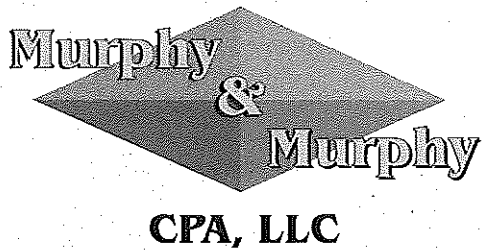


ST. MARY'S COUNTY METROPOLITAN COMMISSION

**FINANCIAL STATEMENTS
AND
SUPPLEMENTARY INFORMATION
WITH
INDEPENDENT AUDITOR'S REPORT
YEARS ENDED JUNE 30, 2008 AND 2007**

CONTENTS

	<u>PAGE</u>
Independent Auditor's Report on Component Unit Financial Statements	1-2
Required supplementary information:	
Management's discussion and analysis	3-8
Basic financial statements:	
Statements of net assets	9-10
Statements of revenues, expenses and changes in fund net assets	11
Statements of cash flows	12-13
Statements of fiduciary net assets	14
Statements of changes in fiduciary net assets	15
Notes to financial statements	16-37
Required supplemental information:	
Schedule of funding progress and Schedule of employer contributions	38
Other supplemental information:	
Schedules of departmental allocable operating and nonoperating revenues and expenses	39-40
Schedules of service charges and direct operating expenses	41-42
Schedules of administrative expenses	43
Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	44-45



**INDEPENDENT AUDITOR'S REPORT ON COMPONENT
UNIT FINANCIAL STATEMENTS**

The Commissioners
St. Mary's County Metropolitan Commission
Hollywood, Maryland

We have audited the accompanying financial statements of the business-type activities of the St. Mary's County Metropolitan Commission (MetCom), a component unit of the County Commissioners of St. Mary's County, as of and for the years ended June 30, 2008 and 2007, which comprise the St. Mary's County Metropolitan Commission's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the St. Mary's County Metropolitan Commission's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the St. Mary's County Metropolitan Commission as of June 30, 2008 and 2007, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Member: AICPA Private Companies Practice Section

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In accordance with Government Auditing Standards, we have also issued our report dated September 30, 2008, on our consideration of the St. Mary's County Metropolitan Commission'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 important for assessing the results of our audits.

The management's discussion and analysis on pages 3-8 and the Schedule of funding progress and Schedule of employer contributions on page 38 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements that comprise the St. Mary's County Metropolitan Commission's basic financial statements. The accompanying supplementary information presented on page 39-43 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Murphy + Murphy CPA LLC

La Plata, Maryland
September 30, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the St. Mary's County Metropolitan Commission's (MetCom's) annual financial report presents our discussion and analysis of MetCom's financial performance during the fiscal years that ended June 30, 2008 and 2007. Please read it in conjunction with MetCom's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- MetCom's net assets increased by \$4.99 million and \$3.95 million, or 9.31% and 7.93%, as a result of operations in fiscal years 2008 and 2007, respectively.
- During the current year, MetCom's revenue from operations was \$10.14 million, representing an increase of 17.62% over the prior year. The increase in operating revenue is due to an increase in rates of approximately 19% for sewer services and 28% for water services. The actual increase was also affected by a drought, which increased water revenues and decreased sewer revenues, and a reduction in engineering services. In fiscal year 2007, revenue from operations was \$8.62 million, or 10.72% over the prior year.
- Effective 7/1/06, MetCom implemented an energy surcharge on all sewer and water services, resulting in \$420K in Energy Surcharge revenue for FY07. New service charges rates were implemented effective 7/1/07, and the energy surcharge was eliminated at that time.
- MetCom's operating expenses excluding depreciation were \$8.67 million during the current year, and \$7.94 million during the prior year.
- MetCom's nonoperating revenue was \$5.82 million during the current year and \$5.35 million in fiscal year 2007, representing an increase of 8.78% and 17.97%, respectively. The increase is the result of the new rate structure for financing capital construction in FY08 and capital contributions received from developers in FY07.
- House Bill 969 was approved in the 2007 Legislative session that changed the way MetCom finances capital construction. New System Improvement Charges became effective October 1, 2007 for all customers with allocations on our water and/or sewer lines, and all new customers after that date will pay a Capital Contribution Charge at time of connection. These charges replace the Benefit Assessment Charges that were used by the Commission for almost 40 years to finance new water and sewer improvements.
- The construction industry has slowed down in FY08, and this has had a negative impact on Engineering Review fees.
- In FY 2008 MetCom established a trust fund for the management of assets and accounting for financial transactions associated with the provision of retiree health insurance coverage. The balance in the trust was \$758 thousand as of 6/30/08.

USING THIS ANNUAL REPORT

This annual report consists of three parts – management’s discussion and analysis, the basic financial statements, and supplemental information. The basic financial statements consist of:

- Statements of net assets
- Statements of revenues, expenses and changes in fund net assets
- Statements of cash flows
- Statements of fiduciary net assets
- Statements of changes in fiduciary net assets
- Notes to financial statements

The Statements of Net Assets provide a snapshot of MetCom’s financial position at both June 30, 2008 and 2007. Amounts on the Statements of Net Assets are cumulative from inception. Both current and long-term assets and liabilities, as well as net assets, are presented.

The Statements of Revenues, Expenses and Changes in Fund Net Assets provide information about the activities of MetCom as a whole and reflect activity for the fiscal years ended June 30, 2008 and 2007. These statements measure operating revenues and expenses as well as non-operating revenues and expenses. The statements also present capital contributions as well as changes in net assets.

The Statements of Cash Flows present the sources and uses of MetCom’s cash. Metcom uses the direct method for presenting the cash flows statements.

The Notes to the financial statements provide information and more detailed data about the financial statements. The Supplementary departmental financial statements report MetCom's activities in more detail by providing information about MetCom’s most financially significant funds.

MetCom operates as an enterprise fund, which is one type of proprietary fund. All of MetCom’s basic services are reported here, including water, sewer, engineering services and general administration, as well as other nonoperating revenues and expenses. MetCom charges customers fees to cover all of the costs of the services it provides. MetCom’s financial statements are presented using the accrual basis of accounting and the economic resources measurement focus. All assets and liabilities are included in the financial statements. Revenue is recognized when water or other services are delivered and expenses are recognized when goods and services are received regardless of when cash is received or paid.

MetCom has one fiduciary fund, Retiree Health Benefit Fund, which is used to account for resources held for the benefit of MetCom employees and retirees. These funds are not available to support MetCom’s operations. The accounting used for fiduciary funds is much like that used for proprietary funds.

The supplementary departmental financial statements provide details about MetCom’s most significant funds – not MetCom as a whole. The Board of Commissioners of MetCom establishes funds to help it manage and control monies for particular purposes or to show that it is meeting legal responsibilities for using certain grants and other money.

METCOM AS A WHOLE

Statements of Net Assets

MetCom's net assets increased by approximately \$5.0 million in FY 2008 and approximately \$3.8 million, net of a prior period adjustment of (\$.1) million, in FY07. The majority of the increase is attributable to the change in net assets invested in capital assets, net of related debt. During fiscal year 2008, developers constructed \$2.1 million of capital assets and donated them to MetCom. In fiscal year 2007, developers contributed \$2.5 million of capital assets. The following condensed statements show the changes in assets, liabilities and net assets for the years ended June 30, 2008, 2007 and 2006.

	MetCom's Net Assets (in millions of dollars) Business-type activities		
	<u>June 30,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current and other assets	\$ 8.4	\$ 5.8	\$ 5.8
Capital assets	<u>71.5</u>	<u>68.9</u>	<u>66.4</u>
Total assets	<u>\$ 79.9</u>	<u>\$ 74.7</u>	<u>\$ 72.2</u>
Long-term debt outstanding	\$ 17.8	\$ 17.7	\$ 19.1
Other liabilities	<u>3.5</u>	<u>3.4</u>	<u>3.3</u>
Total liabilities	<u>\$ 21.3</u>	<u>\$ 21.1</u>	<u>\$ 22.4</u>
Net assets			
Invested in capital assets, net of related debt	\$ 52.2	\$ 49.8	\$ 46.0
Restricted	3.8	2.0	1.9
Unrestricted	<u>2.6</u>	<u>1.8</u>	<u>1.9</u>
Total net assets	<u>\$ 58.6</u>	<u>\$ 53.6</u>	<u>\$ 49.8</u>

Statements of Revenues, Expenses and Changes in Fund Net Assets

Changes in MetCom's net assets can be determined by reviewing the following condensed Statements of Revenue, Expenses and Changes in Fund Net Assets:

	MetCom's Changes in Net Assets (in millions of dollars) Business-type activities		
	Years ended June 30,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating revenues	\$ 10.1	\$ 8.6	\$ 7.8
Operating expenses	8.6	7.9	7.3
Depreciation expense	<u>2.3</u>	<u>2.1</u>	<u>1.9</u>
Operating loss	(0.8)	(1.4)	(1.4)
Net nonoperating revenues	<u>5.8</u>	<u>5.3</u>	<u>4.5</u>
Change in net assets	5.0	3.9	3.1
Net assets at beginning of year, as restated	<u>53.6</u>	<u>49.7</u>	<u>46.7</u>
Net assets at end of year	<u>\$ 58.6</u>	<u>\$ 53.6</u>	<u>\$ 49.8</u>

MetCom's operating revenues totaled \$10.1 million during the current year. Total operating revenues increased by 17.62% over the prior year, compared to an operating revenue of the prior year of \$8.6 million, which was an increase of 10.72% over fiscal year 2006. The current year increase is due to rate increases of approximately 28% in water and 19% in sewer effective 7/1/07, the drought which caused water overage to increase by 78 million gallons, or 25% over the previous year, and customer growth. The prior year increase was due to the energy surcharge implemented 7/1/06 as well as customer growth.

Expenses from MetCom's operating activities excluding depreciation totaled \$8.6 million during the current year and \$7.9 million in the prior year. All of these expenses are considered related to providing water, sewer and engineering services to the residents/businesses of St. Mary's County. Salaries and benefits comprised \$5.4 million, or 62.58% of operating expenses. Power for plant operations was \$1.0 million, or 11.95%. The remaining \$2.2 million, or 25.47%, related to administrative and direct costs.

Net nonoperating revenue increased 8.8% to \$5.8 million during the current year and 17.8% to \$5.3 million in fiscal year 2007. Capital contributions made up \$2.1 million and \$2.5 million of the net nonoperating revenue in fiscal years 2008 and 2007, respectively.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At June 30, 2008, MetCom had \$105.6 million prior to depreciation invested in capital assets.

This represents an increase of 5% over the previous year. As of June 30, 2007, MetCom had \$100.9 million prior to depreciation invested in capital assets. MetCom owns utility and water plants in addition to numerous vehicles, furniture, equipment and computer equipment and a building. The following table summarizes MetCom's capital assets (in millions):

	<u>2008</u>	<u>2007</u>
Utility plants	\$ 75.8	\$ 67.8
Water plants	17.9	15.2
Equipment	5.7	5.1
Capitalized interest	0.8	0.8
Buildings	1.5	1.5
Land	0.6	0.6
Construction in process	<u>3.3</u>	<u>9.9</u>
	105.6	100.9
Accumulated depreciation	<u>34.1</u>	<u>31.9</u>
Net capital assets	<u>\$ 71.5</u>	<u>\$ 69.0</u>

This year's major capital asset additions included:

Marlay-Taylor sludge upgrade, built with proceeds of a loan in the amount of \$4.7 million and \$2.2 million from reserves, total cost \$6.9 million.

Arsenic replacement wells, built with loan proceeds, \$.6 million.

Sewer lines, force mains, manholes, grinder pumps and water mains, valves, fire hydrants, a well and water pump station, constructed and contributed by developers, \$2.1 million.

MetCom's FY09 Capital Improvement Budget for water is \$11.5 million, which includes \$5.1 million for water lines, \$3 million for water storage tanks, \$2.5 million for wells and \$0.9 million for miscellaneous projects. In FY 08 the Capital Improvement Budget for water was \$6.3 million, which included \$1.6 million for wells, \$1.7 million for water lines, \$1.5 million for storage tanks and \$1.5 million for miscellaneous projects.

The FY 09 Capital Improvement Budget for sewer is \$50.1 million, which includes \$6.2 for replacement projects, \$0.8 for pump stations and \$43.1 million for system upgrades and expansion. The largest project is \$40 million for the Enhanced Nutrient Removal, ENR, project at the Marlay-Taylor Wastewater Reclamation Facility. This project is required to meet the requirements of the Chesapeake Bay 2000 agreement and achieves 3mg/l total nitrogen and 0.3mg/l total phosphorous in the effluent. The state is expected to pay for this project. The FY08 Capital Improvement Budget for sewer was \$5.2 million, which included \$1.9 million for repairs and replacements, \$1.2 million for pump stations and \$2.1 million for system upgrades and expansions.

Debt administration

At the end of FY 08 and FY 07, MetCom had a total of \$19.3 and \$19.1 in debt outstanding, respectively.

On November 14, 2007, MetCom issued \$10.9 million of Infrastructure Financing Bonds in conjunction with the Maryland Department of Housing and Community Development. During FY08 MetCom received \$1.8 million in draws on various loans. During FY07 draws totaled \$78 thousand.

The following table summarizes MetCom's debt (in millions):

	<u>2008</u>	<u>2007</u>	% change
Bonds payable	\$ 9.2	\$ 9.5	(3.2)%
Notes, leases and loans payable	<u>10.1</u>	<u>9.6</u>	5.2%
Total debt	<u>\$ 19.3</u>	<u>\$ 19.1</u>	1.0%

The primary sources of revenue available for repayment of debt are System Improvement Charges that are paid by all customers with allocations on our system and Capital Contribution Charges which are paid by all new customers.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

MetCom anticipates about a 3% increase in the total operating revenues for next year as additional customers sign on for water and sewer service. MetCom also increased the rate charged for both water and sewer overages. This rate increase may generate additional revenues while at the same time encouraging conservation, which lowers operating costs.

The total operating expenses in MetCom's Operating Budget for FY09 are basically unchanged from the FY08 Operating Budget, at \$10.3 million. Salaries are the largest component of MetCom's expenses. In FY09 salaries are \$4.7 million, with a \$367 thousand increase over FY08 Operating Budget. Health insurance is almost \$1.3 million, which includes a 19% increase in rates and \$458 thousand to fully fund the Annual Required Contribution, ARC, to the Other Post-Employment Benefit Trust, OPEB. Electricity to operate the water and sewer systems is over \$1 million in the FY09 Operating Budget. We expect to be able to reduce the power used by our water system by 10% and have reflected this in the budgeted amount.

CONTACTING METCOM'S FINANCIAL MANAGEMENT

This financial report is designed to provide citizens, taxpayers, customers, and creditors with a general overview of MetCom's finances and show MetCom's accountability for the money it receives. If you have questions about the report or need additional financial information, contact the MetCom Administrative office at 43990 Commerce Avenue, Hollywood, Maryland 20636.

ST. MARY'S COUNTY METROPOLITAN COMMISSION

STATEMENTS OF NET ASSETS

ASSETS

	<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents	\$ 6,397,782	\$ 4,416,324
Accounts receivable	1,102,000	997,849
Inventory	31,423	28,357
Prepaid expenses	299,352	24,154
	<hr/>	<hr/>
Total current assets	7,830,557	5,466,684
	<hr/>	<hr/>
Noncurrent assets:		
Capital assets, net	71,508,447	68,919,072
Deferred bond issue costs	484,054	283,066
Unamortized bond discount	76,044	81,556
	<hr/>	<hr/>
Total noncurrent assets	72,068,545	69,283,694
	<hr/>	<hr/>
Total assets	\$ 79,899,102	\$ 74,750,378
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes.

ST. MARY'S COUNTY METROPOLITAN COMMISSION

STATEMENTS OF NET ASSETS (CONTINUED)

LIABILITIES AND NET ASSETS

	<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>
Current liabilities:		
Accounts payable	\$ 856,079	\$ 707,521
Accrued interest payable	232,473	179,381
Accrued expenses	472,646	756,743
Deferred income	358,130	357,466
Bond premiums	41,405	45,571
Bonds payable	715,061	674,700
Notes, leases and loans payable	767,163	695,859
	<hr/>	<hr/>
Total current liabilities	3,442,957	3,417,241
	<hr/>	<hr/>
Noncurrent liabilities:		
Bonds payable	8,533,075	8,795,686
Notes, leases and loans payable	9,283,199	8,893,068
	<hr/>	<hr/>
Total noncurrent liabilities	17,816,274	17,688,754
	<hr/>	<hr/>
Total liabilities	21,259,231	21,105,995
	<hr/>	<hr/>
Net assets:		
Invested in capital assets, net of related debt	52,209,949	49,859,759
Restricted	3,801,845	2,074,904
Unrestricted	2,628,077	1,709,720
	<hr/>	<hr/>
Total net assets	58,639,871	53,644,383
	<hr/>	<hr/>
Total liabilities and net assets	\$ 79,899,102	\$ 74,750,378
	<hr/>	<hr/>

See accompanying notes.

ST. MARY'S COUNTY METROPOLITAN COMMISSION

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

	<u>Years ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Operating revenue:		
Service charges	\$ 9,937,238	\$ 8,399,191
Miscellaneous	202,085	221,335
	<hr/>	<hr/>
Total operating revenue	10,139,323	8,620,526
	<hr/>	<hr/>
Operating expenses:		
Direct operating expenses	5,717,744	5,412,666
Administrative expenses	2,955,526	2,523,905
	<hr/>	<hr/>
Total operating expenses	8,673,270	7,936,571
	<hr/>	<hr/>
Operating income before depreciation	1,466,053	683,955
Depreciation	(2,286,655)	(2,079,528)
	<hr/>	<hr/>
Operating loss	(820,602)	(1,395,573)
	<hr/>	<hr/>
Nonoperating revenue (expenses):		
Interest income	206,370	208,957
Benefit assessment charges	452,878	1,944,718
Debt service charges	2,555,360	0
House connection charges - net	406,356	541,203
Water supply fees	193,933	161,578
Water storage fees	309,090	441,462
Interest expense	(869,004)	(751,990)
Other fees	169,448	268,496
	<hr/>	<hr/>
Total nonoperating revenue, net	3,424,431	2,814,424
	<hr/>	<hr/>
Income before contributions	2,603,829	1,418,851
Capital contribution	2,391,659	2,532,265
	<hr/>	<hr/>
Change in fund net assets	4,995,488	3,951,116
	<hr/>	<hr/>
Total net assets - beginning	53,644,383	49,833,850
Prior period adjustment	0	(140,583)
	<hr/>	<hr/>
Total net assets - beginning, as restated	53,644,383	49,693,267
	<hr/>	<hr/>
Total net assets - ending	\$ 58,639,871	\$ 53,644,383
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes.

ST. MARY'S COUNTY METROPOLITAN COMMISSION

STATEMENTS OF CASH FLOWS

	<u>Years ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Receipts from customers	\$ 9,833,751	\$ 8,447,891
Payments to suppliers	(4,728,330)	(4,339,754)
Payments to employees	(4,301,924)	(3,448,797)
Other receipts	202,085	221,335
	<hr/>	<hr/>
Net cash provided by operating activities	1,005,582	880,675
	<hr/>	<hr/>
Cash flows from capital and related financing activities:		
Proceeds from capital debt	1,835,257	78,943
Purchases of capital assets	(2,541,190)	(2,003,233)
Principal paid on capital debt	(1,823,672)	(1,488,100)
Interest paid on capital debt	(787,954)	(713,780)
Other receipts and payments	4,087,065	3,216,874
	<hr/>	<hr/>
Net cash provided (used) by capital and related financing activities	769,506	(909,296)
	<hr/>	<hr/>
Cash flows from investing activities:		
Interest received	206,370	208,957
	<hr/>	<hr/>
Net increase in cash and cash equivalents	1,981,458	180,336
	<hr/>	<hr/>
Cash and cash equivalents at beginning of year	4,416,324	4,235,988
	<hr/>	<hr/>
Cash and cash equivalents at end of year	\$ 6,397,782	\$ 4,416,324
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes.

ST. MARY'S COUNTY METROPOLITAN COMMISSION

STATEMENTS OF CASH FLOWS (CONTINUED)

	<u>Years ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (820,602)	\$ (1,395,573)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,343,474	2,130,992
Changes in assets and liabilities:		
Increase in accounts receivable	(104,151)	(23,486)
(Increase) decrease in prepaid expense	(275,198)	(7,066)
Increase in inventory	(3,066)	(3,944)
Increase (decrease) in accounts payable	148,558	(60,040)
Increase (decrease) in accrued expenses	(284,097)	167,606
Increase in deferred income	664	72,186
Net cash provided by operating activities	<u>\$ 1,005,582</u>	<u>\$ 880,675</u>

SCHEDULE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES

Increase in capital assets	\$ 4,932,849	\$ 4,535,498
Capital contribution	(2,391,659)	(2,532,265)
Purchase of capital assets	<u>\$ 2,541,190</u>	<u>\$ 2,003,233</u>
Additions to capital debt	\$ 2,062,857	\$ 78,943
Deferred bond issue costs	(227,600)	0
Proceeds from capital debt	<u>\$ 1,835,257</u>	<u>\$ 78,943</u>

See accompanying notes.

ST. MARY'S COUNTY METROPOLITAN COMMISSION

STATEMENTS OF FIDUCIARY NET ASSETS

ASSETS

	<u>Years ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Restricted investments	\$ 757,828	\$ -
Total assets	<u>\$ 757,828</u>	<u>\$ -</u>

NET ASSETS

	<u>Years ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
Held in trust for other post employment benefits	\$ 757,828	\$ -
Total net assets	<u>\$ 757,828</u>	<u>\$ -</u>

See accompanying notes.

ST. MARY'S COUNTY METROPOLITAN COMMISSION
STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

	<u>Years ended June 30,</u>	
	<u>2008</u>	<u>2007</u>
ADDITIONS:		
Contributions	\$ 757,828	\$ -
Net additions	\$ 757,828	\$ -
DEDUCTIONS:		
Benefits	\$ -	\$ -
Change in net assets	\$ 757,828	\$ -
NET ASSETS:		
Beginning of year	\$ -	\$ -
End of year	\$ 757,828	\$ -

See accompanying notes.