

ANNUAL FINANCIAL REPORT

of the

**CITY OF MAGNOLIA,
TEXAS**

For the Year Ended
September 30, 2008

*Received & Filed
in the Office of*

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*City Secretary
City of Magnolia, Texas*

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CITY OF MAGNOLIA, TEXAS

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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Members of the City Council
City of Magnolia, Texas:

We have audited the accompanying financial statements of the governmental activities, business-type activities, the discretely presented component units, and each major fund of the City of Magnolia, Texas (the "City"), as of and for the year then ended September 30, 2008, 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's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, business-type activities, discretely presented component units, and each major fund of the City as of September 30, 2008, and the respective changes in financial position, and where applicable, cash flows 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, the budgetary comparisons, and pension information are not required parts 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's basic financial statements. The schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedules have been subjected to 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.

Belt Harris & Associates, LLP

Belt Harris & Associates, LLP
Certified Public Accountants
Houston, Texas
June 5, 2009

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*MANAGEMENT'S DISCUSSION
AND ANALYSIS*

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CITY OF MAGNOLIA, TEXAS

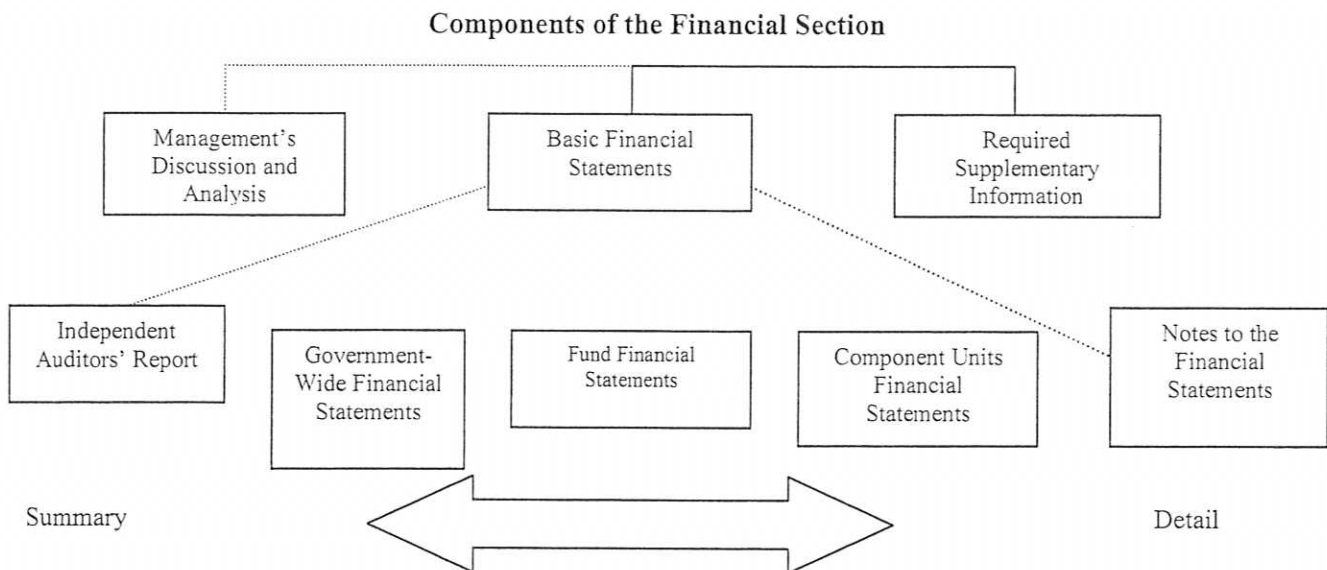
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

September 30, 2008

The purpose of the Managements' Discussion and Analysis ("MD&A") is to give the readers an objective and easily readable analysis of the financial activities of the City of Magnolia, Texas (the "City") for the year ending September 30, 2008. The analysis is based on currently known facts, decisions, or economic conditions. It presents short and long-term analysis of the City's activities, compares current-year results with those of the prior year, and discusses the positive and negative aspects of that comparison. Governmental Accounting Standards Board (GASB) Statement No. 34 establishes the content of the minimum requirements for MD&A. Please read the MD&A in conjunction with the City's financial statements, which follow this section.

THE STRUCTURE OF OUR ANNUAL REPORT

The table of contents presented at the beginning of this report provides an overview of the structure of the City's report, as well as the page numbers where the respective sections can be located within the report, as more fully described below.



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

Government-Wide Statements

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

CITY OF MAGNOLIA, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2008

The Statement of Net Assets presents information on all of the City's assets and liabilities. The difference between the two is reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating. Other non-financial factors, such as the City's property tax base and the condition of the City's infrastructure, need to be considered in order to assess the overall health of the City.

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

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

1. Governmental Activities - Most of the City's basic services are reported here, including general government, public safety, and public works. Interest payments on the City's debt are also reported here. Sales tax, property tax, franchise taxes, municipal court fines and permit fees finance most of these activities.
2. Business-Type Activities - Services involving a fee for those services. These services, the City's water and sewer are reported here.

FUND FINANCIAL STATEMENTS

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

Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating the City's near-term financing requirements.

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

The City maintains four 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, debt service fund, capital projects fund, and the special revenue fund – HB445, which are considered to be major funds. While the debt service fund did not technically qualify as a major fund, management has elected to present it as major for reporting purposes due to its significance.

CITY OF MAGNOLIA, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2008

The City adopts an annual appropriated budget for its general fund, special revenue fund, and debt service fund. A budgetary comparison schedule has been provided for the general fund, special revenue fund and debt service fund to demonstrate compliance with this budget.

Proprietary Funds

The City maintains one type of proprietary fund, enterprise funds, to account for all "business like" activities. The enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the respective enterprise funds.

Notes to Financial Statements

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

Other Information

In addition to basic financial statements, this MD&A, and accompanying notes, this report also presents certain RSI. The RSI that GASB Statement No. 34 requires includes budgetary comparison schedules for the general fund and special revenue fund – HB445 and schedule of funding progress for the Texas Municipal Retirement System.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of the City's financial position. Assets exceeded liabilities by \$3,525,906 at year end.

A large portion of the City's net assets, 41%, reflects its investments in capital assets (e.g. land, city hall, police station, drainage systems, as well as the public works facilities) less any debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the assets themselves cannot be used to liquidate these liabilities.

CITY OF MAGNOLIA, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2008

SUMMARY OF STATEMENT OF NET ASSETS

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2008	2007	2008	2007	2008	2007
Current and other assets	\$ 655,280	\$ 1,262,711	\$ 2,262,591	\$ 3,363,132	\$ 2,917,871	\$ 4,625,843
Capital assets, net	3,404,285	3,145,244	5,005,586	3,820,682	8,409,871	6,965,926
Total Assets	4,059,565	4,407,955	7,268,177	7,183,814	11,327,742	11,591,769
Long-term liabilities	2,322,698	2,367,624	4,705,000	4,780,000	7,027,698	7,147,624
Other liabilities	558,254	328,377	215,884	501,106	774,138	829,483
Total Liabilities	2,880,952	2,696,001	4,920,884	5,281,106	7,801,836	7,977,107
Net Assets:						
Invested in capital assets, net of related debt	1,136,591	1,646,158	300,586	(699,906)	1,437,177	946,252
Restricted	262,630	199,405	-	-	262,630	199,405
Unrestricted	(220,608)	(133,609)	2,046,707	2,602,614	1,826,099	2,469,005
Total Net Assets	\$ 1,178,613	\$ 1,711,954	\$ 2,347,293	\$ 1,902,708	\$ 3,525,906	\$ 3,614,662

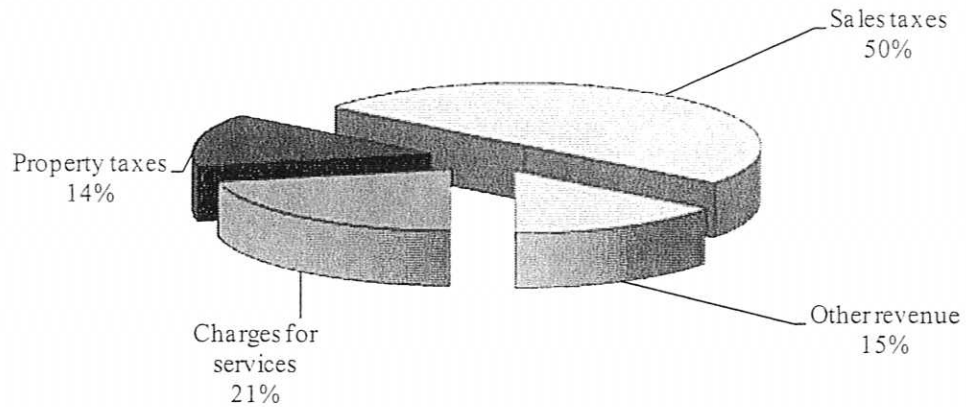
A portion of the primary government's net assets, 7%, represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$1,826,099, may be used to meet the City's ongoing obligation to citizens and creditors.

CHANGES IN NET ASSETS

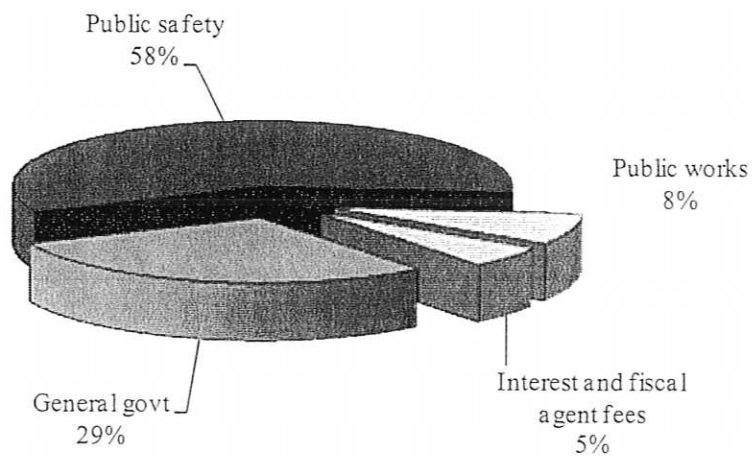
	Governmental Activities		Business-Type Activities		Total Primary Government	
	2008	2007	2008	2007	2008	2007
Revenues						
Program revenues:						
Charges for services	\$ 527,863	\$ 561,288	\$ 1,245,330	\$ 1,409,851	\$ 1,773,193	\$ 1,971,139
General revenues:						
Property taxes	337,984	342,602	-	-	337,984	342,602
Sales taxes	1,220,279	1,063,799	-	-	1,220,279	1,063,799
Other revenue	362,854	260,798	61,165	206,782	424,019	467,580
Total Revenues	2,448,980	2,228,487	1,306,495	1,616,633	3,755,475	3,845,120
Total Expenses	2,305,633	2,391,151	1,538,598	1,190,664	3,844,231	3,581,815
Transfers	(676,688)	-	676,688	-	-	-
Change in Net Assets	(533,341)	(162,664)	444,585	425,969	(88,756)	263,305
Beginning Net Assets	1,711,954	1,874,618	1,902,708	1,476,739	3,614,662	3,351,357
Ending Net Assets	\$ 1,178,613	\$ 1,711,954	\$ 2,347,293	\$ 1,902,708	\$ 3,525,906	\$ 3,614,662

CITY OF MAGNOLIA, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2008

Governmental Activities - Revenues

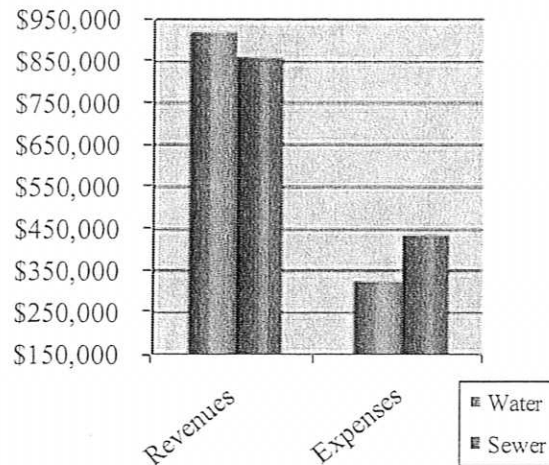


Governmental Activities - Expenses



CITY OF MAGNOLIA, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2008

Business-Type Activities - Revenues and Expenses



Governmental and Business-Type Activities

The City reported an increase in sales tax during the year due to the increased development within the City.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

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

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

The City's governmental funds reflect a combined deficit fund balance of \$50,502. Of this, \$109,588 is reserved for special revenue fund – HB445, \$89,910 for tourism, \$38,005 for municipal court, and \$25,071 for debt service.

There was a decrease in the combined fund balance of \$921,182 from the prior year, primarily attributable to the City using the capital projects fund balance.

The general fund reported a decrease in fund balance due to the addition of personnel to city services.

The debt service fund reported a decrease in fund balance due to bond payments exceeding property taxes received during the year.

The capital projects fund experienced a decrease in fund balance related to ongoing construction projects within the City.

The special revenue fund decreased fund balance by \$20,323 as a result of capital outlay for road construction.

CITY OF MAGNOLIA, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2008

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

GENERAL FUND BUDGETARY HIGHLIGHTS

For the year, the general fund had total revenues of \$2,031,974, a negative budget variance of \$165,206 from the final budget as of September 30, 2008. This variance is primarily due to property taxes and fines and forfeitures reporting less than expected revenues during the year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets - At the end of the year, the City's governmental activities and business-type activities had invested \$3,404,285 and \$5,005,586, respectively, in a variety of capital assets and infrastructure net of accumulated depreciation.

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

Long-Term Debt - At the end of the current year, the City had total long-term debt in governmental activities of \$2,322,698.

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City is experiencing a period of growth. Property values are increasing, commercial development continues, property and sales tax revenues are expanding, and the City is thriving.

Management for the City is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft, or misuse and to ensure that adequate accounting data is compiled to allow for the timely preparation of financial statements in conformity with generally accepted accounting principles. Thus, in future fiscal periods, it is the Mayor and Council's objective to support staff in acquiring and implementing management and financial software (for fund accounting, utility billing, municipal court, and public safety) sufficient to satisfy these requirements, and meet the customer-service demands that accompany the City's expansion.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the City's finances. Questions concerning this report or requests for additional financial information should be directed to the City Administrator, City of Magnolia, Texas, 18111 Buddy Riley Blvd, Magnolia, Texas, 77355.

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FINANCIAL STATEMENTS

CITY OF MAGNOLIA, TEXAS

STATEMENT OF NET ASSETS

September 30, 2008

		Primary Government		
		Governmental	Business-Type	Total
		Activities	Activities	
<u>Assets</u>				
Cash and cash equivalents		\$ 318,981	\$ 1,908,887	\$ 2,227,868
Receivables, (net of allowance for uncollectible)		252,516	58,355	310,871
Due from others		9,238	-	9,238
Internal balances		(53,231)	53,231	-
	Total Current Assets	527,504	2,020,473	2,547,977
Deferred charges		127,776	242,118	369,894
Capital assets:				
Non-depreciable		20,414	108,634	129,048
Net depreciable		3,383,871	4,896,952	8,280,823
	Total Noncurrent Assets	3,532,061	5,247,704	8,779,765
	Total Assets	4,059,565	7,268,177	11,327,742
<u>Liabilities</u>				
Accounts payable and accrued liabilities		545,254	47,804	593,058
Customer deposits		-	71,557	71,557
Accrued interest payable		13,000	96,523	109,523
		558,254	215,884	774,138
Noncurrent liabilities:				
Long-term liabilities due within one year		98,928	80,000	178,928
Long-term liabilities due in more than one year		2,223,770	4,625,000	6,848,770
		2,322,698	4,705,000	7,027,698
	Total Liabilities	2,880,952	4,920,884	7,801,836
<u>Net Assets</u>				
Invested in capital assets, net of related debt		1,136,591	300,586	1,437,177
Restricted for:				
Debt service		25,127	-	25,127
Municipal court		38,005	-	38,005
Tourism		89,910	-	89,910
HB445		109,588	-	109,588
Economic development		-	-	-
Community development		-	-	-
Unrestricted		(220,608)	2,046,707	1,826,099
	Total Net Assets	\$ 1,178,613	\$ 2,347,293	\$ 3,525,906

See Notes to Financial Statements.

Component Units	
4A Economic Development	4B Community Development
\$ 744,581	\$ 397,928
79,483	39,741
-	-
-	-
824,064	437,669
-	-
160,709	-
1,246,189	3,931
1,406,898	3,931
2,230,962	441,600
5,651	7,178
-	-
-	-
5,651	7,178
180,757	78,915
548,836	86,901
729,593	165,816
735,244	172,994
677,305	(161,885)
-	-
-	-
-	-
-	-
818,413	-
-	430,491
-	-
\$ 1,495,718	\$ 268,606

CITY OF MAGNOLIA, TEXAS

STATEMENT OF ACTIVITIES

For the Year Ended September 30, 2008

Functions/Programs	Expenses	Program Revenues Charges for Services
Primary Government		
Governmental Activities		
General government	\$ 673,578	\$ 28,353
Public safety	1,337,003	499,510
Public works	175,879	-
Interest and fiscal agent fees on long-term debt	119,173	-
Total Governmental Activities	<u>2,305,633</u>	<u>527,863</u>
Business-Type Activities		
Water	859,825	920,173
Sewer	434,884	325,157
Interest and fiscal agent fees on long-term debt	243,889	-
Total Business-Type Activities	<u>1,538,598</u>	<u>1,245,330</u>
Total Primary Government	<u>\$ 3,844,231</u>	<u>\$ 1,773,193</u>
 Component Units		
4A Economic development	\$ 285,722	-
4B Community development	14,634	-
Total Component Units	<u>\$ 300,356</u>	<u>-</u>

General Revenues:

Taxes

Property taxes
Sales taxes
Franchise and local taxes
Other revenue
Investment income
Transfers

Total General Revenues and Transfers

Change in Net Assets

Beginning Net Assets

Ending Net Assets

See Notes to Financial Statements.

Net (Expense) Revenue and Changes in Net Assets

Primary Government			Component Units	
Governmental Activities	Business-Type Activities	Total	4A Economic Dev	4B Community Dev
\$ (645,225)	\$ -	\$ (645,225)	\$ -	\$ -
(837,493)	-	(837,493)	-	-
(175,879)	-	(175,879)	-	-
(119,173)	-	(119,173)	-	-
(1,777,770)	-	(1,777,770)	-	-
-	60,348	60,348	-	-
-	(109,727)	(109,727)	-	-
-	(243,889)	(243,889)	-	-
-	(293,268)	(293,268)	-	-
(1,777,770)	(293,268)	(2,071,038)	-	-
-	-	-	(285,722)	-
-	-	-	-	(14,634)
-	-	-	(285,722)	(14,634)
337,984	-	337,984	-	-
1,220,279	-	1,220,279	532,449	266,225
314,550	-	314,550	-	-
32,893	616	33,509	16,510	5,732
15,411	60,549	75,960	-	-
(676,688)	676,688	-	-	-
1,244,429	737,853	1,982,282	548,959	271,957
(533,341)	444,585	(88,756)	263,237	257,323
1,711,954	1,902,708	3,614,662	1,232,481	11,283
\$ 1,178,613	\$ 2,347,293	\$ 3,525,906	\$ 1,495,718	\$ 268,606

CITY OF MAGNOLIA, TEXAS

BALANCE SHEET GOVERNMENTAL FUNDS

September 30, 2008

	General	Debt Service	Capital Projects	Special Revenue-HB445
<u>Assets</u>				
Cash and cash equivalents	\$ 29,570	\$ 25,571	\$ -	\$ 263,840
Receivables, net	201,668	11,107	-	39,741
Due from others	9,238	-	-	-
Due from other funds	168,993	-	-	-
Total Assets	<u>\$ 409,469</u>	<u>\$ 36,678</u>	<u>\$ -</u>	<u>\$ 303,581</u>
<u>Liabilities</u>				
Accounts payable and accrued liabilities	\$ 461,492	\$ -	\$ 57,262	\$ 26,500
Deferred revenue	21,645	11,107	-	-
Due to other funds	53,231	500	1,000	167,493
Total Liabilities	<u>536,368</u>	<u>11,607</u>	<u>58,262</u>	<u>193,993</u>
<u>Fund Balances</u>				
Reserved for:				
HB 445	-	-	-	109,588
Tourism	89,910	-	-	-
Debt service	-	25,071	-	-
Municipal court	38,005	-	-	-
Unreserved/ Undesignated	(254,814)	-	(58,262)	-
Total Fund Balances	<u>(126,899)</u>	<u>25,071</u>	<u>(58,262)</u>	<u>109,588</u>
Total Liabilities and Fund Balances	<u>\$ 409,469</u>	<u>\$ 36,678</u>	<u>\$ -</u>	<u>\$ 303,581</u>

Adjustments for the Statement of Net Assets:

Capital assets used in governmental activities are not current financial resources and therefore not reported in the governmental funds.

Capital assets - non-depreciable	\$ 20,414
Capital assets - net depreciable	<u>3,383,871</u>

Other long-term assets are not available to pay for current-period expenditures and therefore are deferred in the governmental funds.

Some liabilities, including bonds payable, are not reported as liabilities in the governmental funds.

Accrued interest payable	\$ (13,000)
Deferred charges	127,776
Non-current liabilities due in one year	(98,928)
Non-current liabilities due in more than one year	<u>(2,223,770)</u>

Net Assets of Governmental Activities

See Notes to Financial Statements.

Total	
\$	318,981
	252,516
	9,238
	168,993
\$	<u>749,728</u>

\$	545,254
	32,752
	<u>222,224</u>
	<u>800,230</u>

	109,588
	89,910
	25,071
	38,005
	<u>(313,076)</u>
	(50,502)

3,404,285

32,752

	<u>(2,207,922)</u>
\$	<u>1,178,613</u>

CITY OF MAGNOLIA, TEXAS

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES GOVERNMENTAL FUNDS

For the Year Ended September 30, 2008

	General	Debt Service	Capital Projects	Special Revenue-HB445
Revenues				
Property taxes	\$ 178,547	\$ 154,400	\$ -	\$ -
Sales taxes	978,121	-	-	242,158
Franchise fees	154,736	-	-	-
Hotel occupancy tax	29,689	-	-	-
Contributions	130,125	-	-	-
Licenses and permits	28,353	-	-	-
Fines and forfeitures	499,510	-	-	-
Other revenue	32,893	-	-	-
Investment revenue	-	1,716	9,907	3,788
Total Revenues	<u>2,031,974</u>	<u>156,116</u>	<u>9,907</u>	<u>245,946</u>
Expenditures				
Current:				
General government	694,269	-	-	-
Public safety	1,303,489	-	-	-
Public works	104,569	-	-	-
Capital Outlay	-	-	802,206	266,269
Debt Service:				
Principal	21,431	60,000	-	-
Interest and fiscal charges	4,336	108,556	-	-
Total Expenditures	<u>2,128,094</u>	<u>168,556</u>	<u>802,206</u>	<u>266,269</u>
Net Change in Fund Balance	(96,120)	(12,440)	(792,299)	(20,323)
Beginning fund balances	(30,779)	37,511	734,037	129,911
Ending Fund Balances	<u>\$ (126,899)</u>	<u>\$ 25,071</u>	<u>\$ (58,262)</u>	<u>\$ 109,588</u>

See Notes to Financial Statements.

Total
Governmental
Funds

\$	332,947
	1,220,279
	154,736
	29,689
	130,125
	28,353
	499,510
	32,893
	15,411
	<hr/> 2,443,943 <hr/>

694,269
1,303,489
104,569
1,068,475

81,431
112,892
<hr/> 3,365,125 <hr/>

(921,182)

870,680
<hr/> \$ (50,502) <hr/>

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CITY OF MAGNOLIA, 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, 2008

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

Net changes in fund balances - total governmental funds	\$ (921,182)
---	--------------

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

Capital outlay	445,359
Depreciation expense	(186,318)

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	5,037
--	-------

The issuance of long-term debt (e.g., bonds, leases, certificates of obligation) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when they are first issued; whereas, these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items.

Principal expenditures	99,930
Deferred charges	(6,725)

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds.

Accrued interest	444
Compensated absences	30,114

Change in Net Assets of Governmental Activities	\$ <u>(533,341)</u>
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See Notes to Financial Statements.

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CITY OF MAGNOLIA, TEXAS

STATEMENT OF NET ASSETS

PROPRIETARY FUND

September 30, 2008

	Business-Type Activities		
	Water Fund	Sewer Fund	Total
Assets			
Current Assets:			
Cash and cash equivalents	\$ 1,846,728	\$ 62,159	\$ 1,908,887
Receivables, net	40,974	17,381	58,355
Due from other funds	53,231	-	53,231
Deferred charges	242,118	-	242,118
Total Current Assets	2,183,051	79,540	2,262,591
Noncurrent Assets:			
Capital assets:			
Non-depreciable	108,634	-	108,634
Depreciable capital assets	6,353,599	-	6,353,599
Less: accumulated depreciation	(1,456,647)	-	(1,456,647)
Total Capital Assets			
(Net of Accumulated Depreciation)	5,005,586	-	5,005,586
Total Assets	7,188,637	79,540	7,268,177
Liabilities			
Current Liabilities:			
Accounts payable and accrued liabilities	10,701	37,103	47,804
Customer deposits	71,557	-	71,557
Accrued interest payable	96,523	-	96,523
Total Current Liabilities	178,781	37,103	215,884
Noncurrent Liabilities:			
Due within one year	80,000	-	80,000
Due in more than one year	4,625,000	-	4,625,000
Total Noncurrent Liabilities	4,705,000	-	4,705,000
Total Liabilities	4,883,781	37,103	4,920,884
Net Assets			
Invested in capital assets, net of related debt	300,586	-	300,586
Unrestricted	2,004,270	42,437	2,046,707
Total Net Assets	\$ 2,304,856	\$ 42,437	\$ 2,347,293

See Notes to Financial Statements.

CITY OF MAGNOLIA, TEXAS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS PROPRIETARY FUND

For the Year Ended September 30, 2008

	Business-Type Activities		
	Water Fund	Sewer Fund	Total
<u>Operating Revenues</u>			
Service revenues	\$ 868,085	\$ 320,632	\$ 1,188,717
Penalty and interest revenues	13,313	-	13,313
Tap revenues	10,050	4,525	14,575
Impact fees	28,725	-	28,725
Other revenue	616	-	616
Total Operating Revenues	920,789	325,157	1,245,946
<u>Operating Expenses</u>			
Personnel	133,254	122,503	255,757
Contracted services	252,745	168,267	421,012
Services	265,063	123,977	389,040
Supplies	1,009	11,961	12,970
Insurance	6,204	4,226	10,430
Professional fees	3,403	3,450	6,853
Maintenance	115	500	615
Depreciation	198,032	-	198,032
Total Operating Expenses	859,825	434,884	1,294,709
Operating Income (Loss)	60,964	(109,727)	(48,763)
<u>Nonoperating Revenues (Expenses)</u>			
Investment earnings	55,443	5,106	60,549
Interest expense	(243,889)	-	(243,889)
Total Nonoperating Revenues (Expenses)	(188,446)	5,106	(183,340)
Transfers In	676,688	-	676,688
Change in Net Assets	549,206	(104,621)	444,585
Beginning Net Assets	1,755,650	147,058	1,902,708
Ending Net Assets	\$ 2,304,856	\$ 42,437	\$ 2,347,293

See Notes to Financial Statements.

CITY OF MAGNOLIA, TEXAS

STATEMENT OF CASH FLOWS

PROPRIETARY FUND

For the Year Ended September 30, 2008

	Business-Type Activities		
	Water Fund	Sewer Fund	Total
<u>Cash Flows from Operating Activities</u>			
Receipts from customers	\$ 981,831	\$ 365,150	\$ 1,346,981
Payments to suppliers	(796,963)	(304,937)	(1,101,900)
Payments to employees	(133,254)	(122,503)	(255,757)
Net Cash (Used) by Operating Activities	51,614	(62,290)	(10,676)
<u>Cash Flows from Capital and Related Financing Activities</u>			
Acquisition and construction of capital assets	(706,248)	-	(706,248)
Principal paid on debt	(75,000)	-	(75,000)
Interest paid on debt	(243,889)	-	(243,889)
Net Cash (Used) by Capital and Related Financing Activities	(1,025,137)	-	(1,025,137)
<u>Cash Flows from Investing Activities</u>			
Interest on investments	55,443	5,106	60,549
Net Cash Provided by Investing Activities	55,443	5,106	60,549
Net Decrease in Cash and Equivalents	(918,080)	(57,184)	(975,264)
Beginning Cash and Cash Equivalents	2,764,808	119,343	2,884,151
Ending Cash and Cash Equivalents	\$ 1,846,728	\$ 62,159	\$ 1,908,887
Reconciliation of Operating Income (Loss) to Net Cash (Used) by Operating Activities			
Operating Income (Loss)	\$ 60,964	\$ (109,727)	\$ (48,763)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:			
Depreciation	198,032	-	198,032
(Increase) Decrease in:			
Accounts receivable	62,870	39,993	102,863
Due from other funds	(251)	250	(1)
Prepaid costs	5,121	-	5,121
Deferred charges	17,294	-	17,294
Increase (Decrease) in:			
Accounts payable and accrued liabilities	(288,801)	7,194	(281,607)
Accrued interest payable	(1,787)	-	(1,787)
Net Cash (Used) by Operating Activities	(1,828)	-	(1,828)
	\$ 51,614	\$ (62,290)	\$ (10,676)

See Notes to Financial Statements.

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CITY OF MAGNOLIA, TEXAS

NOTES TO FINANCIAL STATEMENTS

For the Year Ended September 30, 2008

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The City of Magnolia, Texas (the "City"), was incorporated under the laws of the State of Texas on September 28, 1968. The City has operated under a "General Law" City which provides for a "Mayor-Council" form of government.

The City provides the following services: general government, public safety, public works, water service, and sewer service.

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

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

Discretely Presented Component Units

Economic Development Corporation – 4A

On September 8, 1997, the City incorporated the "City of Magnolia Economic Development Corporation." The purpose is to promote economic development within the City and the State of Texas in order to eliminate unemployment and underemployment, and to promote and encourage employment and the public welfare of, for, and on behalf of the City, and for improving the assessed valuations through the promotion of: (a) existing business enterprise expansion and retention and (b) new business enterprise development and attraction by developing, implementing, providing and financing projects. A one-half percent City sales tax is designed for this purpose.

Community Development Corporation – 4B

On June 21, 1995, the City incorporated the "City of Magnolia Community Development Corporation." The purpose is to promote economic development within the City and the State of Texas in order to eliminate unemployment and underemployment, and to promote and to encourage employment and the public welfare of, for and on behalf of the City, and for parks, auditoriums, learning centers, open space improvements, athletic and exhibition facilities, and other related

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

improvements and for maintenance and operating costs of publicly owned and operated projects by developing, implementing, providing and financing projects. A one-half percent city sales tax was designated for this purpose until September 14, 2002, when the voters approved reducing the 4B's City sales tax to one-fourth of a percent of the city sales tax.

B. Financial Statement Presentation

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

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

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

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

C. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information about the City as a whole. These statements include all activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include charges paid by the recipients of goods or services offered by the programs and grants that are

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, such as taxes and investment earnings, are presented as general revenues.

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

Governmental Funds

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

General Fund

The general fund is used to account for all financial transactions not properly includable in other funds. The principal sources of revenues include local property taxes, sales and franchise taxes, licenses and permits, and fines and forfeitures. Expenditures include general government, public safety, and public works. The general fund is always considered a major fund for reporting purposes.

Debt Service Fund

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

Capital Projects Fund

The capital projects fund is used to account for the expenditures of resources accumulated from road project grants to construct or acquire capital facilities and improvements. The capital projects fund is considered a major fund for reporting purposes.

Special Revenue Fund

The special revenue fund is used to account for the proceeds of specific revenue sources (other than expendable trusts and major capital projects) that are legally restricted or designated for specified activities. The HB445 fund, used to account for the receipt and expenditure of funds received from additional sales tax within the City, is considered a major fund for reporting purposes.

Proprietary Funds

Proprietary funds are used to account for activities that are similar to those often found in the private sector. All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business activities are accounted for through proprietary funds. The measurement focus is on determination of net income, financial position, and cash flows. Proprietary funds distinguish

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

operating revenues and expenses from non-operating items. Operating revenues include charges for services. Operating expenses include costs of materials, contracts, personnel, and depreciation. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Proprietary fund types follow GAAP prescribed by the Governmental Accounting Standards Board (GASB) and all Financial Accounting Standards Board's (FASB) standards issued prior to November 30, 1989. Subsequent to this date, the City accounts for its proprietary funds as presented by GASB.

Enterprise Funds

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

D. Measurement Focus and Basis of Accounting

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

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

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

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

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

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

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

The statements of net assets, statements of activities, and financial statements of proprietary funds are presented on the accrual basis of accounting. Under this method of accounting, revenues are recognized in the accounting period in which they are earned, and expenses in the accounting period in which they are incurred.

Generally, the effect of interfund activity has been eliminated from the government-wide financial statements.

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

1. Deposits and Investments

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. For the purpose of the statement of cash flows, the proprietary fund types consider temporary investments with maturity of three months or less when purchased to be cash equivalents.

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

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

- Direct obligations of the U.S. Government
- Fully collateralized certificates of deposit and money market accounts
- Statewide investment pools

2. Receivables

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

Advances between funds are offset by a fund balance reserve account in an applicable governmental fund to indicate that they are not available for appropriation and are not expendable available financial resources.

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

All trade receivables are shown net of an allowance for uncollectibles.

Property Taxes

All taxes due to the City on real or personal property are payable at the Office of the Tax Assessor-Collector and may be paid at any time after the tax rolls for the year have been completed and approved, which is no later than October 1. Taxes are due by January 31 of the subsequent year, and all taxes not paid prior to this date are deemed delinquent and are subject to such penalty and interest as the Council may provide by ordinance.

Property taxes attach as an enforceable lien on property as of January 1 each year. Montgomery County Tax Assessor-Collector bills and collects taxes on behalf of the City.

3. Inventories and Prepaid Items

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

4. Capital Assets

Capital assets, which include property, equipment, and infrastructure assets (e.g., roads and similar items) are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. In accordance with GASB Statement No. 34, infrastructure has been capitalized retroactively. Capital assets are defined by the government as assets with an initial, individual cost of more than \$2,500 and an estimated useful life in excess of four years for personal property and \$25,000 or more for buildings and infrastructure. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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

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

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

<u>Asset Description</u>	<u>Estimated Useful Life</u>
Vehicles	5 to 20 years
Furniture and equipment	5 to 20 years
Infrastructure	20 to 75 years
Buildings and improvements	20 to 75 years

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

5. Compensated Employee Absences

The City maintains formal programs for vacation and sick leave. The City's, full-time, permanent employees are granted vacation benefits in varying amounts to specified maximums depending on tenure with the City. Sick leave accrues to full-time, permanent employees to specified maximums.

The estimated amount of compensation for services provided that is expected to be liquidated with expendable available financial resources is reported as an expenditure and a fund liability of the governmental fund that will pay it upon maturity. Amounts of vested or accumulated sick leave and compensatory time that are not expected to be liquidated with expendable available financial resources are maintained separately and represent a reconciling item between the fund and government-wide presentations.

6. Long-Term Obligations

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

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

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

The property tax rate is allocated each year between the general and debt service funds. The full amount estimated to be required for debt service on improvement bonds and certificate of obligation debt is provided by the tax along with the interest earned in the debt service fund.

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

7. Fund Equity

In 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.

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

8. Estimates

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

II. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP) except for the capital projects funds, which adopt a project length budget. The original budget is adopted by the City Council prior to the beginning of the year. The legal level of control is the object and purpose stated in the approved budget. Appropriations lapse at the end of the year. Supplemental budget appropriations were made during the year.

A. Deficit Fund Balances

For the year ended, deficit fund balances were reported in the following funds:

General Fund	\$126,899
Capital Projects Fund	\$ 58,262

III. DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

The City is not involved in any active 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. The City's investment policy requires funds on deposit at the depository bank to be collateralized by securities with a collective market value of at least 102 percent. As of September 30, 2008, market values of pledged securities and FDIC insurance did not exceed bank balances.

B. Receivables

The following comprises receivable balances at year end:

	General	Debt Service	Special Revenue	Water	Sewer
Property taxes	\$ 21,645	\$ 11,107	\$ -	\$ -	\$ -
Sales taxes	161,032	-	39,741	-	-
Other taxes	10,000	-	-	-	-
Others	8,991	-	-	-	-
Accounts	-	-	-	55,974	22,381
Allowance	-	-	-	(15,000)	(5,000)
	<u>\$ 201,668</u>	<u>\$ 11,107</u>	<u>\$ 39,741</u>	<u>\$ 40,974</u>	<u>\$ 17,381</u>

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

C. Capital Assets

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

	Primary Government			
	Beginning Balance	Increases	(Decreases)	Ending Balance
Governmental Activities:				
Capital assets not being depreciated:				
Land	\$ 20,414	\$ -	\$ -	\$ 20,414
Construction in progress	57,168	-	(57,168)	-
Total capital assets not being depreciated	77,582	-	(57,168)	20,414
Other capital assets:				
Vehicles and equipment	519,990	53,572	-	573,562
Buildings and improvements	679,865	-	-	679,865
Infrastructure	4,361,428	448,955	-	4,810,383
Total other capital assets	5,561,283	502,527	-	6,063,810
Less accumulated depreciation for:				
Vehicles and equipment	(386,690)	(43,577)	-	(430,267)
Buildings and improvements	(13,320)	(20,258)	-	(33,578)
Infrastructure	(2,093,611)	(122,483)	-	(2,216,094)
Total accumulated depreciation	(2,493,621)	(186,318)	-	(2,679,939)
Other capital assets, net	3,067,662	316,209	-	3,383,871
Totals	<u>\$ 3,145,244</u>	<u>\$ 316,209</u>	<u>\$ (57,168)</u>	<u>\$ 3,404,285</u>
			Less associated debt	(2,267,694)
			Invested in capital assets, net of related debt	<u><u>\$ 1,136,591</u></u>

Depreciation was charged to governmental functions as follows:

General government	\$ 27,922
Public safety	87,086
Public works	<u>71,310</u>
Total Governmental Activities Depreciation Expense	<u><u>\$ 186,318</u></u>

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

The following is a summary of changes in capital assets for business-type activities for the year ended:

	Primary Government			
	Beginning Balance	Increases	(Decreases)	Ending Balance
Business-Type Activities:				
Capital assets not being depreciated:				
Land	\$ 108,634	\$ -	\$ -	\$ 108,634
Construction in progress	1,040,059	-	(1,040,059)	-
Total capital assets not being depreciated	1,148,693	-	-	108,634
Other capital assets:				
Equipment	105,508	-	-	105,508
Water system	3,825,097	2,422,994	-	6,248,091
Total other capital assets	3,930,605	2,422,994	-	6,353,599
Less accumulated depreciation for:				
Equipment	(105,508)	-	-	(105,508)
Water system	(1,153,108)	(198,031)	-	(1,351,139)
Total accumulated depreciation	(1,258,616)	(198,031)	-	(1,456,647)
Other capital assets, net	2,671,989	2,224,963	-	4,896,952
Totals	<u>\$ 3,820,682</u>	<u>\$ 2,224,963</u>	<u>\$ -</u>	<u>\$ 5,005,586</u>
			Less associated debt	(4,705,000)
			Invested in capital assets, net of related debt	<u><u>\$ 300,586</u></u>

Depreciation was charged to business-type functions as follows:

Water	<u>\$ 198,031</u>
Total Business-Type Activities Depreciation Expense	<u><u>\$ 198,031</u></u>

	Component Unit			
	Beginning Balance	Increases	(Decreases)	Ending Balance
4A Corporation				
Capital assets not being depreciated:				
Land	\$ 15,845	\$ 130,000	\$ -	\$ 145,845
Construction in progress	14,864	-	-	14,864
Total capital assets not being depreciated	30,709	130,000	-	160,709
Other capital assets:				
Buildings and improvements	714,620	-	-	714,620
Pavement improvements	839,645	-	-	839,645
Equipment	7,150	-	-	7,150
Total other capital assets	1,561,415	-	-	1,561,415
Less accumulated depreciation for:				
Buildings and improvements	(105,676)	(17,866)	-	(123,542)
Pavement improvements	(148,030)	(41,982)	-	(190,012)
Equipment	(836)	(836)	-	(1,672)
Total accumulated depreciation	(254,542)	(60,684)	-	(315,226)
Other capital assets, net	1,306,873	(60,684)	-	1,246,189
Totals	<u>\$ 1,337,582</u>	<u>\$ 69,316</u>	<u>\$ -</u>	<u>\$ 1,406,898</u>
			Less associated debt	(729,593)
			Invested in capital assets, net of related debt	<u><u>\$ 677,305</u></u>

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

	Component Unit			
	Beginning Balance	Increases	(Decreases)	Ending Balance
4B Corporation				
Other capital assets:				
Equipment	7,150	-	-	7,150
Total other capital assets	7,150	-	-	7,150
Less accumulated depreciation for:				
Equipment	(836)	(2,383)	-	(3,219)
Total accumulated depreciation	(836)	(2,383)	-	(3,219)
Other capital assets, net	6,314	(2,383)	-	3,931
Totals	\$ 6,314	\$ (2,383)	\$ -	\$ 3,931
			Less associated debt	(165,816)
			Invested in capital assets, net of related debt	\$ (161,885)

D. Long-Term Debt

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

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Governmental Activities:					
Certificates of Obligation	\$ 2,250,000	\$ -	\$ 60,000	\$ 2,190,000	\$ 60,000
Capital leases	117,624	-	39,930	77,694	38,928
	2,367,624	-	99,930	2,267,694 *	98,928
Other liabilities:					
Compensated absences	85,118	-	30,114	55,004	-
Total Governmental Activities	\$ 2,452,742	\$ -	\$ 130,044	\$ 2,322,698	\$ 98,928
Long-term liabilities due in more than one year				\$ 2,223,770	
Business-Type Activities:					
Revenue bonds	\$ 4,780,000	\$ -	\$ 75,000	\$ 4,705,000 *	\$ 80,000
Long-term liabilities due in more than one year				\$ 4,625,000	
4A Corporation					
Revenue bonds	\$ 660,000	\$ -	\$ 95,000	\$ 565,000	\$ 100,000
Capital leases	240,583	-	75,990	164,593	80,757
	\$ 900,583	\$ -	\$ 170,990	\$ 729,593 *	\$ 180,757
Long-term liabilities due in more than one year				\$ 548,836	
4B Corporation					
Capital leases	\$ 240,819	\$ -	\$ 75,003	\$ 165,816 *	\$ 78,915
Long-term liabilities due in more than one year				\$ 86,901	

*Debt associated with capital assets

Long-term liabilities applicable to the City's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities in the governmental funds. The governmental activities compensated absences are generally liquidated by the general fund. Interest

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due.

Long-term debt was comprised of the following debt issues:

Description	Rates	Balance
Business-Type Activities		
Revenue Bonds		
Series 2006	4.0-5.20%	\$ 4,705,000
Governmental Activities		
Certificates of Obligation		
Series 2004	4.93-4.93%	710,000
Series 2006	4.5-4.75%	1,480,000
Total Certificates of Obligation		<u>\$ 2,190,000</u>

The annual requirements to amortize debt issues outstanding at year end were as follows:

Year Ending Sep 30	Business-Type Revenue Bonds		4A Corporation - Revenue Bonds	
	Principal	Interest	Principal	Interest
2009	\$ 80,000	\$ 234,445	\$ 100,000	\$ 28,250
2010	80,000	231,345	105,000	23,250
2011	85,000	228,125	115,000	18,000
2012	90,000	224,763	120,000	12,250
2013	95,000	221,130	125,000	6,250
2014-2018	525,000	1,019,256	-	-
2019-2023	665,000	879,535	-	-
2024-2028	860,000	690,672	-	-
2029-2033	1,110,000	439,286	-	-
2034-2037	1,115,000	119,470	-	-
Total	<u>\$ 4,705,000</u>	<u>\$ 4,288,027</u>	<u>\$ 565,000</u>	<u>\$ 88,000</u>

Year Ending Sep 30	Certificates of Obligation		4A Corporation - Capital Leases	
	Principal	Interest	Principal	Interest
2009	60,000	104,641	80,757	8,184
2010	65,000	101,726	83,836	3,159
2011	70,000	98,564	-	-
2012	75,000	95,178	-	-
2013	75,000	91,545	-	-
2014-2018	455,000	399,721	-	-
2019-2023	700,000	266,348	-	-
2024-2027	690,000	83,601	-	-
Total	<u>\$ 2,190,000</u>	<u>\$ 1,241,324</u>	<u>\$ 164,593</u>	<u>\$ 11,343</u>

Year Ending Sep 30	Governmental Capital Leases		4B Corporation - Capital Leases	
	Principal	Interest	Principal	Interest
2009	38,928	4,187	78,915	7,054
2010	27,415	1,739	83,017	2,952
2011	11,351	311	3,884	73
Total	<u>\$ 77,694</u>	<u>\$ 6,237</u>	<u>\$ 165,816</u>	<u>\$ 10,079</u>

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

Federal Arbitrage

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

The City issues a variety of long-term debt instruments in order to acquire and/or construct major capital facilities (streets, drainage, public safety, water and wastewater) and equipment for general government and enterprise fund activities. These instruments include general obligation bonds, certificates of obligation, and revenue bonds. Future ad valorem tax revenues, water and sewer system revenues, or liens on property and equipment secure these debt obligations.

General obligation bonds are direct obligations of the City for which its full faith and credit are pledged. Repayment of general obligation bonds are from taxes levied on all taxable property located within the City. The City is not obligated in any manner for special assessment debt.

E. Interfund Transactions

The compositions of interfund balances were as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amounts</u>
General	Debt Service	\$ 500
General	Capital Projects	1,000
General	Special Revenue	167,493
Water	General Fund	53,231
	Total	<u><u>\$ 222,224</u></u>

Amounts recorded as due to/from are considered to be temporary loans and will be repaid during the following year.

F. Fund Equity

The City records fund balance reserves on the fund level to indicate that a portion of the fund balance is legally restricted for a specific future use or to indicate that a portion of the fund balance is not available for expenditures. The following is a list of fund balance reserved or designated recognized by the City:

General Fund		
* Reserved for tourism	\$	89,910
* Reserved for municipal court		38,005
Debt Service Fund		
Reserved for debt service	\$	25,071
Special Revenue Fund-HB445		
Reserved for HB445	\$	109,588

*Restricted by enabling legislation

The City restated the beginning fund balances/net assets for the general fund, special revenue fund-HB445, 4A component unit, and 4B component unit for an accrual of sales tax. The beginning fund balances/net assets were restated to a deficit \$30,779, \$129,911, \$1,232,481, and \$11,283, respectively.

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

IV. OTHER INFORMATION

A. Risk Management

The City is exposed to various risks of loss related to torts: theft of, damage to and destruction of assets, errors and omissions, and natural disasters for which the City participates in the Texas Municipal League's General Liability Fund. In addition, the City participates in the Texas Municipal League's Workers' Compensation Fund to insure the City for workers compensation. The City has no additional risk or responsibility to the Pool outside of the payment of insurance premiums. The City has not significantly reduced insurance coverage or had settlements which exceeded coverage amounts for the past three years.

B. Contingent Liabilities

Amounts received or receivable from granting agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount 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.

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

C. Pension Plans

1. Texas Municipal Retirement Systems

Plan Description

The City provides pension benefits for all of its full-time employees through a non-traditional, joint contributory, hybrid defined benefit plan in the state-wide Texas Municipal Retirement System (TMRS), one of 827 currently administered by TMRS, an agent multiple-employer public employee retirement system.

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%, 150%, or 200%) of the employee's accumulated contributions. In addition, the City can grant, as often as annually, another type of monetary credit referred to as an updated service credit which is a theoretical amount which, when added to the employee's accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee 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.

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

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.

Contributions

The contribution rate for the employees is 5%, and the City's matching ratio is currently one to one, both as adopted by City Council. Under the state law governing TMRS, the actuary annually determines the City contribution rate. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to the City matching percent, which are the obligation of the City as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the City to each employee at the time his/her retirement becomes effective. The prior service contribution rate amortizes the unfunded (over funded) actuarial liability (asset) over the remainder of the plan's 25-year amortization period. The projected unit credit actuarial cost method is used for determining the City's contribution rate. Both the employees and the City make contributions monthly.

Since the City needs to know its contribution rate in advance for budgetary purposes, there is a one year delay between the actuarial valuation that serves as the basis for the rate and the calendar year when the rate goes into effect (i.e., December 31, 2007 valuation is effective for rates beginning January 2009).

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Annual Req. Contrib. (ARC)	\$ 34,515	\$ 31,274	\$ 23,461
Contributions Made	34,515	31,274	23,461
NPO at the End of Period	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

All assumptions for the 12/31/07 valuations are contained in the 2007 TMRS Comprehensive Annual Financial Report, a copy of which may be obtained by writing to P.O. Box 149153, Austin, Texas 78714-9153. The following is a summary of the actuarial assumptions:

Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level % of Payroll
Remaining Amortization Period	25 Years - Closed period
Asset Valuation Method	Amortized Cost
Investment Rate of Return	7.00%
Projected Salary Increases	Varies by age and service
Includes Inflation at	3.00%
Cost of Living Adjustments	None
Payroll Growth Assumption	3.00%
Withdrawal Rates for Male/Female	Mid-Low/Mid-Low

Future Funding Requirements

At its December 8, 2007 meeting, the TMRS Board of Trustees adopted actuarial assumptions to be used in the actuarial valuation for the year ended December 31, 2007. A summary of actuarial

CITY OF MAGNOLIA, TEXAS
NOTES TO FINANCIAL STATEMENTS, Continued
For the Year Ended September 30, 2008

assumptions and definitions can be found in the December 31, 2007 TMRS Comprehensive Annual Financial Report (CAFR).

Since its inception, TMRS has used the Unit Credit actuarial funding method. This method accounts for liability accrued as of the valuation date, but does not project the potential future liability of provisions adopted by a city. Two-thirds of the cities participating in TMRS have adopted the Updated Service Credit and Annuity Increases provisions on an annually repeating basis. For the December 31, 2007 valuation, the TMRS Board determined that the Projected Unit Credit (PUC) funding method should be used, which facilitates advance funding for future updated service credits and annuity increases that are adopted on an annually repeating basis. In addition, the Board also adopted a change in the amortization period from a 25-year "open" to a 25-year "closed" period. TMRS Board of Trustee rules provide that, whenever a change in actuarial assumptions or methods results in a contribution rate increase in an amount greater than 0.5%, the amortization period will be increased to 30 years, unless a city requests that the period remain at 25 years. For cities with repeating features, these changes would likely result initially in higher required contributions and lower funded ratios; however, the funded ratio should show steady improvement over time. To assist in this transition to higher rates, the Board also approved an eight-year phase-in period, which will allow cities the opportunity to increase their contributions gradually (approx. 12.5% each year) to their full rate (or their required contribution rate). If the changes in actuarial funding method and assumptions had not been adopted for the 2007 valuation, the city's unfunded actuarial accrued liability would have been \$5,211 and the funded ratio would have been 99.0%.

In addition, TMRS is currently working on its legislative package for 2009. There is a possibility that the Investment rate of return (IRR) assumption of 7% would need to be lowered if desired legislation for the 2009 session is unsuccessful. Maintaining a 7% IRR assumption is contingent in part on the continued diversification of the TMRS portfolio, from an almost exclusive bond portfolio to a portfolio that includes equities as well. If state legislation needed to facilitate the continued diversification is not enacted, TMRS may have to revisit the continued diversification of the portfolio and consider reducing the assumed IRR. A reduction in the IRR would result in increased actuarial accrued liabilities, thus causing further increases in City contribution rates, following the December 31, 2009 actuarial valuation.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF MAGNOLIA, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL

GENERAL FUND

For the Year Ended September 30, 2008

	Original Budgeted Amounts	Final Budgeted Amounts	2008 Actual	Variance with Final Budget Positive (Negative)
Revenues				
Property taxes	\$ 401,800	\$ 401,800	\$ 178,547	\$ (223,253)
Sales taxes	900,251	900,251	978,121	77,870
Franchise fees	152,100	152,100	154,736	2,636
Hotel occupancy tax	32,000	32,000	29,689	(2,311)
Licenses and permits	40,000	40,000	28,353	(11,647)
Fines and forfeitures	645,175	645,175	499,510	(145,665)
Contributions	23,000	23,000	130,125	107,125
Other revenue	2,854	2,854	32,893	30,039
Total Revenues	<u>2,197,180</u>	<u>2,197,180</u>	<u>2,031,974</u>	<u>(165,206)</u>
Expenditures				
General government				
Administration	455,781	442,186	437,253	4,933
Finance	80,724	82,724	82,596	128
City Secretary	67,443	67,443	62,462	4,981
City Council	22,140	5,140	5,093	47
Facilities	91,092	108,692	106,865	1,827
Total General Government	<u>717,180</u>	<u>706,185</u>	<u>694,269</u>	<u>11,916</u>
Public safety				
Police	806,853	814,353	810,402	3,951
City Marshall	58,059	104,440	101,788	2,652
Municipal court	426,448	392,055	391,299	756
Total Public Safety	<u>1,291,360</u>	<u>1,310,848</u>	<u>1,303,489</u>	<u>7,359</u>
Public works	<u>72,717</u>	<u>107,717</u>	<u>104,569</u>	<u>3,148</u>
Debt service				
Principal	21,431	21,431	21,431	-
Interest and fees	4,336	4,336	4,336	-
Total Debt Service	<u>25,767</u>	<u>25,767</u>	<u>25,767</u>	<u>-</u>
Total Expenditures	<u>2,107,024</u>	<u>2,150,517</u>	<u>2,128,094</u>	<u>22,423</u>
Revenues Over (Under) Expenditures	<u>\$ 90,156</u>	<u>\$ 46,663</u>	<u>(96,120)</u>	<u>\$ (142,783)</u>
Beginning Fund Balance			<u>(30,779)</u>	
Ending Fund Balance			<u>\$ (126,899)</u>	

Notes to Required Supplementary Information:

1. Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP).

CITY OF MAGNOLIA, TEXAS
SPECIAL REVENUE FUND - HB 445
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
For the Year Ended September 30, 2008

	Original and Final Budgeted Amounts	2008 Actual	Variance with Final Budget Positive (Negative)
<u>Revenues</u>			
Sales taxes	\$ 320,000	\$ 242,158	\$ (77,842)
Investment revenue	5,000	3,788	(1,212)
Total Revenues	<u>325,000</u>	<u>245,946</u>	<u>(79,054)</u>
<u>Expenditures</u>			
Capital outlay	325,000	266,269	58,731
Total Expenditures	<u>325,000</u>	<u>266,269</u>	<u>58,731</u>
Revenues Over (Under) Expenditures	<u>\$ -</u>	(20,323)	<u>\$ (20,323)</u>
Beginning Fund Balance		<u>129,911</u>	
Ending Fund Balance		<u>\$ 109,588</u>	

Notes to Required Supplementary Information:

1. Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP).

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CITY OF MAGNOLIA, TEXAS

SCHEDULE OF FUNDING PROGRESS- TEXAS MUNICIPAL RETIREMENT SYSTEM

For the Year Ended September 30, 2008

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

Fiscal Year	2008	2007	2006
Actuarial Valuation Date	12/31/2007	12/31/2006	12/31/2005
Actuarial Value of Assets	\$ 493,031	\$ 429,853	\$ 367,267
Actuarial Accrued Liability	\$ 498,242	\$ 441,105	\$ 415,456
Percentage Funded	99.0%	97.4%	88.4%
Unfunded Actuarial			
Accrued Liability	\$ (1,662)	\$ 11,252	\$ 48,189
Annual Covered Payroll	\$ 880,006	\$ 800,760	\$ 643,999
Unfunded Actuarial Accrued Liability			
(UAAL) % of Covered Payroll	-0.2%	1.4%	7.5%
Net Pension Obligation (NPO)			
at the Beginning of Period	\$ -	\$ -	\$ -
Annual Req. Contrib. (ARC)	\$ 34,515	\$ 31,274	\$ 23,461
Contributions Made	\$ 34,515	\$ 31,274	\$ 23,461
NPO at the End of Period	\$ -	\$ -	\$ -

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SCHEDULES

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CITY OF MAGNOLIA, TEXAS
SCHEDULE OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
DEBT SERVICE FUND
For the Year Ended September 30, 2008

	Original and Final Budgeted Amounts	2008 Actual	Variance with Final Budget Positive (Negative)
<u>Revenues</u>			
Property taxes	\$ 282,245	\$ 154,400	\$ (127,845)
Investment revenue	12,500	1,716	(10,784)
Total Revenues	294,745	156,116	(138,629)
<u>Expenditures</u>			
Principal	93,745	60,000	33,745
Interest and fiscal charges	201,000	108,556	92,444
Total Expenditures	294,745	168,556	126,189
Revenues Over (Under) Expenditures	\$ -	(12,440)	\$ (12,440)
Beginning Fund Balance		37,511	
Ending Fund Balance		\$ 25,071	

Note to Supplementary Information:

1. Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP).

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*Received & Filed
in the Office of*

JUN 22 2009

*City Secretary
City of Magnolia, Texas*

Management Letter

June 5, 2009

To the Honorable Mayor and
Members of City Council,
City of Magnolia, Texas:

The American Institute of Certified Public Accountants issued a new auditing standard that must be followed when communicating certain internal control related matters as part of an audit of financial statements effective for audit periods ending on or after December 31, 2006. The new standard (Statement on Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, "SAS 112") provides guidance to auditors on communicating internal control matters to management and the governing body, board of directors, or equivalent body. Although it replaces a similar standard, it includes some new guidance and revises certain terminology, as defined below. With new definitions auditors will now be reporting more findings to a City. Also, auditors are now required to report on issues identified in previous years that have not been corrected. This may include not only comments from prior letters, but also other issues that came up during previous audits.

It is important to note when reviewing findings reported within this letter that classification of the findings is based on the definitions above as required by SAS 112. Please note that these classifications are based on the potential impact to the financial statement, not necessarily the likelihood of actual loss to the City. Accordingly, the City's assessment of the "significance", ranking of severity, or time table for addressing, or not addressing, the findings, will likely be substantially different based on a number of factors. Our report on internal related matters is as follows.

In planning and performing our audit of the financial statements of the City of Magnolia, Texas (the "City"), for the year ended September 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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 a combination of control deficiencies, that adversely affects the City'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 City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. A material weakness is a significant deficiency, or a 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 City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

Our findings and additional comments are as follows:

Material Weaknesses:

1. FINANCIAL STATEMENT PRESENTATION

Finding

The City has engaged a licensed certified public accounting firm to both prepare and audit the City's annual financial report. The City ensures the quality of its annual financial report by engaging a qualified audit firm with particular expertise in governmental audits and reading preliminary drafts of its annual financial report. The City does not have specific controls in place to separately review the selection and application of accounting principles and resulting disclosures and presentations within the financial statements. Although it is common within the government sector as a whole, and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect (SAS No. 112 effective year ends on or after December 15, 2006). Since some presentations and disclosures may be material to the financial statements this weakness in internal control, would be classified as material.

Recommendation

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

2. ACCOUNTING RECORDS AND ADJUSTMENTS

Finding

The City reviews its accounting information and compares the information to their knowledge of historical events. From time to time the auditor recommends adjustments to these records, as well as proposes other adjustments needed for preparing full accrual statements in compliance with GASB 34 which are only needed at year end. Although it is common within the government sector and most private companies to rely on their audit firm for these services, an audit firm cannot be considered part of its client's internal control by professional standards currently in effect (SAS No. 112 effective year ends on or after December 15, 2006). Since some adjustments and calculation made by the auditor may be material to the financial statements, this weakness in internal control would be classified as material.

Recommendation

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

3. SEGREGATION OF DUTIES

Background

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

Finding

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

Recommendation

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

4. INTERNAL CONTROL ASSESSMENT, COMMUNICATION, AND MONITORING

Finding

Like many organizations of its size and complexity the City does not have a formal process for assessing risk associated with key controls related to its financial operations and fraud. In addition, while a number of processes are used to communicate internal controls (such as formal actions taken by City Council, policies and procedures, memos, and controlling legislation), a single source such as a complete policy and procedures manual does not exist. Likewise, the City does not have a formal process for monitoring its internal control.

Recommendation

The City should continue to monitor the need for more formally established processes to assess risk, communicate controls, and monitor controls. The City might consider at some point having an annual workshop with City Council and management to specifically discuss risk and key controls to mitigate those risks. The City's assessment of its risk and evaluation of the effectiveness of control can then be utilized to determine the sufficiency of the level of documentation.

5. MONTH END CLOSING PROCEDURES

Finding

It appeared the City lacked a formal process for closing the books at the end of each month. A large number of adjustments were required at year end during the audit process to correct general ledger account balances. Accordingly, it did not appear that some subsidiary ledgers and other support were being compared to the general ledger on a monthly basis to ensure that interim financial statements were correct. Subsequent to year end, the City hired a finance officer who has begun overseeing the month end closing process, and the City expects this finding will not occur in future years.

Recommendation

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

Significant Deficiencies:

6. CAPITAL ASSETS

Finding

During the audit, the capital assets schedule was not updated with current year activity. Management is aware of this and has begun to determine how to complete the schedule with current personnel.

Recommendation

The City should continue to oversee the completion of the capital asset schedule during the year and prior to the audit process.

7. MUNICIPAL COURT PROCEDURES

Finding

We noted that the City did not maintain adequate detail related to the municipal court deposits that are made daily into the City's cash.

Recommendation

The City should print a detail of all money received that is used to reconcile that day's activities in preparation of the daily deposit.

8. PLEDGED COLLATERAL

Finding

As of September 30, 2008, the City did not have adequate collateralization with either FDIC insurance or securities pledged for bank balances with Woodforest National Bank.

Recommendation

The City should monitor such balances in conjunction with the bank on a daily basis and ensure balances have sufficient insurance or collateral pledged.

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

We would like to thank the City and the City's management for their cooperation during the course of our audit. Please feel free to contact us at your convenience to discuss this report or any other concerns that you may have.

Belt Harris & Associates, LLP

Belt Harris & Associates, LLP
Certified Public Accountants
Houston, Texas



*Received & Filed
in the Office of*

JUN 22 2009

*City Secretary
City of Magnolia, Texas*

Required Auditor Disclosure Letter

June 5, 2009

To the Honorable Mayor and
Members of City Council,
City of Magnolia, Texas:

We have audited the financial statements of the governmental activities, business-type activities, the discretely presented component units, and each major fund of the City of Magnolia, Texas, (the "City"), for the year ended September 30, 2008, and have issued our report thereon dated . Professional standards require that we provide the City, (the "governing body"), with the following information related to our audit.

I. Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated November 16, 2008, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with its oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve the governing body or management of its responsibilities.

II. Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to the governing body in our engagement letter dated November 16, 2008.

III. Significant Audit Findings

1. Qualitative Aspects of Accounting Practices

- A. Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application.
 - i. The significant accounting policies used by the City are described in Note I to the financial statements.
 - ii. No new accounting policies were adopted and the application of existing policies was not changed during the year.
 - iii. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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

Management's estimate of the useful lives of capital assets is based on industry standards relating to capital assets. We evaluated the key factors and assumptions used to develop the useful lives of capital assets in determining that it is reasonable in relation to the financial statements taken as a whole.

- C. The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was:

The disclosure of the City's long-term debt.

2. Difficulties Encountered in Performing the Audit

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

3. Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. The attached schedule summarizes both material and immaterial misstatements detected as a result of our audit procedures.

4. Disagreements with Management

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

5. Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 1, 2009.

6. Management Consultations with Other Independent Accountants

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

7. Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions

occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the governing body and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

Belt Harris & Associates, LLP

Belt Harris & Associates, LLP
Certified Public Accountants
Houston, Texas

Client: **City of Magnolia, Texas**
Engagement: **4.0 - Magnolia 9/30/2008**
Period Ending: **9/30/2008**
Workpaper: **2.5.12 - Adjusting Journal Entries Report**

Account	Description	W/P Ref	Debit	Credit
Adjusting Journal Entries JE # 1				
		C.05		
To record mixed beverages accrual. Client should reverse @ 10/01/08				
01-136	MIX BEVERAGE RECEIVABLE		2,066.62	
01-40107	Mix Beverage Tax Revenue			2,066.62
Total			2,066.62	2,066.62
Adjusting Journal Entries JE # 2				
		C.05b		
To record sales taxes accrual. Client should reverse @ 10/01/08				
01-150	Sales Tax Receivable		158,965.22	
06-150	Sales Tax Receivable		39,741.31	
07-150	Sales Tax Receivable		79,482.61	
11-150	Sales Tax Receivable		25,407.60	
01-40116	Sales Tax Revenue			158,965.22
06-40014	4B 1/4 % Sales Tax Revenue			39,741.31
07-40011	4A 1/2 % Sales Tax Revenue			79,482.61
11-40009	HB 445 Sales Tax Revenue 1/4%			25,407.60
Total			303,596.74	303,596.74
Adjusting Journal Entries JE # 3				
		E.02		
To record OGSR3 account payable @ 9/30/08 year end.				
11-500850	HB445 Road Repair		26,500.00	
11-202	ACCOUNTS PAYABLE			26,500.00
Total			26,500.00	26,500.00
Adjusting Journal Entries JE # 4				
		E.02		
To record GEN account payable @ 9/30/08 year end.				
01-501632	Consultant/Contract Services		8,097.20	
01-501640	Legal		6,361.59	
01-501640	Legal		6,391.25	
01-501643	Engineering		5,827.50	
01-501643	Engineering		29,963.03	
01-502677	IT Services		3,865.00	
01-502760	Fuel		3,677.63	
01-503632	Contract/Consulting Services		3,200.00	
01-503632	Contract/Consulting Services		3,200.00	
01-509705	Hurricane IKE" Disaster Recov"		9,262.50	
01-202	ACCOUNTS PAYABLE			79,845.70
Total			79,845.70	79,845.70
Adjusting Journal Entries JE # 5				
		E.02		
To record Water account payable @ 9/30/08 year end.				
02-500631	Contract Service Eco		17,214.96	
02-202	ACCOUNT PAYABLE			17,214.96
Total			17,214.96	17,214.96
Adjusting Journal Entries JE # 6				
		E.02		
To record SEWER account payable @ 9/30/08 year end.				
03-500631	Contract Service / ECO		17,484.98	

Client: *City of Magnolia, Texas*
Engagement: *4.0 - Magnolia 9/30/2008*
Period Ending: *9/30/2008*
Workpaper: *2.5.12 - Adjusting Journal Entries Report*

Account	Description	W/P Ref	Debit	Credit
03-500672	Garbage Service		6,261.94	
03-500857	Sludge Hauling		12,562.00	
03-202	ACCOUNT PAYABLE			36,308.92
Total			36,308.92	36,308.92
Adjusting Journal Entries JE # 7				
To record W&S depreciation expense.		H.02		
02-500858	Depreciation		137,456.81	
02-160	ACCUMULATED DEPRECIATION			137,456.81
Total			137,456.81	137,456.81
Adjusting Journal Entries JE # 8				
To adjust W&S unamortized bond issuance cost		I.11		
25-500035	Unamortized Bond Issuance Expense		8,945.24	
02-145	Unamortized Bond Issuance Cost			8,945.24
Total			8,945.24	8,945.24
Adjusting Journal Entries JE # 9				
To record actual taxes receivable at year end.		C.02		
01-135	TAXES RECEIVABLE		7,456.24	
01-225	DEFERRED REVENUE			7,456.24
Total			7,456.24	7,456.24
Adjusting Journal Entries JE # 11				
To record WSF unbilled account receivable at year end.		D.03		
02-40001	Water Fund Revenue		62,870.05	
02-120	ACCOUNTS RECEIVABLE-UNBILLED			62,870.05
Total			62,870.05	62,870.05
Adjusting Journal Entries JE # 12				
To record sewer and garbage unbilled accounts receivable at year end.		D.03		
03-40001	Sewer Revenue		27,195.53	
03-40011	Garbage Revenue		12,797.89	
03-120	ACCOUNTS RECEIVABLE			39,993.42
Total			39,993.42	39,993.42
Adjusting Journal Entries JE # 13				
To record long term debt and correct net assets				
02-231	Long-Term Debt-2006 Rev Bond		1,787.46	
02-399	RETAINED EARNINGS		4,916,357.54	
02-302	To be Provided for Pmt-LT Debt			4,780,000.00
02-40001	Water Fund Revenue			138,145.00
Total			4,918,145.00	4,918,145.00
Adjusting Journal Entries JE # 14				
To correct general fund				
01-399	FUND BALANCE		49,659.00	
01-502501	Salaries			49,659.00
Total			49,659.00	49,659.00

Client: **City of Magnolia, Texas**
Engagement: **4.0 - Magnolia 9/30/2008**
Period Ending: **9/30/2008**
Workpaper: **2.5.12 - Adjusting Journal Entries Report**

Account	Description	W/P Ref	Debit	Credit
Adjusting Journal Entries JE # 15				
To adjust for payroll reconciliation				
01-49906	INTRA-FUND TRANSFER 4B (06)		8,714.02	
01-49907	INTRA-FUND TRANSFER 4A (07)		8,789.08	
01-120	DUE (TO)FROM 4B			1,701.66
01-502536	Payroll Tax (F.I.C.A.)			15,801.44
Total			17,503.10	17,503.10
Adjusting Journal Entries JE # 16				
To record estimated franchise tax receivable				
01-137	FRANCHISE TAX RECEIVABLE		10,000.00	
01-40120	Franchise Tax Revenue			10,000.00
Total			10,000.00	10,000.00
Adjusting Journal Entries JE # 18				
To record 4A account payable at 9/30/08.				
		E.06		
07-500640	Legal		1,721.00	
07-201	ACCOUNTS PAYABLE			1,721.00
Total			1,721.00	1,721.00
Adjusting Journal Entries JE # 19				
To record payroll accrual @ 9/30/08. Client should reverse @ 10/01/08.				
		F.02		
01-501501	Salaries		9,630.60	
01-202	ACCOUNTS PAYABLE			9,630.60
Total			9,630.60	9,630.60
Adjusting Journal Entries JE # 20				
To record amortized bond issue expense.				
02-500035	Amortized Bond Issue Expense		8,349.00	
02-145	Unamortized Bond Issuance Cost			8,349.00
Total			8,349.00	8,349.00
Adjusting Journal Entries JE # 21				
To adjust sales taxes at year end.				
01-40116	Sales Tax Revenue		96,263.82	
06-40014	4B 1/4 % Sales Tax Revenue		24,065.97	
07-40011	4A 1/2 % Sales Tax Revenue		48,131.94	
11-40009	HB 445 Sales Tax Revenue 1/4%		24,065.95	
01-399	FUND BALANCE			96,263.82
06-399	FUND BALANCE			24,065.97
07-399	FUND BALANCE			48,131.94
11-399	FUND BALANCE			24,065.95
Total			192,527.68	192,527.68
Adjusting Journal Entries JE # 22				
To adjust CIP and adding additional capital asset.				
02-152	PLANT FACILITIES		1,716,746.25	
02-500858	Depreciation		60,574.87	

Client: **City of Magnolia, Texas**
Engagement: **4.0 - Magnolia 9/30/2008**
Period Ending: **9/30/2008**
Workpaper: **2.5.12 - Adjusting Journal Entries Report**

Account	Description	W/P Ref	Debit	Credit
02-146	Construction in Progress			1,040,058.63
02-160	ACCUMULATED DEPRECIATION			60,574.87
02-500861	Transfer to R/Bond 2006			676,687.62
Total			1,777,321.12	1,777,321.12

Adjusting Journal Entries JE # 23

To record Food Basket bank account for receipts for water revenue

02-106	FOODBASKET /AMER PAY SYSTEM		93,909.75	
02-40001	Water Fund Revenue			93,909.75
Total			93,909.75	93,909.75

Adjusting Journal Entries JE # 24

To record wages payable

01-100	CLAIM ON CASH		29,569.94	
06-100	CLAIM ON CASH		945.01	
07-100	CLAIM ON CASH		945.01	
01-219	Wages Payable			29,569.94
06-219	Wages payable			945.01
07-219	Wages payable			945.01
Total			31,459.96	31,459.96

Adjusting Journal Entries JE # 25

To correct customer deposits

02-220	CUSTOMER DEPOSITS		7,893.28	
02-40001	Water Fund Revenue			7,893.28
Total			7,893.28	7,893.28

Adjusting Journal Entries JE # 26

To record receivable in DSF

01-225	DEFERRED REVENUE		11,107.41	
05-135	TAXES RECEIVABLE		11,107.41	
01-135	TAXES RECEIVABLE			11,107.41
05-225	DEFERRED TAX REVENUE			11,107.41
Total			22,214.82	22,214.82