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CITY OF MAGNOLIA, MISSISSIPPI

FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

RECEIVED

JUN 25 2007

STATE AUDITOR'S OFFICE

**CITY OF MAGNOLIA, MISSISSIPPI
FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2006**

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ALFORD, HOLLOWAY & SMITH, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

P.O. BOX 888, 104 COMMERCE PLACE

McCOMB, MISSISSIPPI 39649-0888

(601) 684-9721

INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Board of Alderpersons
City of Magnolia, Mississippi

We have audited the accompanying combined statement of cash receipts and disbursements (all funds) of the City of Magnolia, Mississippi, for the year ended September 30, 2006, as listed in the table of contents, which comprise a portion of the City's basic financial statements required by accounting principles generally accepted in the United States of America, as applied to the City's cash receipts and disbursements basis of accounting. The financial statement and schedules are the responsibility of the City's management. Our responsibility is to express an opinion on the financial statement and schedules 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 statement is 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 opinion.

As discussed in Note 1, the City of Magnolia, Mississippi, prepares its financial statement on the cash receipts and disbursements basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Management has not presented government-wide financial statements to display the cash receipts and disbursements of its governmental and business-type activities. Accounting principles generally accepted in the United States of America, as applied to the City's cash receipts and disbursements basis of accounting, require the presentation of government-wide financial statements. The amounts that would be reported in the government-wide financial statements resulting from cash receipts and disbursements transactions for the City's governmental and business-type activities are not reasonably determinable.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with the basis of accounting described in Note 1, the cash receipts and disbursement financial position of the City of Magnolia, Mississippi, for the year ended September 30, 2006.

In accordance with Government Auditing Standards, we have also issued our report dated February 3, 2007, on our consideration of the City of Magnolia, Mississippi's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management also has not presented the management's discussion and analysis and other required supplementary information that the Government Accounting Standards Board has determined is required to supplement, although not required to be a part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the financial statement that comprises the City of Magnolia, Mississippi's basic financial statement. The other supplemental information listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statement of the City of Magnolia, Mississippi. The information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the financial statement taken as a whole, on the basis of accounting described in Note 1.

A handwritten signature in cursive script that reads "Alford, Holloway & Smith, PLLC".

Alford, Holloway & Smith, PLLC

February 3, 2007

CITY OF MAGNOLIA, MISSISSIPPI
COMBINED STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS (ALL FUNDS)
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006

| | GENERAL | DEBT SERVICE | PROPRIETARY FUNDS | TOTAL (MEMCRANDUM ONLY) 2006 |
|--------------------------------------|---------------------|-------------------|----------------------|------------------------------------|
| Revenue receipts: | | | | |
| Taxes - Advalorem | \$ 490,048 | \$ 56,699 | \$ - | \$ 546,747 |
| Licenses and permits | 4,900 | | | 4,900 |
| Intergovernmental Revenues: | | | | |
| Grant Revenue | | | | |
| CDBG | - | | 365,142 | 365,142 |
| FEMA | 355,253 | | | 355,253 |
| COPS Grant | 26,769 | | | 26,769 |
| State Shared Revenues | 451,565 | | | 451,565 |
| Grants from Local Governments | 60,340 | | | 60,340 |
| Utility franchise | 76,824 | | | 76,824 |
| Fines and forfeits | 14,901 | | | 14,901 |
| Charges for services: | | | | |
| Sanitation and fire protection | 154,455 | | | 154,455 |
| Water and sewer | - | | 977,480 | 977,480 |
| Customer deposits/refunds | - | | 11,557 | 11,557 |
| Total revenue receipts | 1,635,055 | 56,699 | 1,354,179 | 3,045,933 |
| Other receipts: | | | | |
| Loans and transfers | 60,148 | 83,100 | 655,648 | 798,896 |
| Interest | 34,071 | 979 | 10,672 | 45,722 |
| Other | 137,356 | 15,616 | - | 152,972 |
| Total other receipts | 231,575 | 99,695 | 666,320 | 997,590 |
| Total receipts | 1,866,630 | 156,394 | 2,020,499 | 4,043,523 |
| Cash balance - beginning of year | 871,603 | 34,468 | 199,575 | 1,105,646 |
| Total amount to account for | \$ 2,738,233 | \$ 190,862 | \$ 2,220,074 | \$ 5,149,169 |
| Operating disbursements: | | | | |
| General government | \$ 253,734 | \$ - | \$ - | \$ 253,734 |
| Municipal court | 44,509 | | | 44,509 |
| Public safety | 330,346 | | | 330,346 |
| Sanitation | 120,257 | | | 120,257 |
| Highways and streets | 339,357 | | | 339,357 |
| Culture and recreation | 19,994 | | | 19,994 |
| Enterprises: | | | | |
| Water and sewer | - | | 283,209 | 283,209 |
| Interest on bonds and notes payable | - | 4,179 | 222,425 | 226,604 |
| Total operating disbursements | 1,108,197 | 4,179 | 505,634 | 1,618,010 |
| Other disbursements: | | | | |
| Bonds and notes retired | - | 94,537 | 875,442 | 969,979 |
| Grant expenditures | | | | |
| FEMA | 334,455 | | | 334,455 |
| Park | 98,217 | | | 98,217 |
| Capital outlay | 32,476 | | 407,022 | 439,498 |
| Loans and transfers | 735,000 | 56,699 | 7,197 | 798,896 |
| Total other disbursements | 1,200,148 | 151,236 | 1,289,661 | 2,641,045 |
| Total disbursements | 2,308,345 | 155,415 | 1,795,295 | 4,259,055 |
| Cash balance - end of year | 429,888 | 35,447 | 424,779 | 890,114 |
| Total amount accounted for | \$ 2,738,233 | \$ 190,862 | \$ 2,220,074 | \$ 5,149,169 |

See accompanying notes to financial statement.

**CITY OF MAGNOLIA, MISSISSIPPI
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2006**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Magnolia was incorporated on April 26, 1859. The City operates under a Mayor-Alderman form of government and provides all of the rights and privileges provided by statute for municipalities. The accounting policies of the City conform to the laws of Mississippi for a municipality with a population of less than 3,000.

A. Reporting Entity

In evaluating how to define the City for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity is made by applying the criteria set forth in GAAP. 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. The other 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. Based upon the application of these criteria, the following is a brief review of each potential component unit addressed in defining the government's reporting entity.

Excluded from the reporting entity:

Magnolia Public Library. This potential component unit has a separate appointed board and provides services to residents, generally within the geographic boundaries of the government. This is excluded from the reporting entity because the government does not have the ability to exercise influence or control over the daily operations, approve budgets or provide funding.

B. Fund Accounting

The government uses funds to report on its financial position and the results of its operations. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. Funds are classified into two categories: governmental and proprietary.

Governmental funds are used to account for all or most of a government's general activities, including the collection and disbursement of earmarked monies (special revenue funds), the acquisition or construction of general fixed assets (capital projects funds), and the servicing of general long-term debt (debt service funds). The general fund is used to account for all activities of the general government not accounted for in some other fund.

Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Goods or services from such activities can be provided either to outside parties (enterprise funds) or to other departments or agencies primarily within the government (internal service funds).

C. Basis of Accounting

The financial statement is prepared on the cash receipts and disbursements basis, as prescribed by the Office of the State Auditor. Consequently, certain revenues are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred.

D. Restricted Assets

Certain proceeds of enterprise fund revenue bonds, as well as certain resources set aside for their repayment, are restricted because their use is limited by applicable bond covenants. In addition, the State Revolving Fund loan requires that a reserve fund maintain a balance of one year maintenance cost. These restrictions totaled \$60,593 at September 30, 2006. Cash restricted by various grants totaled \$136,709; by donors, \$7,284; and by others, \$12,893.

E. Cash Deposits and Investments

Cash includes amounts in demand deposits as well as short-term certificates of deposit.

F. Memorandum Only - Total Columns

Total columns on the combined statement of cash receipts and disbursements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations or cash flows in conformity with other comprehensive basis of accounting. Neither are such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

G. Budgets

The budget is prepared on the cash basis as legally required by statute. The budget is adopted by the Board of Alderpersons and filed with the taxing authority. Amendments can be made on the approval of the Board of Alderpersons. By statute, final budget and tax levy must be adopted on or before September 15 for the following year.

NOTE 2 – REPORT CLASSIFICATIONS

Receipts and disbursements were classified according to requirements for small towns in the State of Mississippi as prescribed by the Office of the State Auditor.

NOTE 3 – PROPERTY TAX REVENUE

Property taxes are assessed by the City on a calendar year basis. Property taxes are considered delinquent February 1 and a tax sale is held in August for unpaid taxes. Property tax revenue is recognized when collected, due to uncertainty of collecting property taxes after September 30.

For the current year, the City levied taxes in the amount of 29.9 mills. Advalorem tax collections were found to be within the limitation of Sec 27-39-32 to 27-39-323, Miss. Code Ann (1972).

NOTE 4 – CASH AND CASH EQUIVALENTS

The collateral for public entities' deposits in financial institutions is held in the name of the State Treasurer under a program established by Section 27-105-5 Miss. Code Ann. (1972). Under this program, the entity's funds are protected through a collateral pool administered by the State Treasurer. Financial institutions holding deposits of public funds must pledge securities as collateral against those deposits. In

the event of failure of a financial institution, securities pledged by that institution would be liquidated by the State Treasurer to replace the public deposits not covered by the Federal Depository Insurance Corporation.

At September 30, 2006, the carrying amount of the City's cash deposits, including certificates of deposit, was \$888,990 and the bank balance was \$949,591.

NOTE 5 - RISK MANAGEMENT

The City of Magnolia is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries of employees; and natural disasters. The City participates in two separate risk pools to provide coverage for possible losses due to these risks. These pools are described below:

- A. Mississippi Municipal Workers' Compensation Group
This pool was formed under the Mississippi Workers' Compensation Act to provide coverage for claims arising from injuries to employees. The City is jointly and severally liable for obligations of the group.

- B. Mississippi Municipal Liability Plan
This pool was formed under inter-local agreements for the purpose of providing the liability coverage prescribed by the Plan for the member municipalities. The pool uses a "service company" to manage the plan's day to day activities.

The City of Magnolia pays premiums based upon an actuarial assessment of the City's loss experience rate and the plan's overall financial condition. The City may be assessed if, at any time, the assets of the plan, in the opinion of the Board of Trustees, are insufficient to discharge its obligations.

NOTE 6 - CHANGES IN GENERAL FIXED ASSETS

A summary of changes in general fixed assets follows:

| | <u>Balance</u> <u>10-1-05</u> | <u>Additions</u> | <u>Deletions</u> | <u>Balance</u> <u>9-30-06</u> |
|--|----------------------------------|----------------------|-------------------|----------------------------------|
| Land | \$ 75,566 | \$ | \$ | \$ 75,566 |
| Buildings and Improvements (including parking lots) | 1,073,431 | | | 1,073,431 |
| Equipment | <u>640,321</u> | <u>32,476</u> | <u> </u> | <u>672,797</u> |
| Total | <u>\$ 1,789,318</u> | <u>\$ 32,476</u> | <u>\$ -0-</u> | <u>\$1,821,794</u> |

A summary of proprietary fund type property, plant, and equipment at September 30, 2006 follows:

| | Balance <u>10-1-05</u> | <u>Additions</u> | <u>Deletions</u> | Balance <u>9-30-06</u> |
|--------------------------------------|---------------------------|------------------|------------------|---------------------------|
| Land | \$ 30,764 | \$ | \$ | \$ 30,764 |
| Construction in progress | 10,116 | 140,145 | | 150,261 |
| Improvements other than Buildings | 13,183,501 | 248,757 | | 13,432,258 |
| Equipment | <u>242,958</u> | <u>18,120</u> | <u>-0-</u> | <u>261,078</u> |
| | 13,467,339 | 407,022 | -0- | 13,874,361 |
| Less accumulated depreciation | <u>(4,135,547)</u> | <u>(363,369)</u> | <u>-0-</u> | <u>(4,498,916)</u> |
| | <u>\$ 9,331,792</u> | <u>\$ 43,653</u> | <u>\$ -0-</u> | <u>\$ 9,375,445</u> |

NOTE 7 - DEFINED BENEFIT PENSION PLAN

Plan Description. The City of Magnolia, Mississippi contributes to the Public Employees' Retirement System of Mississippi (PERS), a cost-sharing, multiple-employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by State law and may be amended only by the State of Mississippi Legislature. PERS issues a publicly available financial report that includes financial statements and required supplementary information. That information may be obtained by writing to Public Employee Retirement System, PERS Building, 429 Mississippi Street, Jackson, MS 39201-1005 or by calling (601) 359-3589 or 1-800 444 PERS.

Funding Policy. PERS members are required to contribute 7.25% of their annual covered salary and the City of Magnolia, Mississippi is required to contribute at an actuarially determined rate. The current rate is 11.3% of annual covered payroll. The contribution requirements of PERS members are established and may be amended only by the State of Mississippi Legislature. The City of Magnolia, Mississippi's contributions to PERS for the year ending September 30, 2006 was \$44,980.

NOTE 8 - EMPLOYMENT SECURITY FUND

Mississippi State Code (1972 Sec. 71-5-359) states that a municipality may elect to maintain an unemployment fund and pay all base unemployment claims and one-half of extended unemployment claims out of such fund. The fund after January 1, 1979 will maintain a minimum balance of 2% of the covered wages paid during the next preceding year. A total of \$508,995 was paid in wages during the year. At September 30, 2006, the fund had a balance of \$12,893, which was in excess of the \$10,180 requirement.

SUPPLEMENTAL INFORMATION

**CITY OF MAGNOLIA, MISSISSIPPI
SCHEDULE OF LONG-TERM DEBT
SEPTEMBER 30, 2006**

| | Balance Outstanding Oct. 1, 2005 | Transactions During Fiscal Year | | Balance Outstanding Sept. 30, 2006 |
|----------------------|--|------------------------------------|-----------|--|
| | | Issued | Redeemed | |
| \$ 14,537 | \$ | - | \$ 14,537 | \$ - |
| 80,000 | | - | 80,000 | - |
| 94,537 | | - | 94,537 | - |
| Revenue Bonds | | | | |
| 9,164 | | - | 3,602 | 5,562 |
| 9,164 | | - | 3,602 | 5,562 |
| 103,701 | | - | 98,139 | 5,562 |

General Obligation Bonds
\$125,000 Hospital Series 1977-I bond due in annual installments of \$8,256 through January 1, 2007; including interest at 5%

\$450,000 Public Improvement serial bond due in annual installments of \$10,000 to \$40,000 plus interest at 10% to 7.5% through June 1, 2006

Total General Obligation Bonds

Revenue Bonds
\$65,000 Waterworks System Revenue bond due in annual installments of \$4,061 plus interest at 5% through January 1, 2008

Total Revenue Bonds

Total Bonds

**CITY OF MAGNOLIA, MISSISSIPPI
SCHEDULE OF SURETY BONDS FOR MUNICIPAL OFFICIALS
SEPTEMBER 30, 2006**

| <u>Position</u> | <u>Company</u> | <u>Bond</u> |
|-----------------|---------------------------|-------------|
| Mayor | Scott Municipal Insurance | \$ 50,000 |
| City Clerk | Scott Municipal Insurance | \$ 50,000 |
| Police Chief | Scott Municipal Insurance | \$ 50,000 |
| Deputy Clerk #1 | Scott Municipal Insurance | \$ 10,000 |
| Policeman #1 | Morrell Agency | \$ 25,000 |
| Policeman #2 | Morrell Agency | \$ 25,000 |
| Policeman #3 | Morrell Agency | \$ 25,000 |
| Policeman #4 | Morrell Agency | \$ 25,000 |
| Policeman #5 | Morrell Agency | \$ 25,000 |
| Policeman #6 | Morrell Agency | \$ 25,000 |
| Policeman #7 | Morrell Agency | \$ 25,000 |
| Policeman #8 | Morrell Agency | \$ 25,000 |
| Policeman #9 | Morrell Agency | \$ 25,000 |
| Policeman #10 | Morrell Agency | \$ 25,000 |
| Policeman #11 | Morrell Agency | \$ 25,000 |
| Policeman #12 | Morrell Agency | \$ 25,000 |
| Alderman #1 | Scott Municipal Insurance | \$ 15,000 |
| Alderman #2 | Scott Municipal Insurance | \$ 15,000 |
| Alderman #3 | Scott Municipal Insurance | \$ 15,000 |
| Alderman #4 | Scott Municipal Insurance | \$ 15,000 |
| Alderman #5 | Scott Municipal Insurance | \$ 15,000 |

**CITY OF MAGNOLIA, MISSISSIPPI
SCHEDULE OF DEPOSITS AND INVESTMENTS – ALL FUNDS
SEPTEMBER 30, 2006**

The City has no investments other than short-term certificates of deposit which are included in "cash".

At year-end 100% of the cash on deposit and certificates of deposit were covered by federal depository insurance or by collateral held in the pledging financial institution's trust departments in the government's name.

**CITY OF MAGNOLIA, MISSISSIPPI
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED SEPTEMBER 30, 2006**

| <u>Federal Grantor/Pass Through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-Through Entity Identifying Number</u> | <u>Federal Expenditures</u> |
|--|------------------------------------|---|---------------------------------|
| U.S. Department of Homeland Security | 97.036 | 1604-DR-MS-113- 44680-00 | \$355,253 |
| U.S. Department of Housing and Urban Development CDBG | 14.228 | 1122-05-251-PF-01 | 124,213 |
| U.S. Department of Housing and Urban Development CDBG | 14.228 | 1121-04-251-ED-01 | 238,640 |
| U.S. Department of Housing and Urban Development CDBG | 14.228 | 1117-01-251-EM-00 | 2,289 |
| U.S. Department of Transportation Recreational Trails Program | 20.219 | 28-RTP-0101 | 80,000 |
| U.S. Department of Justice 2006 Hurricane Relief Program | 16.592 | 2006-DH-BX-0438 | 24,935 |
| U.S. Department of Justice Justice Assistance Grant Program | 16.592 | 2005-DJ-BX-0365 | <u>1,834</u> |
| Total Expenditures of Federal Awards | | | <u>\$827,164</u> |

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of City of Magnolia, Mississippi and is presented on the cash receipts and disbursements basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the combined cash receipts and disbursement statement.

**CITY OF MAGNOLIA
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
YEAR ENDED SEPTEMBER 30, 2006**

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None.

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH STATE LAWS AND REGULATIONS**

Honorable Mayor and Board of Alderpersons
City of Magnolia, Mississippi

We have audited the combined statement of cash receipts and disbursements of the City of Magnolia, Mississippi as of and for the year ended September 30, 2006 and have issued our report dated February 3, 2007. We have 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.

As required by the state legal compliance audit program prescribed by the Office of the State Auditor, we have also performed procedures to test compliance with certain state laws and regulations. However, providing an opinion on compliance with state laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of those procedures and our audit of the combined statement of cash receipts and disbursements disclosed no material instances of noncompliance with state laws and regulations.

This report is intended for the information of the City's management and the Office of the State Auditor and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Alford, Holloway & Smith, PLLC

February 3, 2007

ALFORD, HOLLOWAY & SMITH, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

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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

Honorable Mayor and Board of Alderpersons
City of Magnolia, Mississippi

We have audited the combined statement of cash receipts and disbursements of the City of Magnolia, Mississippi as of and for the year ended September 30, 2006, and have issued our report thereon dated February 3, 2007. 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 of Magnolia, Mississippi's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be a material weakness. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we considered to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Magnolia, Mississippi's financial statement is 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.

This report is intended solely for the information and use of the management, others within the organization, Board of Alderpersons, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Alford, Holloway & Smith, PLLC

February 3, 2007

ALFORD, HOLLOWAY & SMITH, PLLC

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133

Honorable Mayor and Board of Alderpersons
City of Magnolia, Mississippi

Compliance

We have audited the compliance of City of Magnolia, Mississippi with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended September 30, 2006. City of Magnolia, Mississippi's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of City of Magnolia, Mississippi's management. Our responsibility is to express an opinion on City of Magnolia, Mississippi's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about City of Magnolia, Mississippi's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of City of Magnolia, Mississippi's compliance with those requirements.

In our opinion, City of Magnolia, Mississippi complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2006.

Internal Control Over Compliance

The management of City of Magnolia, Mississippi is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered City of Magnolia, Mississippi's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the management, others within the organization, Board of Alderpersons, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Alfred, Holloway & Smith, P.C.

February 3, 2007

**CITY OF MAGNOLIA, MISSISSIPPI
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED SEPTEMBER 30, 2006**

Section I-Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:

Adverse

Internal control over financial reporting:

Material weakness (es) identified?

_____ Yes X No

Reportable condition(s) identified that are not considered to be material weakness(es)?

_____ Yes X None reported

Noncompliance material to financial statements noted?

_____ Yes X No

Federal Awards

Internal control over major programs:

Material weakness(es) identified?

_____ Yes X No

Reportable condition(s) identified that are not considered to be material weakness(es)?

_____ Yes X None reported

Type of auditor's report issued on compliance for major programs:

Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?

_____ Yes X No

Identification of major programs:

CFDA Numbers

Name of Federal Program or Cluster

97.036

State-Local Disaster Assistance

14.228

Small Municipalities & Limited Populations

Dollar threshold used to distinguish between type A and type B programs :

\$ 300,000

Auditee qualified as low-risk auditee?

_____ Yes X No

Section II-Financial Statement Findings

None.

Section III-Federal Award Findings and Questioned Costs

None.