,346	185,721	45,783
FUND BALANCES, ENDING	\$(3,570)	\$ 104,823	\$ 22,245

Special Revenue			Capital Projects			Total
Hotel Occupancy Tax	Library	Tax Increment Reinvestment Zone	2002 Certificates of Obligation	Street Projects	Debt Service	Nonmajor Governmental Funds
\$ -	\$ -	\$ 23,588	\$ -	\$ -	\$ 870,610	\$ 894,198
82,172	-	-	-	-	-	82,172
-	-	-	-	-	-	11,634
-	2,724	-	-	-	-	10,824
9,949	5,624	12,330	44,548	15,977	724	100,154
-	1,000	-	-	-	-	1,177
<u>92,121</u>	<u>9,348</u>	<u>35,918</u>	<u>44,548</u>	<u>15,977</u>	<u>871,334</u>	<u>1,100,159</u>
-	-	-	446,732	-	-	446,732
-	-	-	-	-	-	24,736
70,000	-	-	-	-	-	94,052
-	-	-	-	-	485,000	485,000
-	-	-	-	-	334,931	334,931
-	-	-	131,451	-	-	227,928
<u>70,000</u>	<u>-</u>	<u>-</u>	<u>578,183</u>	<u>-</u>	<u>819,931</u>	<u>1,613,379</u>
<u>22,121</u>	<u>9,348</u>	<u>35,918</u>	<u>(533,635)</u>	<u>15,977</u>	<u>51,403</u>	<u>(513,220)</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>1,216,586</u>	<u>-</u>	<u>35,662</u>	<u>1,252,248</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>1,216,586</u>	<u>-</u>	<u>35,662</u>	<u>1,252,248</u>
22,121	9,348	35,918	682,951	15,977	87,065	739,028
<u>193,905</u>	<u>125,397</u>	<u>317,282</u>	<u>(682,951)</u>	<u>198,084</u>	<u>473,496</u>	<u>863,063</u>
<u>\$ 216,026</u>	<u>\$ 134,745</u>	<u>\$ 353,200</u>	<u>\$ -</u>	<u>\$ 214,061</u>	<u>\$ 560,561</u>	<u>\$ 1,602,091</u>



PATTILLO, BROWN & HILL, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS ■ BUSINESS CONSULTANTS

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

The Honorable Mayor and
Members of the City of Council
City of Kyle, Texas

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Kyle, Texas as of and for the year ended September 30, 2007, and have issued our report thereon dated April 11, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule as Items 07-01, 05-01, 05-02, 04-04, and 04-06 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiencies described above to be a material weakness.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the City in a separate letter dated April 11, 2008.

This report is intended solely for the information and use of management, others within the City, and City Council and is not intended to be and should not be used by anyone other than these specified parties.

Pattillo, Brown & Hill, L.L.P.

April 11, 2008

CITY OF KYLE, TEXAS

SCHEDULE OF MATERIAL WEAKNESSES

FOR THE YEAR ENDED SEPTEMBER 30, 2007

07-01 MUNICIPAL COURT RECEIVABLE

During our audit of the City's Municipal Court Fines receivable, we noted a detailed listing that includes items that are considered receivables for financial reporting purposes was not readily available. We recommend the City generate a detailed listing of capias pro fines receivable at the end of the fiscal year in order to facilitate the preparation of its financial statements.

05-01 BANK RECONCILIATIONS

Monthly bank reconciliations assist in detecting errors in a timely manner and aid in providing management accurate cash position balances to make prudent financial decisions. Bank reconciliations are not performed promptly and some discrepancies identified were not corrected in the general ledger. We recommend bank reconciliations be performed promptly and discrepancies be investigated and corrected in a timely manner.

05-02 RECONCILIATION OF GENERAL LEDGER ACCOUNTS TO THE SUBSIDIARY LEDGER

Detail listings (subsidiary ledger) were not available or reconciled to certain account balances at year-end. These accounts include utility receivables, property taxes, accounts payable, accrued liabilities, and other miscellaneous receivables and payables. A detail listing supporting the amount on the general ledger is an important element in the internal control structure over account balances. We recommend a detailed listing be generated at the end of each month and reconciled to the general ledger. This will provide the City with an accurate listing of the items comprising account balances during the year, assist in detecting errors in a timely manner, and provide an audit trail.

04-04 DEVELOPER DEPOSITS

During our audit of the City's liabilities, we noted that a detail listing (subsidiary ledger) was not available for developer deposits. A detailed listing supporting the amount on the general ledger is an important element in the internal control structure over these accounts. Currently, the City has researched each of the developer deposits and is in the process of analyzing the information for accuracy. We recommend that a detailed listing be generated at the end of each month and reconciled to the general ledger. Additionally, a statement reporting activity should be generated for each developer and payment should be requested when necessary. This will provide the City with an accurate listing of the items comprising these account balances during the year, assist in detecting errors in a timely manner and provide an audit trail. Progress has been made related to developer deposits, but there were additional accounts that needed to be investigated.

04-06 INFRASTRUCTURE REPORTING

Infrastructure assets should be reported as a part of the City's capital assets upon implementation of Governmental Accounting Standards Board Statement No. 34. Infrastructure assets generally should be reported at historical cost (if purchased or constructed) or estimated fair value (if donated) at the time of acquisition. In the current fiscal year (the year of implementation), adequate information for infrastructure donated by developers was unavailable. As a result, we recommend that the City obtain information from developers in order to determine the estimated fair value of donated infrastructure as required by GASBS No. 34.

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City of Kyle, Texas
100 W. Center Street
Kyle, Texas 78640
(512) 262-1010