

City of Mary Esther, Florida

Financial Statements

Year Ended September 30, 2008

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INDEPENDENT AUDITOR'S REPORT

The Honorable Mayor and Members of the City Council
City of Mary Esther, Florida

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Mary Esther, Florida (hereinafter referred to as "City"), as of and for the year 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 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 Mary Esther, Florida as of September 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 13, 2009, 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 and budgetary comparison information on pages 2 through 8 and 39, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Carr, Riggs & Ingram, L.L.C.

Destin, Florida
August 13, 2009

Management's Discussion and Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis (MD&A) of the City of Mary Esther, Florida's (the "City") financial performance provides an overview of financial activity, identifies changes in financial position, and assists the reader in focusing on significant financial issues for the fiscal year ended September 30, 2008. The MD&A provides summary level financial information; therefore, it should be read in conjunction with the accompanying financial statements.

HIGHLIGHTS

Financial Highlights

- Total assets decreased by \$211,813.
- Net assets decreased by \$26,093.
- Total revenues decreased by 19% or \$1,015,806 and total expenses increased by 1% or \$57,463, respectively.

USING THE ANNUAL REPORT

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments*, as amended by Statement 37. The Statement of Net Assets and the Statement of Activities (on pages 9 and 10) provide information about the activities of the City as a whole and present a longer-term view of the City's finances. Fund financial statements start on page 11. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the City's operations in more detail than the government-wide statements by providing information about the City's funds. The remaining statements provided financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the government.

Reporting the City as a Whole

The Statement of Net Assets and the Statement of Activities

Our analysis of the City as a whole begins on page 4. One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the City as a whole and about its activities in a way that helps answer that question. These statements include *all* assets and liabilities 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 regardless of when cash is received or paid.

These two statements report the City's *net assets* and changes in them. You can think of the City's net assets - the difference between assets and liabilities – as one way to measure the City's financial health, or *financial position*. Over time, *increases or decreases* in the City's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the City's property tax base and the condition of the City's roads, to assess the *overall health* of the City.

In the Statement of Net Assets and the Statement of Activities, we divide the City into two kinds of activities:

- *Governmental activities* – Most of the City's basic services are reported here, including the police, fire, public works, library, parks department, and general administration. Property taxes, franchise fees, state revenue sharing, and state and federal grants finance most of these activities.
- *Business-type activities* – The City charges a fee to customers to help cover all or most of the cost of water and sewer services it provides.

Reporting the City's Funds

Fund Financial Statements

Our analysis of the City's funds begins on page 6. The fund financial statements begin on page 11 and provide detailed information about the most significant funds – not the City as a whole. Some funds are required to be established by State law and by bond covenants. However, the City Council establishes many other funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money. The City's two kinds of funds – governmental and proprietary – use different accounting approaches.

- *Governmental funds* – Most of the City's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual accounting*, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the City's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. We describe the relationship (or differences) between governmental *activities* (reported in the Statement of Net Assets and the Statement of Activities) and governmental *funds* in the reconciliations on pages 12 and 14.
- *Proprietary funds* – When the City charges customers for the services it provides – whether to outside customers or to other units of the City – these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the City's proprietary fund is the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds.

The City as Trustee

Reporting the City's Fiduciary Responsibilities

The City is the trustee, or fiduciary, for its employees' pension plan. All of the City's fiduciary activities are reported in separate Statements of Pension Trust Fund Net Assets and Changes in Pension Trust Fund Net Assets on pages 19 and 20. We exclude these activities from the City's other financial statements because the City cannot use these assets to finance its operations. The City is responsible for ensuring that the assets reported in this fund are used for their intended purpose.

THE CITY AS A WHOLE

The following table reflects the net assets (in thousands) of the City's governmental activities and business-type activities and is compared to the prior year.

	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total Primary Government</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Assets						
Current and other assets	\$ 3,285	\$ 3,305	\$ 2,220	\$ 2,109	\$ 5,505	\$ 5,414
Capital assets, net	6,792	6,901	8,279	8,473	15,071	15,374
Total assets	<u>\$ 10,077</u>	<u>\$ 10,206</u>	<u>\$ 10,499</u>	<u>\$ 10,582</u>	<u>\$ 20,576</u>	<u>\$ 20,788</u>
Liabilities						
Current liabilities	\$ 26	\$ 34	\$ 420	\$ 413	\$ 446	\$ 447
Other liabilities	151	154	2,250	2,432	2,401	2,586
Total liabilities	<u>177</u>	<u>188</u>	<u>2,670</u>	<u>2,845</u>	<u>2,847</u>	<u>3,033</u>
Net assets						
Invested in capital assets, net of debt	6,792	6,901	5,824	5,842	12,616	12,743
Restricted for debt service	-	-	759	737	759	737
Unrestricted	3,108	3,117	1,246	1,158	4,354	4,275
Total net assets	<u>9,900</u>	<u>10,018</u>	<u>7,829</u>	<u>7,737</u>	<u>17,729</u>	<u>17,755</u>
Total liabilities and net assets	<u>\$ 10,077</u>	<u>\$ 10,206</u>	<u>\$ 10,499</u>	<u>\$ 10,582</u>	<u>\$ 20,576</u>	<u>\$ 20,788</u>

For more detailed information, see the accompanying Statement of Net Assets.

Total assets decreased by \$212,000 during the fiscal year ended September 30, 2008. This decrease occurred as a result of depreciation of capital assets. Total liabilities decreased by \$186,000 at September 30, 2008 primarily due to payment of debt during the year. The City's combined net assets decreased by \$26,000.

The following table reflects the changes in net assets (in thousands) of the City's governmental activities and business-type activities and compares the current and previous fiscal year.

	Governmental Activities		Business-type Activities		Total Primary Government	
	2008	2007	2008	2007	2008	2007
Program revenues	\$ 336	\$ 642	\$ 1,274	\$ 1,200	\$ 1,610	\$ 1,842
General revenues	1,775	2,192	878	1,246	2,653	3,438
Total revenues	<u>2,111</u>	<u>2,834</u>	<u>2,152</u>	<u>2,446</u>	<u>4,263</u>	<u>5,280</u>
Function/program expenses	<u>2,383</u>	<u>2,328</u>	<u>1,906</u>	<u>1,904</u>	<u>4,289</u>	<u>4,232</u>
Increase (decrease) in net assets	(272)	506	246	542	(26)	1,048
Transfers	155	155	(155)	(155)	-	-
Net assets beginning of year	<u>10,018</u>	<u>9,357</u>	<u>7,737</u>	<u>7,350</u>	<u>17,755</u>	<u>16,707</u>
Net assets end of year	<u>\$ 9,901</u>	<u>\$ 10,018</u>	<u>\$ 7,828</u>	<u>\$ 7,737</u>	<u>\$ 17,729</u>	<u>\$ 17,755</u>

For more detailed information, see the accompanying Statements of Activities.

The City's total revenues decreased by 19% or \$1,017 and total expenses increased by 1% or \$57,000, respectively. The overall results were a \$26,000 decrease in net assets for fiscal year 2008. Our analysis below separately considers the operations of governmental and business-type activities.

Governmental Activities

The City's revenue for governmental activities decreased by 26%, or \$723,000, while expenses for the governmental activities increased by 2% or \$55,000. The decline in revenues occurred as a result of the City receiving less federal and state grant revenues than they received in the previous year.

Business-type Activities

Revenues of the City's business – type activities show a decrease of 12% or \$294,000 from the previous fiscal year, while expenses increased slightly at less than 1% or \$2,000. The decrease in revenues is due primarily to a decrease in CBDG grant funds received as compared to prior year.

THE CITY'S FUNDS

As the City completed the year, its governmental funds (as presented in the balance sheet on page 11) reported a *combined* fund balance of \$3,258,602, which is \$13,066 lower than last year's total of \$3,271,668. The decrease in fund balance is the result of capital outlay purchases in the Capital Improvement fund.

General Fund Budgetary Highlights

Over the course of the year, the City typically revises the City budget. For the current year, there were no revisions. Total revenues for the General fund were \$194,644 less than budgeted amounts. Total expenses for the General fund were \$231,564 less than budgeted amounts.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At September 30, 2008, the City had \$15,071,671 invested in capital assets (net of depreciation). This amount represents a net decrease (including additions and deductions) of \$303,000 or 2% as compared to fiscal year 2007.

A listing of capital assets (in thousands) of governmental and business-type activities by major category, net of depreciation, for the current and prior year follows:

	Governmental Activities		Business-type Activities		Total Primary Government	
	2008	2007	2008	2007	2008	2007
Land	\$ 4,363	\$ 4,363	\$ 78	\$ 78	\$ 4,441	\$ 4,441
Construction in progress	-	-	-	2,744	-	2,744
Buildings	1,658	1,731	83	55	1,741	1,786
Improvements other than building	188	221	7,970	5,430	8,158	5,651
Machinery and equipment	583	586	148	166	731	752
Totals	\$ 6,792	\$ 6,901	\$ 8,279	\$ 8,473	\$ 15,071	\$ 15,374

For additional information on Capital Assets, see Note 4 in the accompanying financial statements.

Debt

At September 30, 2008, the City had \$2,455,235 in bonds outstanding, net of unamortized discount and deferred refunding expenses, versus \$2,631,978 in the prior year, a decrease of \$176,743 as shown below:

	2008	2007	Change
Water and sewer revenue bonds, Series 1996	\$ 2,455,235	\$ 2,631,978	\$ (176,743)

The last payment on the debt is due in fiscal year 2018. The maximum debt service in any one year on this debt is estimated to be \$348,503 in 2015. The minimum debt service is estimated to be \$323,466 in 2018. The City pledged as security for payment of the principal and interest on the Water and Sewer Revenue Bonds the net revenues (gross revenues less cost of operation and maintenance) derived from operation of the water and sewer system together with the proceeds derived from utility taxes collected on water, electricity, natural gas, and telecommunication services charged to customers within the City and from franchise fees collected from Gulf Power Company, Okaloosa Gas District and various telephone companies.

For additional information on Debt, see Note 5 in the accompanying financial statements.

ECONOMIC FACTORS AND NEXT YEAR’S BUDGETS AND RATES

The City of Mary Esther was established as a town under Laws of the State of Florida in 1946. On June 5, 1984, after referendum vote by the citizens of Mary Esther, the Council approved ordinance number 84-3 to incorporate Mary Esther as a city. A five-person council governs the City. The City has taxing authority and receives funds from the State. Revenues are generated by charges to the City’s customers for water and wastewater related services.

As for the City’s governmental activities, rates for fiscal year 2009 have been established to provide for the operations of the City and necessary capital requirements. Ad valorem tax rates for fiscal year 2009 were decreased from 3.0125 mills to 2.6996 mills.

FUTURE FINANCIAL FACTORS

The City is investigating the option of annexing areas west of Mary Esther including residential areas on Hurlburt Field, AFB. Future revenues and expenses of this possible expansion are unknown as of the date of this report; however, the City has no plans to provide additional services to the expanded area if annexed.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Finance Department at (850) 243-3566.

MANAGEMENT

Lynne Oler (previously John Lulue)
City Manager

Tammy King
City Clerk

Steven Rausch
Financial Director

CITY COUNCIL

"Chuck" Bolton
Mayor

Ron Stearns
Mayor Pro Tem

George Crews
Councilmember

Frank Crowder
Councilmember

Lee Griffin
Councilmember

Richard Reinlie
Councilmember

Basic Financial Statements

City of Mary Esther, Florida

Statement of Net Assets

<i>September 30,</i>	2008		
	Governmental Activities	Business-type Activities	Total
Assets			
Cash and cash equivalents	\$ 1,126,042	\$ 557,287	\$ 1,683,329
Investments	2,028,215	655,711	2,683,926
Accounts receivable	37,311	207,488	244,799
Due from other governments	13,085	-	13,085
Internal balances	78,713	(78,713)	-
Other current assets	1,375	-	1,375
Restricted assets - cash	-	298,898	298,898
Restricted assets - investments	-	549,352	549,352
Bond issue costs, net	-	29,626	29,626
Capital assets, net	6,792,448	8,279,223	15,071,671
Total assets	10,077,189	10,498,872	20,576,061
Liabilities			
Accounts payable	7,721	88,528	96,249
Due to other governments	-	413	413
Accrued interest - restricted	-	38,056	38,056
Customer deposits - restricted	-	88,249	88,249
Accrued payroll	18,418	-	18,418
Noncurrent liabilities:			
Due within one year	-	205,000	205,000
Due in more than one year	150,425	2,250,235	2,400,660
Total liabilities	176,564	2,670,481	2,847,045
Net assets			
Invested in capital assets, net of related debt	6,792,448	5,823,988	12,616,436
Restricted for:			
Debt Service	-	758,788	758,788
Unrestricted	3,108,177	1,245,615	4,353,792
Total net assets	\$ 9,900,625	\$ 7,828,391	\$ 17,729,016

See accompanying notes to financial statements.

City of Mary Esther, Florida

Statement of Activities

Year ended September 30,

2008

Function/Program	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		Total
					Governmental Activities	Business-type Activities	
Governmental activities:							
General government	\$ 460,651	\$ 136,838	\$ -	\$ -	\$ (323,813)	\$ -	\$ (323,813)
Public safety	1,079,069	199,281	-	-	(879,788)	-	(879,788)
Transportation	383,279	-	50,875	-	(332,404)	-	(332,404)
Human services	16,204	-	-	-	(16,204)	-	(16,204)
Culture and recreation	266,360	-	105,286	-	(161,074)	-	(161,074)
Unallocated depreciation and loss on asset disposed	177,759	-	-	-	(177,759)	-	(177,759)
Total governmental activities	2,383,322	336,119	156,161	-	(1,891,042)	-	(1,891,042)
Business-type activities:							
Water and sewer	1,905,694	1,273,667	-	-	-	(632,027)	(632,027)
Total primary government	\$ 4,289,016	\$ 1,609,786	\$ 156,161	\$ -	(1,891,042)	(632,027)	(2,523,069)
General revenues							
Taxes:							
Property taxes, levied for operational purposes					1,049,146	-	1,049,146
Sales taxes					432,396	-	432,396
Franchise fees					-	222,480	222,480
Utility service fees					-	468,796	468,796
Grants and contributions not restricted to specific programs					123,501	-	123,501
Investment earnings					763	65,666	66,429
Miscellaneous					12,353	121,875	134,228
Transfers					155,211	(155,211)	-
Total general revenues					1,773,370	723,606	2,496,976
Change in net assets					(117,672)	91,579	(26,093)
Net assets, October 1, 2007					10,018,297	7,736,812	17,755,109
Net assets, September 30, 2008					\$ 9,900,625	\$ 7,828,391	\$ 17,729,016

See accompanying notes to financial statements.

City of Mary Esther, Florida

Balance Sheet - Governmental Funds

September 30,

	2008		
	General Fund	Capital Improvement Fund	Total Governmental Funds
Assets			
Cash and cash equivalents	\$ 1,126,042	\$ -	\$ 1,126,042
Investments	1,751,467	276,748	2,028,215
Due from other funds	1,108	590,860	591,968
Due from other governments	13,085	-	13,085
Accounts receivable - other	37,311	-	37,311
Other current assets	1,375	-	1,375
Total assets	\$ 2,930,388	\$ 867,608	\$ 3,797,996
Liabilities and fund balances			
Liabilities:			
Accounts payable	\$ 7,721	\$ -	\$ 7,721
Accrued payroll	18,418	-	18,418
Due to other funds	513,255	-	513,255
Total liabilities	539,394	-	539,394
Fund balances:			
Reserved for encumbrances	4,953	-	4,953
Unreserved, reported in:			
General fund	2,386,041	-	2,386,041
Capital improvement fund	-	867,608	867,608
Total fund balances	2,390,994	867,608	3,258,602
Total liabilities and fund balances	\$ 2,930,388	\$ 867,608	\$ 3,797,996

See accompanying notes to financial statements.

Reconciliation of the Balance Sheet to the Statement of Net Assets

<i>September 30,</i>	2008
Total fund balance - governmental funds	\$ 3,258,602
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.	6,792,448
Compensated absences are not due and payable in the current period and therefore are not reported in the governmental funds	(150,425)
Total net assets - governmental activities	\$ 9,900,625

See accompanying notes to financial statements.

Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds

Year Ended September 30,

	2008		
	General Fund	Capital Improvement Fund	Total Governmental Funds
Revenues			
Taxes	\$ 1,049,146	\$ -	\$ 1,049,146
Licenses and permits	167,735	-	167,735
Intergovernmental	712,058	-	712,058
Charges for services	136,838	-	136,838
Fines and forfeitures	31,546	-	31,546
Miscellaneous	13,117	-	13,117
Total revenues	2,110,440	-	2,110,440
Expenditures			
General government	458,058	-	458,058
Public safety	1,079,069	-	1,079,069
Transportation	386,399	-	386,399
Human services	16,204	-	16,204
Culture and recreation	263,240	-	263,240
Capital outlay	25,761	49,986	75,747
Total expenditures	2,228,731	49,986	2,278,717
Excess (deficiency) of revenues over expenditures	(118,291)	(49,986)	(168,277)
Other financing sources (uses)			
Transfers in	155,211	36,920	192,131
Transfers out	(36,920)	-	(36,920)
Total other financing sources (uses)	118,291	36,920	155,211
Net change in fund balances	-	(13,066)	(13,066)
Fund Balance, October 1, 2007	2,390,994	880,674	3,271,668
Fund Balance, September 30, 2008	\$ 2,390,994	\$ 867,608	\$ 3,258,602

See accompanying notes to financial statements.

Reconciliation of the Statement of Revenues, Expenditures and Changes
in Fund Balances of Governmental Funds to the Statement of Activities

<u>Year ended September 30,</u>	<u>2008</u>
Net change in fund balances - total governmental funds	\$ (13,066)
Capital outlay, reported as expenditures in governmental funds, is shown as capital assets in Statement of Net Assets.	75,747
Depreciation expense on governmental capital assets and losses on capital asset disposals are included in the governmental activities in the Statement of Activities.	(183,901)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.	3,548
<u>Change in net assets of governmental activities</u>	<u>\$ (117,672)</u>

See accompanying notes to financial statements.

City of Mary Esther, Florida

Balance Sheet - Proprietary Fund

<i>September 30,</i>	2008
	Water and Sewer Fund
Assets	
Current assets:	
Cash and cash equivalents	\$ 557,287
Investments	655,711
Receivables	207,488
Total current assets	1,420,486
Restricted assets:	
Cash	298,898
Investments	549,352
Total restricted assets	848,250
Bond issue costs (net of accumulated amortization)	29,626
Fixed assets (net of accumulated depreciation)	8,279,223
Total assets	\$ 10,577,585
Liabilities and Net Assets	
Liabilities	
Current Liabilities:	
Accounts payable	\$ 88,528
Due to other governments	413
Current liabilities payable from restricted assets	331,305
Due to other funds	78,713
Total current liabilities	498,959
Non-current liabilities:	
Water & sewer revenue bonds, series 1996	2,250,235
Total liabilities	2,749,194
Net assets	
Invested in capital assets, net of related debt	5,823,988
Restricted for debt service	758,788
Unrestricted	1,245,615
Total net assets	7,828,391
Total liabilities and net assets	\$ 10,577,585

See accompanying notes to financial statements.

Statement of Revenues, Expenses and Changes in Fund Net Assets
Proprietary Fund

<i>Year ended September 30,</i>	2008
	Water and Sewer Fund
Revenues	
Charges for services:	
Water utility revenue	\$ 538,725
Sewer utility revenue	734,942
Total revenues	1,273,667
Operating expenses	
Personal services	80
Professional services	1,298,660
Communications	5,256
Utilities	6,041
Insurance	84,772
Printing and binding	4,874
Repairs and maintenance	54,065
Other current charges	1,393
Office supplies	2,833
Operating supplies	156
Amortization	26,460
Depreciation	273,856
Total operating expenses	1,758,446
Operating income	(484,779)
Non-operating revenues (expenses)	
Interest earnings	65,666
Interest expense	(147,248)
Utility service fees	468,796
Franchise fees	222,480
Miscellaneous income	121,875
Total non-operating revenues (expenses)	731,569
Net income (loss) before operating transfers	246,790
Other financing sources (uses)	
Operating transfers to other funds	(155,211)
Net income (loss)	91,579
Net assets, October 1, 2007	7,736,812
Net assets, September 30, 2008	\$ 7,828,391

See accompanying notes to financial statements.

City of Mary Esther, Florida

Statement of Cash Flows - Proprietary Fund

<i>Year ended September 30,</i>	2008
Cash flows from operating activities	
Receipts from customers	\$ 1,306,567
Payments to suppliers	(1,456,695)
Net cash used by operating activities	(150,128)
Cash flows from non-capital financing activities	
Utility service fees	461,909
Franchise fees	222,480
Advances from other funds	77,605
Transfers to other funds	(155,211)
Miscellaneous revenue	121,875
Net cash provided by non-capital financing activities	728,658
Cash flows from capital and related financing activities	
Acquisition of fixed assets	(79,604)
Principal paid on bonds	(200,000)
Interest paid on bonds	(147,248)
Net cash used by capital and related financing activities	(426,852)
Cash flows from investing activities	
Redemption of investments	(31,497)
Interest income	66,064
Net cash provided by investing activities	34,567
Net increase in cash and cash equivalents	186,245
Cash and cash equivalents, beginning of year	669,940
Cash and cash equivalents, end of year	\$ 856,185
Composition of cash and cash equivalents	
Unrestricted	\$ 557,287
Restricted	298,898
Total cash and cash equivalents	\$ 856,185

(continued)

See accompanying notes to financial statements.

Statement of Cash Flows - Proprietary Fund (Continued)

<i>Year ended September 30,</i>	2008
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:	
Operating income (loss)	\$ (484,779)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Amortization	26,460
Depreciation	273,856
Change in operating assets and liabilities:	
Accounts receivable	31,916
Accounts payable	1,435
Deposits	984
Net cash provided (used) by operating activities	\$ (150,128)

See accompanying notes to financial statements.

City of Mary Esther, Florida

Statement of Net Assets - Pension Trust Fund

<i>September 30,</i>	2008
Assets	
Investments	\$ 1,071,636
Total assets	1,071,636
Liabilities	
Liabilities	-
Total liabilities	-
Net assets	
Held in trust for pension benefits	\$ 1,071,636

See accompanying notes to financial statements.

City of Mary Esther, Florida

Statement of Changes in Net Assets - Pension Trust Fund

<i>Year ended September 30,</i>	2008
Additions	
Contributions	\$ 101,030
Intererst/ dividends	31,223
Investment gains (losses)	(88,553)
Total additions	43,700
Deductions	
Benefits and other withdrawals	145,990
Total deductions	145,990
Change in net assets	(102,290)
Net assets, October 1, 2007	1,173,926
Net assets, September 30, 2008	\$ 1,071,636

See accompanying notes to financial statements.

NOTE 1 – NATURE OF ORGANIZATION

The City of Mary Esther (hereinafter referred to as "City") was established as a town under Laws of the State of Florida in 1946. On June 5, 1984, after referendum vote by the citizens of Mary Esther, the Council approved ordinance number 84-3 to incorporate Mary Esther as a city. The City operates under a council form of government and provides the following services: public safety (law enforcement, fire control, and protective inspections), physical environment (community development), transportation (road and street facilities), human services (animal control), culture and recreation (library and parks and recreation), sanitation (water and sewer utilities), and general government.

In evaluating how to define the City for financial reporting purposes, management has considered all potential component units. The decision to include, or exclude, a potential component unit in the reporting entity was made by applying the criteria set forth in Government Accounting Standards Board Statement 14. The basic - but not the only - criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations, and accountability for fiscal matters. A second criterion used in evaluating potential component units is the scope of public service. Application of this criterion involves considering whether the activity benefits the City and/or its citizens, or whether the activity is conducted within the geographic boundaries of the City and is generally available to its citizens. A third criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the City is able to exercise oversight responsibilities. Management determined that there were no other government units located within the geographic boundaries of the City and, thus, no potential component units were considered.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Measurement Focus, Basis of Accounting and Basis of Presentation

Government-wide Financial Statements – Government-wide financial statements, including the statement of net assets and statement of activities, present information about the City as a whole. These statements include the non-fiduciary financial activity of the primary government.

Government-wide financial statements are prepared using the economic resources measurement focus. The statement of activities presents a comparison between direct expenses and program revenues for each function or program of the City's governmental activities. Direct expenses are those that are specifically associated with a service, program, or department and are thereby clearly identifiable to a particular function.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Program revenues include charges paid by the recipient of the goods or services offered by the program and grants and contributions that are restricted to meeting the operations or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues, with certain exceptions. The comparison of direct expenses with program revenues identifies the extent to which each governmental function or business segment is self-financing or draws from the general revenues of the City.

The effects of interfund activity have been eliminated from the government-wide financial statements.

The government-wide financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when a liability is incurred, regardless of the timing of the related cash flows. Property taxes are recognized in the year for which they are levied. Revenues from grants, entitlements, and donations are recognized in the fiscal year in which all eligibility requirements imposed by the provider have been satisfied.

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

Fund Financial Statements

Governmental Funds are used to account for the general government activities. Governmental fund types use the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when 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. The City considers all revenues available if they are collected within 60 days after year end. Expenditures are recorded when the related fund liability is incurred, except for unmatured interest on general long-term debt which is recognized when due, and certain compensated absences and claims and judgments which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

Property taxes, franchise taxes, licenses, interest and special assessments are susceptible to accrual. Sales taxes collected and held by the state at year end on behalf of the City are also recognized as revenue. Other receipts and taxes become measurable and available when cash is received by the City and are recognized as revenue at that time.

Entitlements and shared revenues are recorded at the time of receipt or earlier if the susceptible to accrual criteria are met. Expenditure-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other grant requirements have been met.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Governmental funds include the following major funds:

The General Fund is the City's primary operating fund. This fund accounts for all financial resources of the general government, except those required to be accounted for in another fund. All general tax revenues and other receipts that are not restricted by law or contractual agreement to some other fund are accounted for in this fund. General operating expenditures, fixed charges and capital improvement costs that are not paid through other funds are paid from the General Fund.

The Capital Improvement Fund accounts for the acquisition of fixed assets or construction of major capital facilities (other than those financed by Proprietary Funds) that are financed from grants or transfers from other funds.

Proprietary Funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The City applies all applicable Governmental Accounting Standards Board ("GASB") pronouncements as well as Financial Accounting Standards Board ("FASB") statements and interpretations issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Proprietary funds include the following fund types:

Enterprise Funds are used to account for those operations that are financed and operated in a manner similar to private business or where the City has decided that the determination of revenues earned, costs incurred and/or net income is necessary for management accountability. The City's Water and Sewer Fund is an enterprise fund.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's enterprise fund are charges to customers for sales of water and sewer services. Operating expenses for enterprise funds include the cost of sales and service, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Fiduciary Funds account for assets held by the City in a trustee capacity or as an agent on behalf of others. Trust funds account for assets held by the City under the terms of a formal trust agreement.

Pension Trust Fund is custodial in nature and does not present results of operations or have a measurement focus. Pension Trust Funds are accounted for using the modified accrual basis of accounting. The Pension Trust Fund accounts for the assets of the City's Employee Thrift Plan.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New Accounting Pronouncements

The Governmental Accounting Standards Board issued Statements No. 45, “Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions” which becomes effective for the District for its fiscal year beginning October 1, 2009. The City is analyzing the effects of this pronouncement and plans to adopt it by the effective date as required. The City does not anticipate a material impact with the adoption of this standard.

Cash and Cash Equivalents

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

The City maintains its deposits with banks qualified as public depositories under Florida law. All deposits are insured by Federal depository insurance and/or collateralized pursuant to the Public Depository Security Act of the State of Florida.

Under this method, all the City’s deposits are fully insured or collateralized at the highest level of security as defined by *Governmental Accounting Standards Board, Statement Number 40, Deposits and Investment Disclosures (An Amendment of Governmental Accounting Standards Board, Statement Number 3)*.

Investments

The City is authorized under the City’s investment policy to invest and reinvest surplus public funds in its control or possession, in accordance with resolutions to be adopted from time to time and in accordance with Chapter 166.261, as amended under Chapter 21 Part IV, sections 218.40 through 218.45.

According to its policy, the City’s primary objectives in priority order are: 1) safety, 2) liquidity, and 3) return on investment. The policy prohibits the following investments and investment practices:

1. Purchases on margin or short sales.
2. Derivative securities that are, in effect, a leveraged bet on future movements of interest rates or some price index. Collateralized mortgage obligations, because of their complexity and prepayment rate uncertainties, are prohibited.
3. Lending securities with an agreement to buy them back after a stated period of time (reverse purchased agreements from the perspective of the public body).

All investments are stated at fair market value.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments (continued)

The City's investment pool participates in the Local Government Surplus Trust Fund, operated by Florida's State Board of Administration (SBA). The SBA is governed by Chapter 19-7 of the Florida Administrative Code (FAC). The FAC provides guidance and establishes the general operating procedures for the administration of the Local Government Surplus Trust Fund. Additionally, the Florida Auditor General performs an operational audit of activities and investments of the SBA. In accordance with GASB Statement Number 31, the Local Government Surplus Trust Fund is a "2A-7 like" pool and thus, SBA investments are valued using the pooled share price.

The City's current investment policy allows certain types of investments and prohibits other types of investments. Investments in common stock are neither specifically allowed nor prohibited in the investment policy. Management concluded that the continued ownership by the City of these common stock investments is acceptable under the current investment policy.

Receivables and Payables

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

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

All receivables in governmental funds are shown net of an allowance for uncollectibles. At September 30, 2008, the City considers all receivables collectible and accordingly does not have an allowance.

Services provided, deemed to be at market, or near market rates, are treated as revenues and expenditures/expenses. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund, and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation.

Property Taxes

The City's ad valorem taxes are assessed by the Okaloosa County Property Appraiser and collected by the Okaloosa County Tax Collector in accordance with Florida Statutes. The City retains the right and duty to set millage rates. Property taxes are not recorded as receivables at September 30th because, though legally assessed as of January 1, they are not due and payable until after the close of the fiscal year ended the following September 30th.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Receivables and Payables (continued)

Property Taxes (continued)

The following is the current property tax calendar.

Assessment date	January 1, 2008
Levy date	November 1, 2008
Due date	March 31, 2009
Delinquency date	April 1, 2009

Discounts of 1% for each month taxes are paid prior to March are granted.

Revenue recognition criteria for property taxes under GASB requires that only property taxes expected to be collected within 60 days of the current period be accrued. Property taxes which are uncollected as of the end of the fiscal year are generally immaterial in amount and highly susceptible to uncollectibility; therefore, they are not recorded as a receivable at the balance sheet date.

Water and Sewer Charges Receivable

Accounts receivable from customers are reported at the outstanding balance due from customers, net of any allowance for doubtful accounts. The City provides for doubtful accounts based on experience and analysis of individual accounts. When the collectibility of a receivable becomes questionable, an allowance for doubtful accounts is established. When specific accounts are determined to be uncollectible, they are written off by charging the allowance and crediting the receivable. At September 30, 2008, an allowance for doubtful accounts of \$10,000 has been established.

Restricted Assets

Certain proceeds of the City's enterprise fund Revenue Bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants. Additionally, customer deposits for water and sewer services are classified as restricted assets.

Fixed Assets

Capital assets acquired or constructed for general City purposes are reported at cost in the government-wide statement of net assets but are not reported in the governmental fund financial statements. Donated fixed assets are recorded at their estimated fair value at the date of donation. The City's capitalization level is \$500.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fixed Assets (continued)

Interest costs incurred during construction of general capital assets are not considered material and are not capitalized as part of the construction.

As allowed under GASB Statement Number 34, the City elected not to capitalize and report public domain (infrastructure) general fixed assets (e.g., roads, bridges, sidewalks; and other assets that are immovable and of value only to the government) retroactively.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are expensed as incurred.

Property, plant and equipment in the proprietary funds of the government are recorded at cost. Property, plant and equipment donated to these proprietary fund type operations are recorded at their estimated fair value at the date of donation.

Major outlays for capital assets and improvements are capitalized in proprietary funds as projects are constructed. Interest incurred during the construction phase of proprietary fund fixed assets is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds over the same period.

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

Assets	Years
Improvements other than buildings	10 - 50
Machinery, equipment and vehicles	5 - 10

Compensated Absences

Vested or accumulated leave (annual, personal and sick) 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. All vested or accumulated leave is accrued when incurred in the government-wide and proprietary fund financial statements. In accordance with the provisions of Governmental Accounting Standards Board Statement No. 16, *Accounting for Compensated Absences*, no liability is recorded for nonvesting accumulating rights to receive sick pay or personal leave benefits.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences (continued)

The policy of the City for annual leave is as follows:

Length of Employment	Earned Leave Per Year
0 - 6 months	40 hours
7 months - 2 years	80 hours
3 - 4 years	120 hours
over 5 years	160 hours

Certain employees are grandfathered in under the previous annual leave policy and may accumulate leave at a rate of 200 hours for 9-10 years of service and 240 hours for service in excess of 11 years.

Upon proper separation (termination) of employment, employees will be paid for all accumulated annual leave up to 240 hours.

Employees of the City also accumulate personal leave at a rate of four hours per month. Upon termination of employment, employees will be paid for all personal leave up to 96 hours.

The policy of the City for sick leave is that all full-time, permanent employees accrue sick leave at a rate of eight hours per month. The maximum number of hours to be accumulated is 1,260 for fire department employees and 960 for all other employees. Upon proper separation (termination) of employment, employees will be paid for accumulated sick leave at a rate of two hours for each eight hours of accumulated sick leave. In the case of death while employed, all accumulated sick leave will be paid to the beneficiary.

In the government-wide financial statements, compensated absences (i.e., paid absences for employee vacation leave and sick leave) are recorded as liabilities to the extent that it is probable that the benefits will result in termination payments. A liability is reported in the governmental fund financial statements only for the current portion of compensated absences expected to be paid using expendable available resources.

Long-Term Obligations

Long-term debt and other obligations financed by the enterprise fund are reported as liabilities in the fund and in the government-wide statement of net assets. For proprietary fund types, bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight line method. Bonds payable are reported net of the applicable bond premium or discount. Issuance costs are reported as deferred charges net of accumulated amortization at September 30, 2008 of \$29,626.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund Equity

Reservations of fund balance represent amounts that are legally segregated for a specific purpose. Reservations of retained earnings are limited to outside third-party restrictions. Designations of fund balance represent tentative management plans that are subject to change.

Use of 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 expenses during the reporting period. Actual results could differ from those estimates.

Budgetary Information

Annual appropriated budgets are adopted for the General Fund, Capital Improvement Fund, and the Water and Sewer Fund. The annual budgets for the General Fund and Capital Improvement Fund are adopted using the modified accrual basis of accounting, which is in accordance with GAAP for governmental fund types. The Water and Sewer Fund budget is also adopted on the modified accrual basis, which is not consistent with GAAP for proprietary fund types. Every appropriation, except an appropriation for a capital expenditure, lapse at the end of the year to the extent it has not been expended or encumbered.

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

1. Prior to September 30, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following October 1. The operating budget includes proposed expenditures and revenue sources.
2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to October 31, the budget is legally enacted through passage of an ordinance.
4. The City Manager is authorized to transfer budgeted amounts among programs within a department, office or agency within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the City Council.
5. Budgeted amounts have been amended by the City Council or by City Manager in accordance with applicable City ordinances.
6. Encumbrance accounting is employed in governmental funds. Encumbrances (e.g., purchase orders, contracts) outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent year.

City of Mary Esther, Florida
Notes to Financial Statements

NOTE 3 – INVESTMENTS

The following is a summary of the City's investments:

Investments - Governmental Funds

<i>September 30,</i>	2008			Credit Risk	Average Maturity
	Unrestricted	Restricted	Total		
Certificates of Deposit	\$ 1,908,957	\$ 549,352	\$ 2,458,309	n/a	18 months
Common Stock	172,756	-	172,756	n/a	n/a
Local Government Surplus Funds Trust Fund	602,213	-	602,213	S & P AAAM	34 days
Total investments	\$ 2,683,926	\$ 549,352	\$ 3,233,278		

Investments - Pension Fund

<i>September 30,</i>	2008		Fair Value
Money Market			\$ 17,447
Mutual Funds			260,642
Guaranteed Investment Contracts			791,360
Corporate Stocks			2,187
Total investments			\$ 1,071,636

Concentration risk – The City's investment policy requires diversification, but does not specify limits on types of investments.

Custodial credit risk – For an investment, custodial credit risk is the risk that the City will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. The City has adopted a policy for custodial risk. At September 30, 2008, the common stock listed above is maintained with a third party for custodial purposes in the name of the City.

Interest rate risk – The City does not have a formal policy for addressing interest rate risk; however, investments are made with discretion, to seek reasonable returns, preserve capital, and in general, avoid speculative investments. The City manages its exposure to declines in fair values from interest rate changes by reviewing the portfolio on an ongoing basis for changes in effective yield amounts.

The Local Government Surplus Funds Trust Fund is similar to a mutual fund in that funds are available on a same day basis. As of September 30, 2008, the Local Government Surplus Funds Trust Fund had total investments of approximately \$7 billion. The portfolio's weighted average maturity is limited to 90 days. The investment pool was restructured in 2007 and implemented temporary restrictions on the withdrawal of monies that were on deposit including the requirement that a redemption fee be paid for withdrawals in excess of amounts to be periodically set by the State Board of Administration.

Notes to Financial Statements

NOTE 3 – INVESTMENTS (CONTINUED)

Information regarding the restructuring and withdrawal restrictions is available from the City and the State Board of Administration. Amounts on deposit by the City that are subject to restriction are not significant.

The common stock investments held by the City are a result of demutualization transactions entered into by the City's insurance company, Principal Financial Group, Inc., and retirement plan fiduciary, Prudential Financial, Inc. during the fiscal year ending September 30, 2002. Both of these companies converted from mutual insurance companies to stock companies. In demutualization, membership interests of eligible policy and contract holders are exchanged for compensation, which may be in the form of stock, cash or policy/contract enhancements. During the fiscal year ended September 30, 2008, the City recognized \$76,630 in net unrealized losses related to its common stock investments.

NOTE 4 - CHANGES IN CAPITAL ASSETS

Changes in capital assets for the year ended September 30, 2008 are shown below:

	Beginning Balance	Additions	Deletions	Transfers	Ending Balance
Governmental Activities:					
<i>Capital assets not being depreciated:</i>					
Land	\$ 4,363,248	\$ -	\$ -	\$ -	\$ 4,363,248
Construction in progress	-	-	-	-	-
Total capital assets not being depreciated	4,363,248	-	-	-	4,363,248
<i>Capital assets being depreciated:</i>					
Buildings	2,026,476	-	-	(45,664)	1,980,812
Improvements other than building	380,773	-	-	-	380,773
Machinery, equipment and vehicles	1,554,594	75,747	(6,142)	45,664	1,669,863
Total capital assets being depreciated	3,961,843	75,747	(6,142)	-	4,031,448
<i>Less accumulated depreciation for:</i>					
Buildings	295,484	27,016	-	-	322,500
Improvements other than building	159,262	33,944	-	-	193,206
Machinery, equipment and vehicles	969,743	116,799	-	-	1,086,542
Total accumulated depreciation	1,424,489	177,759	-	-	1,602,248
Total capital assets being depreciated, net	2,537,354	(102,012)	(6,142)	-	2,429,200
Governmental activities capital assets, net	\$ 6,900,602	\$ (102,012)	\$ (6,142)	\$ -	\$ 6,792,448

City of Mary Esther, Florida
Notes to Financial Statements

NOTE 4 – CHANGES IN CAPITAL ASSETS (CONTINUED)

	Beginning Balance	Additions	Deletions	Transfers	Ending Balance
Business-type Activities:					
<i>Capital assets not being depreciated:</i>					
Land	\$ 77,878	\$ -	\$ -	\$ -	\$ 77,878
Construction in progress	2,744,377	118,612	-	(2,862,989)	-
Total capital assets not being depreciated	2,822,255	118,612	-	-	77,878
<i>Capital assets being depreciated:</i>					
Buildings	63,415	28,718	-	-	92,133
Improvements other than building	10,036,358	-	(97,122)	2,862,989	12,802,225
Machinery, equipment and vehicles	595,533	27,587	(24,995)	-	598,125
Total capital assets being depreciated	10,695,306	56,305	(122,117)	-	13,492,483
<i>Less accumulated depreciation for:</i>					
Buildings	8,378	970	-	-	9,348
Improvements other than building	4,605,934	252,953	(26,804)	-	4,832,083
Machinery, equipment and vehicles	429,774	19,933	-	-	449,707
Total accumulated depreciation	5,044,086	273,856	(26,804)	-	5,291,138
Total capital assets being depreciated, net	5,651,220	(217,551)	(95,313)	-	8,201,345
Business-type activities capital assets, net	\$ 8,473,475	\$ (98,939)	\$ (95,313)	\$ -	\$ 8,279,223

The City elected not to capitalize and report general infrastructure assets (e.g., roads, bridges, sidewalks; and other assets that are immovable and of value only to the government) retroactively. The City did not have any general infrastructure asset additions during the fiscal year ending September 30, 2008.

Depreciation expense for fiscal year ended September 30, 2008, totaled \$177,759 for governmental activities and \$273,856 for business-type activities. Depreciation expense was not allocated to specific functions.

Notes to Financial Statements

NOTE 5 – LONG-TERM DEBT

Proprietary Fund

In October, 1996, the City issued \$4,390,000 of Water and Sewer Revenue Bonds (Series 1996) with an average interest rate of 5.2 percent to advance refund \$4,030,000 of outstanding 1992 Series bonds with an average interest rate of 6.8 percent. The net proceeds of \$4.2 million (after payment of \$160,000 in bond issue costs and \$61,500 in discounts) plus \$164,700 of 1992 Series sinking fund moneys were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1992 Series bonds. As a result, the 1992 Series bonds are considered to be defeased and the liability for those bonds has been removed from the books of the Water and Sewer Fund.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$432,647. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2018 using straight-line amortization.

The City pledged as security for payment of the principal and interest on the Water and Sewer Revenue Bonds the net revenues (gross revenues less cost of operation and maintenance) derived from operation of the water and sewer system together with the proceeds derived from utility taxes collected on water, electricity, natural gas, and telecommunication services charged to customers within the City and from franchise fees collected from Gulf Power Company, Okaloosa Gas District and various telephone companies. Revenue bonds outstanding, net of unamortized discount of \$26,796 and deferred refunding expenses of \$187,969 at year end, are as follows:

Purpose	Interest Rates	Amount
Water and sewer system acquisition, construction, extension and improvements	4.0% - 5.375%	\$ 2,455,235

Revenue bond debt service requirements to maturity are as follows:

<i>Fiscal year ending September 30,</i>	Principal	Interest	Total
2009	\$ 205,000	\$ 136,847	\$ 341,847
2010	220,000	125,846	345,846
2011	235,000	113,958	348,958
2012	245,000	101,296	346,296
2013-2017	1,450,000	287,527	1,737,527
2018	315,000	8,466	323,466
Total	\$ 2,670,000	\$ 773,940	\$ 3,443,940

City of Mary Esther, Florida
Notes to Financial Statements

NOTE 5 – LONG-TERM DEBT (CONTINUED)

Interest expense for the fiscal year ended September 30, 2008, totaled \$147,248 for business-type activities.

Additional disclosures required by the Water and Sewer Revenue Bonds, Series 1996:

Schedule of Insurance	Coverage
Liability - Property/Physical Damage	\$ 2,000,000
Bond, Blanket Protection Administrative	2,000,000
Inspection, Water and Sewer, and Fire Department	1,000,000
Fidelity bond - City Manager	100,000
Fidelity bond - City Clerk	100,000
Workers' Compensation	1,000,000
Accidental Death and Dismemberment	N/A

As of September 30, 2008, there were 1,874 customers connected to the City's water and 1,859 customers connected to the sewer system.

Changes in Long-Term Liabilities

Long-term liability activity for the fiscal year ended September 30, 2008, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Governmental Activities					
Compensated absences	\$ 153,973	\$ -	\$ (3,548)	\$ 150,425	\$ -
Business-type Activities					
Water and sewer					
bonds payable	\$ 2,870,000	\$ -	\$ (200,000)	\$ 2,670,000	\$ 205,000
Less deferred amount					
on refundings	(208,329)	-	20,360	(187,969)	-
Less unamortized discount	(29,693)	-	2,897	(26,796)	-
Total bonds payable	2,631,978	-	(176,743)	2,455,235	205,000
Business-type activities					
long-term liabilities	\$ 2,631,978	\$ -	\$ (176,743)	\$ 2,455,235	\$ 205,000

City of Mary Esther, Florida
Notes to Financial Statements

NOTE 5 – LONG-TERM DEBT (CONTINUED)

Records kept for compensated absences related only to hours earned, used, and available. Accordingly, only the net change in compensated absences payable is shown.

Compensated Absences

The total amounts of the vested portions of compensated absences as of September 30, 2008, were as follows:

<u>September 30,</u>	<u>Annual Leave</u>	<u>Sick Leave</u>	<u>Total</u>
Governmental activities	\$ 110,298	\$ 40,127	\$ 150,425

NOTE 6 – RESTRICTED NET ASSETS AND RESTRICTED ASSET ACCOUNTS

The City's bond covenants require certain restrictions of the Water and Sewer Fund's net assets. The restricted amounts are as follows:

<u>September 30,</u>	<u>2008</u>
Restricted for bond reserve requirement	\$ 430,352
Restricted for revenue bond debt service	209,350
Restricted for renewal and replacement	119,086
Total restricted net assets	\$ 758,788

The balances of the Water and Sewer Fund's restricted asset accounts are as follows:

<u>September 30,</u>	<u>2008</u>
Customer deposits	\$ 89,462
Revenue bond reserve account	430,352
Revenue bond debt service account	209,350
Revenue bond renewal and replacement account	119,086
Total restricted assets	\$ 848,250

City of Mary Esther, Florida
Notes to Financial Statements

NOTE 7 – INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

The following is a summary of interfund receivables and payables reported in the fund financial statements:

<i>September 30,</i>	Interfund	
	Receivables	Payables
<i>Governmental funds:</i>		
General Fund	\$ 1,108	\$ 476,335
Capital Improvement Fund	553,940	-
<i>Proprietary funds:</i>		
Water and Sewer Fund	-	78,713
Total	\$ 555,048	\$ 555,048

Other governmental fund receivables represent the transfer of excess revenues over expenses from the general fund to cover capital improvement expenditures.

The following is a summary of interfund transfers as reported in the fund financial statements:

<i>September 30,</i>	Interfund	
	Transfers In	Transfers Out
<i>Between governmental and business-type columns:</i>		
General Fund (2)	\$ 155,211	\$ -
Water and Sewer Fund (2)	-	155,211
<i>Between funds within the governmental or business-type columns: (1)</i>		
General Fund (3)	-	36,920
Capital Improvement Fund (3)	36,920	-

Notes:

- (1) These transfers are eliminated in the consolidation, by column, for the Governmental and Business-type Activities.
- (2) Transfer of excess funds from the Water and Sewer Fund to the General Fund is budgeted for and made annually to balance the General Fund budget.
- (3) Transfer of excess of revenues over expenses from the General Fund to the Capital Improvement Fund is made annually to fund capital improvement expenditures.

NOTE 8 – RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City pays an annual premium to the Preferred Governmental Insurance Trust for the following insurance coverage: general liability, auto liability, auto physical damage, workers' compensation, inland marine, boiler machinery and special events coverage. The Preferred Governmental Insurance Trust is self-sustaining through member premiums and reinsures through commercial companies for claims in excess of specified levels, depending on the type of coverage.

The City carries commercial insurance for all other risks of loss, including fidelity bond, accidental death and dismemberment and employee health insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE 9– EMPLOYEE THRIFT PLAN

The City offers its employees an Employee Thrift Plan, a defined contribution plan created in accordance with Internal Revenue Code Sections 401(a) and 501(a), as amended from time to time. The Plan is available to all City employees who have attained the age of eighteen. The City's contribution to the Plan is an amount equal to six percent (6%) of the Participant's compensation for the plan year. In addition, the City contributes on behalf of each Participant who makes a contribution to the Deferred Compensation Plan one dollar (\$1.00) for every one dollar (\$1.00) of said contributions to the Deferred Compensation Plan in increments of one percent (1%) of compensation, up to eight percent (8%). Any forfeiture during the year may be used to fund the City's contribution requirement.

The vesting percentage of City contributions is determined in accordance with the following schedule:

Number of Years of Service Credit for Purposes of Vesting	Vested Percentage
1	20%
2	40%
3	60%
4	80%
5	100%

During the fiscal year ended September 30, 2008, the City made contributions totaling \$101,030.

NOTE 10 – LITIGATION

The City is involved in several pending and threatened legal actions. In the opinion of City management, after consulting with legal counsel, the range of potential loss from all such claims and actions should not materially affect the financial condition of the City.

Required Supplementary Information
(Other Than MD&A)

City of Mary Esther, Florida

Budgetary Comparison Schedule - General Fund

Year ended September 30,

2008

	<u>Budgeted Amounts</u>			Variance with Final Budget Positive (Negative)
	Original	Final	Actual	
Revenues				
Taxes	\$ 1,036,183	\$ 1,036,183	\$ 1,049,146	\$ 12,963
Licenses and permits	173,000	173,000	167,735	(5,265)
Intergovernmental	797,377	797,377	712,058	(85,319)
Charges for services	134,874	134,874	136,838	1,964
Fines and forfeitures	58,100	58,100	31,546	(26,554)
Miscellaneous	105,550	105,550	13,117	(92,433)
Total revenues	2,305,084	2,305,084	2,110,440	(194,644)
Expenditures				
General government	611,847	611,847	458,058	153,789
Public Safety	1,108,211	1,108,211	1,079,069	29,142
Transportation	406,755	406,755	386,399	20,356
Human services	16,203	16,203	16,204	(1)
Culture and recreation	242,102	242,102	263,240	(21,138)
Capital outlay	75,177	75,177	25,761	49,416
Total expenditures	2,460,295	2,460,295	2,228,731	231,564
Excess (deficiency) of revenues over expenditures	(155,211)	(155,211)	(118,291)	36,920
Other financing sources (uses)				
Transfers in	155,211	155,211	155,211	-
Transfers out	-	-	(36,920)	36,920
Net other financing sources (uses)	155,211	155,211	118,291	(36,920)
Net change in fund balance	-	-	-	-
Fund balance, October 1, 2007	2,390,994	2,390,994	2,390,994	2,390,994
Fund balance, September 30, 2008	\$ 2,390,994	\$ 2,390,994	\$ 2,390,994	\$ 2,390,994

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

The Honorable Mayor and Members of the City Council
City of Mary Esther, Florida

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Mary Esther, Florida (hereinafter referred to as the "City"), as of and for the year ended September 30, 2008, which collectively comprise the City's basic financial statements and have issued our report thereon dated August 13, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A material weakness is a deficiency, or a combination of control deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies to be material weaknesses.

- ***Accruals***

Generally accepted accounting principles (GAAP) require the use of the accrual method of accounting in which revenues and expenses are recorded during the period incurred and not

necessarily when received or paid. We proposed several material audit adjustments for receivables and payables not accrued in the proper period of the financial statements. Had these adjustments not been posted, utility expenses, tax revenue, accounts payable and taxes receivables would have been materially understated. We recommend that procedures be established to properly record expenses and revenues in the year that they are earned and we suggest that management reconcile subsidiary accounts receivable and accounts payable ledgers to the general ledger on a monthly basis.

- ***Investment Activities***

During our audit, we proposed an adjustment to recognize a material loss on investments in the General Fund. We recommend that procedures be implemented to recognize gains/losses on investments throughout the year on either a monthly or quarterly basis.

- ***Fixed Assets***

GAAP requires capitalization of certain assets when those assets are significant and have an economic benefit that is greater than one year. While the City's transactions are generally recorded properly under this method, we proposed one audit adjustment for a transaction not posted to the proper account that was significant. General and Water and Sewer Funds asset purchases greater than \$500 should be recorded as capital outlay expenditures and fixed assets, respectively. Current year additions should be recorded in the fixed asset system as purchases are made throughout the year. By year end, depreciation expense should be recorded and any assets disposed of during the year should be removed from the fixed asset software and accounting system.

- ***Preparation of Financial Statements in Accordance to GAAP***

The preparation of financial statements in accordance with generally accepted accounting principles requires the preparer to have knowledge of the accounting principles affecting the entity, including financial statement disclosure requirements, the awareness of changes occurring in the accounting industry that could impact the entity's financial statements, and the knowledge of resources for researching detailed accounting issues. Generally this knowledge is obtained through continued education courses and experience in public accounting. Since most small governmental organizations are not adequately staffed to prepare full disclosure financial statements, this task is left to the certified public accounting firm engaged by the City. Before the financial statements could be prepared, we were also required to propose several significant adjustments as noted in this letter. Since the City must rely on our firm to propose these significant adjustments, and to prepare its annual financial statements in accordance with generally accepted accounting principles, this is considered a material weakness in the City's internal control.

A significant deficiency is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below to be significant deficiencies.

- ***Bond Amortization***

During audit fieldwork, an adjustment was proposed to record current year bond amortization expense. We recommend that the City develop a process to internally review the bond amortization schedule and to properly adjust the expense at year end.

- ***Interfund Transfers***

During the audit, an entry was proposed to record interfund transfers according to budgeted amounts and to transfer excess funds from the General Fund to the Capital Improvement

Fund. We recommend that management establish procedures to appropriately post closing entries to transfer funds according to the City's budget and policies.

Compliance

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

Other Matters

During the first four and a half months of the fiscal 2007-2008 year, the City operated without a financial director. We believe that some of the material weaknesses and significant deficiencies could have been prevented or at least reduced had this position been filled during these months.

We noted certain matters that we reported to management of the City in a separate letter dated August 13, 2009.

Management's Response

Responses to Audit Reported Material Weaknesses:

Accruals

We will implement the suggested procedure of reconciling subsidiary accounts receivable and accounts payable ledgers to the general ledger on a monthly basis. At fiscal year end, we will ensure accounts receivable and accounts payable are accrued in the proper fiscal year period in accordance with GAAP. We will add these procedures to a checklist used by our accounting department.

Investment Activities

We will implement a quarterly review of the City's stock investments and properly record any realized or unrealized gains or losses in accordance with GAAP. We will add these procedures to a checklist used by our accounting department.

Fixed Assets

We have implemented procedures to ensure General Fund and Water & Sewer Fund fixed asset purchases or disposals of fixed assets with an initial purchase price of \$500 or greater are recorded as capital outlay expenses and fixed assets, respectively. Procedures will be strengthened to ensure all fixed asset additions are loaded into the fixed asset system as purchases are made and removed from the system as assets are disposed of throughout the year. Procedures to calculate and record the appropriate amount of depreciation expense will be implemented. These procedures will be added to a checklist used by our accounting department.

Management's Response (Continued)

Preparation of Financial Statement in Accordance to GAAP

The City of Mary Esther is a relatively small city and chooses to hire auditors to prepare the City's financial statements. Currently, the City of Mary Esther is not adequately staffed to prepare full disclosure financial statements. The accounting staff is working on acquiring the continuing education that may lead to the ability to prepare their financial statements in-house at some point in the future.

Responses to Audit Reported Significant Deficiencies:

Bond Amortization

The City of Mary Esther refinanced the 1996 Water/Sewer Bond with a bank loan in 2009 and will write off the remaining bond amortization as an expense in FY 2008-2009. Staff will implement procedures to properly record this adjustment and any future amortization adjustments that may be required if any other amortization adjustments are required for any GAAP reason in the future. A contingent reminder will be added to our checklist used by our accounting department.

Interfund Transfers

We have implemented procedures to ensure the entire budgeted interfund transfer is properly recorded in a timely manner at fiscal year end. This procedure will be added to a checklist used by our accounting department.

City of Mary Esther's response to the findings identified in our audit is described above. We did not audit City of Mary Esther's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the City Council, management, the Florida Auditor General, federal and state awarding agencies and pass-through entities, and specific legislative or regulatory bodies and is not intended to be and should not be used by anyone other than these specified parties.

Carri Riggs & Ingram, L.L.C.

Destin, Florida
August 13, 2009

MANAGEMENT LETTER

The Honorable Mayor and Members of the City Council
City of Mary Esther, Florida

We have audited the financial statements of the City of Mary Esther, Florida (hereinafter referred to as the "City"), as of and for the year ended September 30, 2008, and have issued our report thereon dated August 13, 2009.

We conducted our audit in accordance with United States generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. We have issued our Report on Internal Control over Financial Reporting and on Compliance and Other matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*. Disclosures in this report which is dated August 13, 2009, should be considered in conjunction with this management letter.

Additionally, our audit was conducted in accordance with the provisions of Chapter 10.550, Rules of the Auditor General, which govern the conduct of local governmental entity audits performed in the State of Florida and, unless otherwise required to be reported in the report on compliance and internal controls or schedule of findings and questioned costs, this letter is required to include the following information.

Section 10.554(1)(i)1., Rules of the Auditor General, requires that we determine whether or not corrective actions have been taken to address significant findings and recommendations made in the preceding annual financial audit report. There were no recommendations made in the preceding annual audit report.

Section 10.554(1)(i)2., Rules of the Auditor General, requires our audit to include a review of the provisions of Section 218.415, Florida Statutes, regarding the investment of public funds. In connection with our audit, we determined that the City complied with Section 218.415, Florida Statutes.

Section 10.554(1)(i)3., Rules of the Auditor General, requires that we address in the management letter any recommendations to improve financial management, accounting procedures, and internal controls. In connection with our audit, we noted several findings addressed in the Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*. In addition, there are two (2) recommendations noted below under the heading "RECOMMENDATIONS".

Section 10.554(1)(i)4., Rules of the Auditor General, requires that we address violations of provisions of contract and grant agreements or abuse that have an effect on the financial statements that is less than material but more than inconsequential. In connection with our audit, we did not have any such findings.

Section 10.554(1)(i)5., Rules of the Auditor General, requires, based on professional judgment, the reporting of the following matters that are inconsequential to the financial statements, considering both quantitative and qualitative factors: (1) violations of laws, rules, regulations, and contractual provisions or abuse that have occurred, or are likely to have occurred, and would have an immaterial effect on the financial statements; (2) improper or illegal expenditures that would have an immaterial effect on the financial statements; (3) control deficiencies that are not significant deficiencies, including but not limited to: (a) improper or inadequate accounting procedures (e.g., the omission of required disclosures from the financial statements); (b) failures to properly record financial transactions; and (c) other inaccuracies, shortages, defalcations, and instances of fraud discovered by, or that come to the attention of, the auditor. In connection with our audit, we did not have any such findings.

Section 10.554(1)(i)6., Rules of the Auditor General, requires that the name or official title and legal authority for the primary government and each component unit of the reporting entity be disclosed in this management letter, unless disclosed in the notes to the financial statements. The information required is disclosed in the notes to the financial statements.

Section 10.554(1)(i)7.a., Rules of the Auditor General, requires a statement be included as to whether or not the local governmental entity has met one or more of the conditions described in Section 218.503(1), Florida Statutes, and identification of the specific condition(s) met. In connection with our audit, we determined that the City did not meet any of the conditions described in Section 218.503(1), Florida Statutes.

Section 10.554(1)(i)7.b., Rules of the Auditor General, requires that we determine whether the annual financial report for the City for the fiscal year ended September 30, 2008, filed with the Florida Department of Financial Services pursuant to Section 218.32(1)(a), Florida Statutes, is in agreement with the annual financial audit report for the fiscal year ended September 30, 2008. In connection with our audit, we determined that these two reports were in agreement.

Section 10.554(1)(i)7.c. and 10.556(7), Rules of the Auditor General, require that we apply financial condition assessment procedures. In connection with our audit, we applied financial condition assessment procedures. It is management's responsibility to monitor the entity's financial condition, and our financial condition assessment was based in part on representations made by management and the review of financial information provided by same.

RECOMMENDATIONS

Postemployment Benefits Other Than Pensions

The Governmental Accounting Standards Board issued Statements No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" which becomes effective for the City for its fiscal year beginning October 1, 2009. The City is analyzing the effects of this pronouncement and plans to adopt it by the effective dates as required. The City does not anticipate a material impact with the adoption of this standard.

Court/Fine Revenues

In connection with our audit, we noted a decline in the Court/Fine Revenues account as compared to previous years and to budgeted amounts. We recommend that the City investigate further with the Okaloosa Clerk's office and the Okaloosa County Sheriff's Department and determine reasons for the unexpected decline.

Responses to Audit Reported Recommendations:

Postemployment Benefits Other Than Pensions

We will continue to investigate the effects of GASB Statement 45 "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions". For the short term, no material impact is anticipated. We will monitor the City's potential responsibilities to comply with this Statement.

Court/Fine Revenues

The City has investigated this matter with the help of the Okaloosa County Clerk's office and the Okaloosa County Sheriff's Department in order to determine the reasons for the unexpected decline in Court/Fine revenues. As of the date of this report, no obvious improprieties have been discovered. The Okaloosa County Clerk's office and the Okaloosa County Sheriff's Department have agreed to continue to monitor the paperwork involved to ensure the court fine revenue due to the City comes our way. The City will continue to monitor the court fine revenue closely.

Pursuant to Chapter 119, Florida Statutes, this management letter is a public record and its distribution is not limited. Auditing standards generally accepted in the United States of America require us to indicate that this letter is intended solely for the information and use of management, the City Council, and the Florida Auditor General and is not intended to be and should not be used by anyone other than these specified parties.

Carr, Riggs & Ingram, L.L.C.

Destin, Florida
August 13, 2009

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH BOND COVENANTS**

The Honorable Mayor and Members of the City Council
City of Mary Esther, Florida

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of the governmental activities, the business-type activities, and each fund of the City of Mary Esther, Florida (hereinafter referred to as the "City"), as of and for the year ended September 30, 2008, which collectively comprise the City's basic financial statements and have issued our report thereon dated August 13, 2009.

In connection with our audit, nothing came to our attention that caused us to believe that the City failed to comply with the terms, covenants, provisions, or conditions contained in the Water and Sewer Refunding Revenue Bonds, Series 1996 debt agreement, dated October 1, 1996, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

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

Carr, Riggs & Ingram, L.L.C.

Destin, Florida
August 13, 2009