



COMPREHENSIVE ANNUAL FINANCIAL REPORT

**FOR THE YEAR ENDED
SEPTEMBER 30, 2006**

PREPARED BY

**FINANCE DEPARTMENT
CITY OF STEPHENVILLE, TEXAS**

CITY OF STEPHENVILLE, TEXAS

TABLE OF CONTENTS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	<u>Page Number</u>
INTRODUCTORY SECTION	
Letter of Transmittal	i – iv
GFOA Certificate of Achievement	v
Organizational Chart.....	vi
Principal City Officials	vii
FINANCIAL SECTION	
Independent Auditors’ Report.....	1 – 2
Management’s Discussion and Analysis	3 – 10
Basic Financial Statements	
Government-wide Financial Statements	
Statement of Net Assets.....	11
Statement of Activities.....	12
Fund Financial Statements	
Balance Sheet – Governmental Funds	13
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds	14

(continued)

CITY OF STEPHENVILLE, TEXAS
TABLE OF CONTENTS
(Continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2006

	<u>Page Number</u>
FINANCIAL SECTION (Continued)	
Fund Financial Statements (Continued)	
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities.....	15
Statement of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual – General Fund.....	16 – 18
Statement of Net Assets – Proprietary Funds	19
Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds	20
Statement of Cash Flows – Proprietary Funds.....	21 – 22
Statement of Fiduciary Net Assets.....	23
Notes to Financial Statements.....	24 – 45
Combining Fund Statements and Schedules	
Nonmajor Governmental Funds	
Combining Balance Sheet.....	46
Combining Statement of Revenues, Expenditures and Changes in Fund Balances	47

(continued)

CITY OF STEPHENVILLE, TEXAS
TABLE OF CONTENTS
(Continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2006

	<u>Page Number</u>
FINANCIAL SECTION (Continued)	
Combining Fund Statements and Schedules (Continued)	
Nonmajor Special Revenue Funds	
Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual – Hotel/Motel Occupancy Tax Fund	48
Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual – Child Safety Fund	49
Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual – Public Safety Fund	50
Nonmajor Debt Service Fund	
Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual	51
Nonmajor Enterprise Funds	
Combining Balance Sheet	52
Combining Statement of Revenues, Expenses and Changes in Fund Net Assets	53
Combining Statement of Cash Flows	54 – 55

(continued)

CITY OF STEPHENVILLE, TEXAS

**TABLE OF CONTENTS
(Continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2006**

**Page
Number**

FINANCIAL SECTION (Continued)

Combining Fund Statements and Schedules (Continued)

Agency Funds

Combining Statement of Changes in Assets and Liabilities 56

**Table
Number Page
Number**

STATISTICAL SECTION (Unaudited)

Net Assets by Component.....	1	57
Changes in Net Assets	2	58 – 59
Fund Balances – Governmental Funds	3	60
Changes in Fund Balances – Governmental Funds	4	61 – 62
Assessed Value and Estimated Actual Value of Taxable Property.....	5	63
Direct and Overlapping Property Tax Rates	6	64
Principal Property Taxpayers.....	7	65
Property Tax Levies and Collections.....	8	66
Ratios of Outstanding Debt by Type	9	67
Ratios of Net General Bonded Debt Outstanding.....	10	68

(continued)

CITY OF STEPHENVILLE, TEXAS

**TABLE OF CONTENTS
(Continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2006**

	<u>Table Number</u>	<u>Page Number</u>
STATISTICAL SECTION (Unaudited)		
Direct and Overlapping Governmental Activities Debt.....	11	69
Legal Debt Margin and Tax Rate Limitations Information	12	70
Pledged Revenue Coverage	13	71
Demographic and Economic Statistics	14	72
Principal Employees	15	73
Fulltime Equivalent City Government Employees by Function/Program	16	74
Operating Indicators by Function/Program	17	75
Capital Asset Statistics by Function/Program.....	18	76

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INTRODUCTORY SECTION

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November 22, 2006

The Honorable Mayor, City Council and the Citizens of the City of Stephenville

The City of Stephenville (the “City”) Financial Management Policies requires that the City’s Finance Department prepare a complete set of financial statements presented in conformity with generally accepted accounting principles (GAAP) and audited in accordance with generally accepted auditing standards by a firm of licensed certified public accountants. Accordingly, the Comprehensive Annual Financial Report for the City of Stephenville, Texas for the fiscal year ended September 30, 2006, is hereby issued.

This report consists of management’s representations concerning the finances of the City. Consequently, management assumes full responsibility for the completeness and reliability of all the information presented in this report. To provide a reasonable basis for making representations, the City has established a comprehensive internal control framework that is designed both to protect the City’s assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the City’s financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the City’s comprehensive framework of internal controls has been designed to provide reasonable, rather than absolute, assurance that the financial statements will be free from material misstatements. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The City’s financial statements have been audited by Pattillo, Brown and Hill LLP, Independent Certified Public Accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City for the fiscal year ended September 30, 2006, are free of material misstatements. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the City’s financial statements for the fiscal year ended September 30, 2006, are fairly presented in conformity with GAAP. The independent auditors’ report is presented as the first component of the financial section of this report.

GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of a Management’s Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City’s MD&A can be found immediately following the report of the independent auditor.

Profile of the City

The City was incorporated in 1889 and chartered a home-rule city under Texas law in 1961. The City occupies approximately 10.26 square miles and serves a population of about 16,882. The City is empowered by state statute to levy a tax on both real and business personal property located within its boundaries. The City also has the power by state statute to extend its corporate city limits by annexation, which is done periodically when deemed appropriate by the City Council.

The City operates under the mayor-council form of government. Policy-making and legislative authority are vested in a governing Council consisting of the Mayor and eight (8) Council members. The City Council is responsible for, among other things, passing ordinances, adopting the budget, appointing committees, and hiring the City Administrator. The City Administrator is responsible for carrying out the policies and ordinances of the City Council, for overseeing the day-to-day operations of the City, and appointing head of various departments. The Mayor and City Council members serve two (2) year terms. All elected officials are elected at-large.

The basic financial statements of the City include all governmental activities, organizations and functions for which the City is financially accountable as defined by the Government Accounting Standards Board (GASB). Based on these criteria, no other governmental organizations are included in this report.

Services Provided. The City provides a full range of services, including public safety (police, fire and emergency medical), maintenance of streets and infrastructure, sanitation services, maintenance of the treated water distribution system and both sanitary and storm sewer collection and transmission systems, recreational activities and cultural events, landfill operations, airport facility maintenance as well as general administrative services.

Economic Conditions and Outlook

The information presented in the financial statements is perhaps best understood when it is considered from the broader of the specific environment within which the City operates.

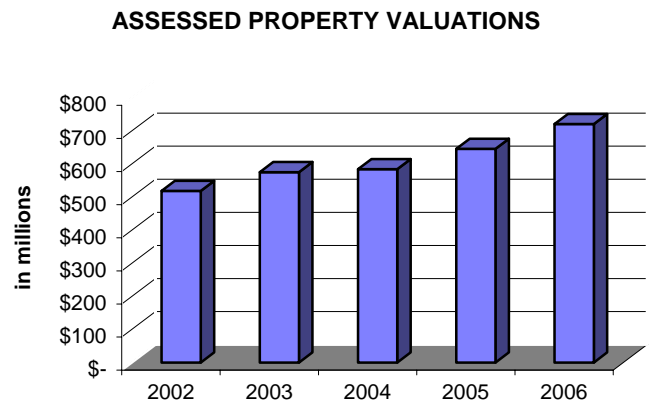
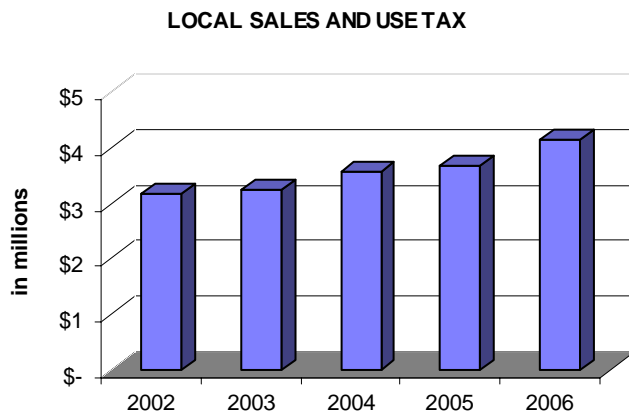
Local Economy. The City currently enjoys a favorable economic environment, bolstered by the strength of both Cross Timbers area and the State of Texas. Stephenville continues to act as a retail hub of the area. While many cities in the state are seeing the effect of a downturn in their economy, Stephenville has maintained its strong economic position. Strong property values, sales tax receipts and building activity are key indicators of the strength of the City’s economic position.

The following facts reflect Stephenville’s economic condition and outlook:

Property valuations increased by about \$75,600,000 (11.7%) in 2006 to \$719,600,000. Residential and commercial activity continues to be strong. With new residential building lots going on line this year and commercial buildings currently under construction, all signs point to property valuations continuing to increase.

The property tax rate is \$.4750 was a reduction from the past three (3) years.

Sales tax collections continue to experience growth this year showing a 10.4% increase over the previous year.



Accounting System and Budgetary Control

The City’s accounting records for general governmental operations are maintained on a modified accrual basis, with the revenues being recorded when available and measurable and expenditures being recorded when the services or goods are received and the liabilities incurred. Accounting records for the City’s utilities are maintained on the accrual basis.

In developing and maintaining the City's accounting system, consideration is given to the adequacy of the internal control structure. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition; and (2) the reliability of financial records for preparing financial statements and maintaining accountability of assets. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management.

All internal control evaluations occur within the above framework. We believe that the City's internal controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

The annual budget serves as the foundation of the City's financial planning and control. The City Charter provides that the City Council shall adopt the annual budget prepared by the City Administrator. The proposed budget must be submitted to the City Secretary no later than August 1st with the adoption taking place no later than September 23rd. The City Administrator is authorized to transfer budgeted amounts between line items and departments within any fund; however any revisions that alter the total expenditures of any fund must be approved by the City Council.

Budgetary control has been established at the departmental level. Financial reports are produced showing budget and actual expenditures by line item, and are distributed monthly to the departmental management and to others upon request.

Individual line items are reviewed and analyzed for budgetary compliance. Personnel expenditures are monitored and controlled at a position level and capital expenditures are monitored and controlled item by item. Revenue budgets are reviewed monthly.

Budget-to-actual comparisons are provided in this report for the General Fund on pages 16 – 18.

Long Range Planning/Financial Management. Users of this document, as well as others interested in the programs and services offered by the City of Stephenville, are encouraged to read the City's Fiscal Year 2006 –2007 Budget. The document details the City's long-term goals and financial policies, describes program accomplishments and initiatives, and outlines the City's capital improvement program. Also available for reference is the City of Stephenville's Comprehensive Plan which was adopted in 2006 and maps out the City's future strategies.

The City's ability to respond to ongoing economic challenges will require careful long-range planning. The City has responded by fiscal conservatism and implementing operating budget efficiencies that have resulted in its maintaining healthy fund balances in its General Fund and water/wastewater funds.

Debt Management. The City has been funding its capital program from current revenues and surplus working capital since 1996.

Cash Management. The City utilizes its bank depository contract and its investment policy in the management of all cash. Under the bank depository contract, the City operating account earns the bank's public fund interest rate. During the fiscal year ended September 30, 2006, the average rate on the operating account balances was 4.36 percent. The City's investment policy embraces current state regulations on the investment of public funds and authorizes the City to invest in certificates of deposits from the bank depository, direct obligations of the United States Government, obligations of an agency of the United States Government and local government investment pools. The combination of these investment vehicles provided a weighted average return of 4.68 percent over the fiscal year. The City requires that all deposits be collateralized with securities held in joint accounts at First Financial Bank of Stephenville. Collateral is monitored monthly to ensure that the market value of the pledged securities equals or exceeds the related deposit or investment balance. Investments are always executed delivery-versus-payment method. That is, funds are not wired or paid until verification has been made that the correct security has been received. Securities are held on behalf of the City by the City's agent. All collateral shall be subject to verification and audit by the Finance Director and the City's independent auditors.

Tax Appraisal/Collection Responsibilities. Under Texas law enacted in 1979, and subsequent revisions of the State Property Tax Code, the appraised value of taxable property in Stephenville is established by the Erath County Appraisal District. The City of Stephenville and other taxing jurisdictions in Erath County provide a pro rata share of the budgeted expenditures incurred by the Appraisal District, based on individual levy. Erath County Tax Assessor-Collector provides tax collection services for the City and other taxing jurisdictions in Erath County.

Risk Management. Risk management within the City is a joint effort of all City department heads in coordination with the City's property and casualty insurance provider. Under a contractual arrangement, the City's facilities, procedures and claims are reviewed and evaluated by the loss prevention representative with the insurance provider. The representative and department heads address areas of needs as identified through both external and internal analysis.

The minimizing of risk is addressed through employee training in the form of training films, safety courses and on-site instruction.

The City purchases liability insurance with limits of \$2 million for all exposures. The City also purchases workers' compensation coverage through a public entity insurance pool.

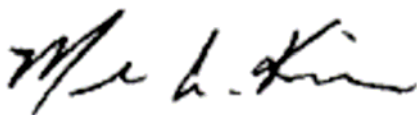
Awards. The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement in Financial Reporting to the City of Stephenville for its Comprehensive Annual Financial Report for the fiscal year ended September 30, 2005.

The Certificate of Achievement is a prestigious national award-recognizing conformance with the highest standards for preparation of state and local government financial reports. This award was the 23rd consecutive year that the City of Stephenville has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to GFOA to determine its eligibility for another certificate.

Acknowledgements. The preparation of this report on a timely basis could not be accomplished without the efficient and dedicated services of the entire staff of the City. We would like to express our appreciation to all staff members who assisted and contributed to its preparation. We would also like to thank the Mayor and City Council members for their interest and support in planning and conducting the financial operations of the City in a responsible and progressive manner.

Respectfully Submitted,



Mark A. Kaiser
City Administrator

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Stephenville
Texas

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

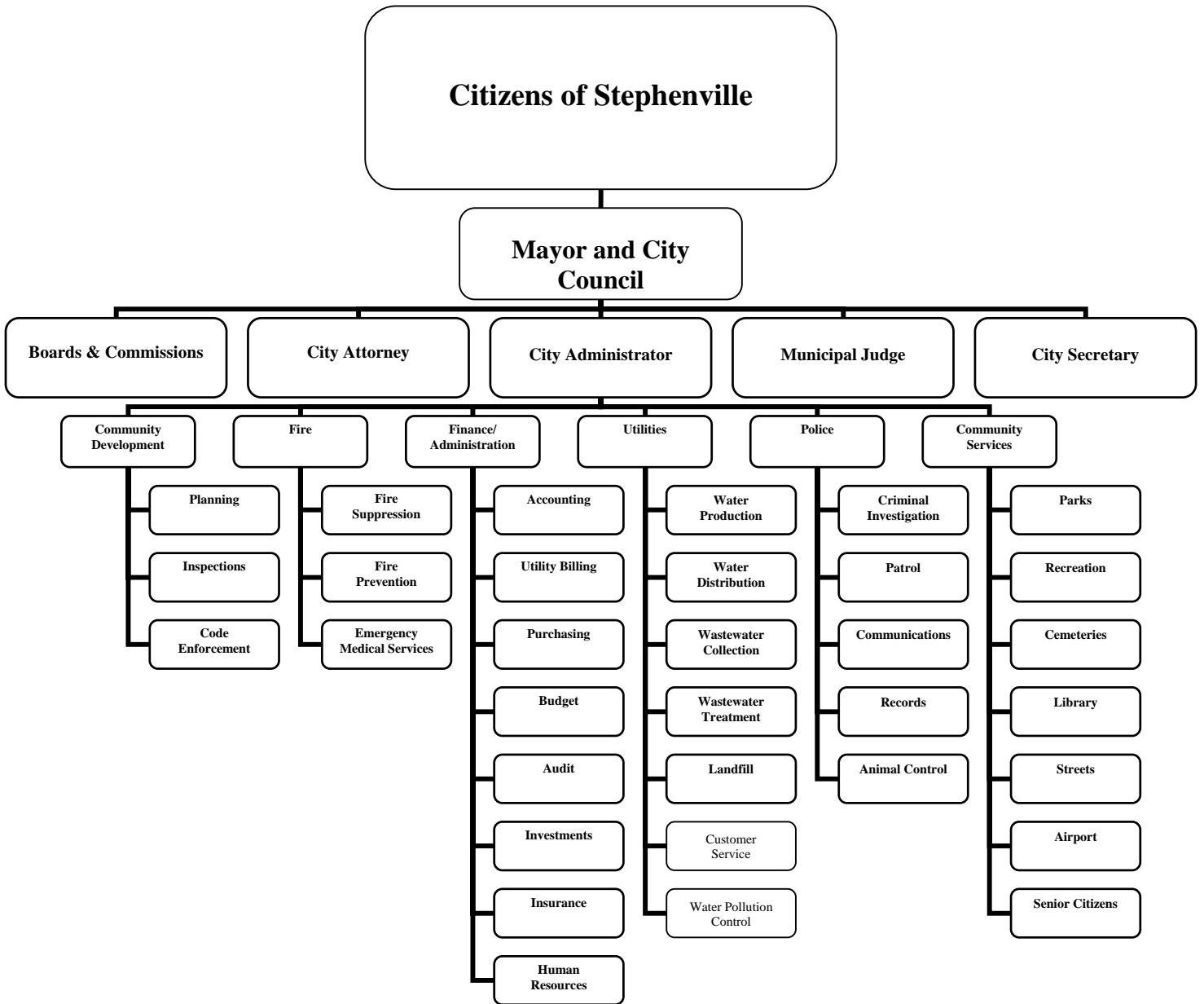


President

Executive Director

CITY OF STEPHENVILLE, TEXAS

ORGANIZATION CHART



CITY OF STEPHENVILLE, TEXAS

PRINCIPAL CITY OFFICIALS

SEPTEMBER 30, 2006

Mayor	Russell E. Jergins
Council Members	Dr. Malcolm L. Cross
	Barry Ratliff
	Alan Nash
	Cyndi Godwin
	Todd McEvoy
	Andrew Johnson
	Mark Murphy
	Nancy Hunter
City Administrator	Mark A. Kaiser
Director of Finance/Administration	Vacant
Director of Utilities	Nick Williams
Director of Community Development	Betty Chew
Police Chief	Roy Halsell
Fire Chief	Jimmy Chew
Director of Community Services	Drew Wells
City Secretary	Cindy Stafford

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FINANCIAL SECTION

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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Members of City Council
City of Stephenville, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Stephenville, Texas, as of and for the year ended September 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Stephenville's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Stephenville, Texas, as of September 30, 2006, and the respective changes in financial position and cash flows, where applicable, and the budgetary comparison for the General Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2006, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Stephenville, Texas' basic financial statements. The introductory section, combining and individual nonmajor fund financial statements and schedules, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

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

November 16, 2006

**MANAGEMENT'S
DISCUSSION AND ANALYSIS**

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**BASIC
FINANCIAL STATEMENTS**

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**COMBINING FUND
STATEMENTS AND SCHEDULES**

NONMAJOR GOVERNMENTAL FUNDS

Special Revenue Funds are used to account for specific revenue that is legally restricted to expenditures for particular purposes.

Hotel/Motel Occupancy Tax – This fund is used to account for hotel/motel occupancy tax revenue to be used for enhancing and promoting tourism and convention activity for the benefit of the hotel industry.

Child Safety – This fund is used to account for court costs used to operate a City school crossing guard program, or programs designated to enhance child safety, health, or nutrition; including child abuse prevention and intervention and drug and alcohol abuse prevention.

Public Safety – This fund is used to account for court costs used to promote various public safety programs.

The *Debt Service Fund* is used to account for the accumulation of resources and payment of general obligation bond principal and interest from governmental resources.

NONMAJOR ENTERPRISE FUNDS

Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business enterprises – where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or where the City has decided that periodic determination of net income is appropriate for accountability purposes.

Sanitary Landfill – This fund is used to account for solid waste collection and disposal services provided to the residents of the City.

Airport – This fund is used to account for municipal airport services and to support air transportation and charter services.

Storm Water Drainage – This fund is used to account for revenues collected and project costs for mitigating storm water drainage problems throughout the City.

FIDUCIARY FUNDS

Agency funds are used to account for assets held by the City as an agent for individuals, private organizations, other governments and/or other funds.

Senior Citizens – This fund is used to account for assets held for the benefit of a citizens' group.

STATISTICAL SECTION

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