

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE AGUAS BUENAS

AUDITORIA 2004-2005

30 DE JUNIO DE 2005

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ASUNTOS MUNICIPALES
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MUNICIPALITY OF AGUAS BUENAS
SINGLE AUDIT REPORTING PACKAGE
FOR THE YEAR ENDED JUNE 30, 2005

MUNICIPALITY OF AGUAS BUENAS

FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2005

**MUNICIPALITY OF AGUAS BUENAS
SINGLE AUDIT REPORTING PACKAGE
FOR THE YEAR ENDED JUNE 30, 2005**

TABLE OF CONTENTS

	<u>Page</u>
<u>FINANCIAL SECTION</u>	
Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-11
Basic Financial Statements:	
Statement of Net Assets	12
Statement of Activities	13-14
Fund Financial Statements:	
Balance Sheet – Governmental Funds	15
Reconciliation of the Governmental Funds Balance Sheet to Statement of Net Assets	16
Statement of Revenues, Expenditures and Changes in Fund Balance	17-18
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance to the Statement of Activities	19
Note to the Financial Statements	20-36
<u>REQUIRED SUPPLEMENTARY INFORMATION</u>	37
Schedule of Budgetary Comparison – General Funds	38
Notes to Schedule of Budgetary Comparison	39-40
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS	41-42
Notes to Schedule of Expenditures of Federal Awards	43
Report on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	44-46
Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133	47-49
SCHEDULE OF FINDINGS AND QUESTIONED COSTS	50
Section I. – Summary of Auditor's Results	51
Section II. - Financial Statements Findings	52
Section III. – Federal Awards Findings and Questioned Costs	53-61

Carlos R. Diáz Negrón

Certified Public Accountant

MEMBER:

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INDEPENDENT AUDITOR'S REPORT

**To the Honorable Mayor and
Municipal Legislative Body
Municipality of Aguas Buenas
Aguas Buenas, Puerto Rico**

I have audited the financial statements of the governmental activities, each major funds, and the aggregate remaining fund information of the Municipality of Aguas Buenas as of and for the year ended June 30, 2005 which collectively comprise the basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. My responsibility is to express an opinion on these financial statements based on my audit. I did not audit the financial statements of the business-type activities. Those statements were audited by other auditors whose report has been furnish to me, and in my opinion, insofar as it relates to the amounts included for Espiritu Santo Project, is based solely on the report of the other auditors.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that I 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. I believe that my audit provides a reasonable basis for my opinions.

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major funds, and the aggregate remaining fund information of the Municipality of Aguas Buenas as of June 30, 2005, and the respective changes in financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONTINUED):

In accordance with Government Auditing Standards, I have also issued a report dated October 26, 2005, in my consideration of Municipality of Aguas Buenas's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts grants agreements and other matters. The purposes 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 my audit.

The management's discussion and analysis and budgetary comparison information on pages 3 through 11 and 37 are not required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Aguas Buenas's 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 not a required part of the basic financial statements of the Municipality of Aguas Buenas. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.



October 26, 2005
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2007

The stamp No. 2112400 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

On July 1, 2003 the management of the Municipality of Aguas Buenas implemented Statement 34 of the government Accounting Standards Board (GASB) "*Basic Financial Statement Management's Discussion and Analysis-for State and Local Government*".

Our discussion and analysis of the Municipality of Aguas Buenas Puerto Rico, financial performance provides an overview of the Municipality's financial activities during the fiscal years ending June 30, 2005 and 2004. Please read in conjunction with the Municipality's financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality's total net assets decreased by \$ 677,198 during 2005.
- The assets of the Municipality's on the government-wide basis exceeded its liabilities at the close of fiscal year 2005 by \$11,716,756 (net assets).
- At the close of the current fiscal year, the Municipality's government funds reported combined ending fund balances of \$2,482,273 a decrease of \$789,974 in comparison with the prior year.
- The General Fund, on current financial resources basis, reported an excess of expenditures and other financial uses over revenues and other financing sources of \$1,132,587.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$765,755.
- The investment in Capital Assets as of June 30, 2005 was \$15,274,383 (net depreciation), 3% less of prior year's balance.
- Long term-debts decreased to \$1,029,028 approximately 13 percent with respect to prior year.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 10-12) provide information about the activities of the Municipality as a whole and present a longer-term view of the Municipality's finance. Fund financial statements start on page 13. For government activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statement also report the Municipality's operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds. The remaining statements provide financial information about activities for which the Municipality acts solely as a trustee or agent for the benefit of those outside of the government.

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

REPORTING THE MUNICIPALITY AS A WHOLE

The Statements of Net Assets and the Statements of Activities

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. 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 Municipality's net assets and changes in them. You can think of the Municipality's net assets (the difference between assets and liabilities) as one way to measure the Municipality's financial health, or financial position. Over time, increase or decrease in the Municipality's net assets are one indicator of whether its financial health is improving or deteriorating.

The Statement of Net Assets and the Statement of Activities was divided into two kinds of activities:

- **Governmental Activities** – Most of the Municipality's basic services are reported here, including the municipal police, public works, garbage disposal, public energy and health services, and general administration. Property taxes, municipal license tax, state and federal grants finance most of these activities.
- **Business Activities** – The Municipality owns the Espiritu Santo Project (Project), a housing development consisting of land, buildings and other improvements, which leases its 50 rental units to low and moderate income individuals in Aguas Buenas. The Project operates under Section 515 of SDA Rural Development (USDA-RD) Housing of the National Housing Act with HUD Section 8 Housing Assistance Payments Program.

FUND FINANCIAL STATEMENTS

The fund financial statements begin on page 13 and provide detailed information about the most significant funds, not the Municipality as a whole. The Municipality operates under four major funds the General Fund, the CDBG fund, the HUD fund and the Debt Service fund. Other minor funds as Capital Projects, Joint Resolutions Childcare program and other federal funds was presented under the column Other Governmental Funds.

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

- Governmental funds-Most of the Municipality 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 the modified accrual accounting method, which measures cash and other financial assets that can readily be converted to cash. The governmental fund statements provide detailed short-term view of the Municipality 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 Municipality activities. We describe the relationship (or differences) between governmental activities (reported in the Statements of Net Assets and the Statement of Activities) and governmental fund in the reconciliation at the fund financial statements.

A comparative analysis of overall fund financial activities is presented below:

ASSETS	2005	2004	Change	%
Cash, and cash equivalents	\$2,687,292	\$3,375,960	\$ 688,668	20%
Cash with fiscal agents	1,193,432	1,449,449	256,017	18%
Accounts Receivable (Municipal license taxes)	26,671	46,889	20,218	43%
Due from other funds	981,698	1,532,421	550,723	36%
Due from agencies	1,094,910	482,178	(612,732)	-127%
	<u>\$5,984,003</u>	<u>\$6,886,897</u>	<u>\$902,894</u>	<u>13%</u>
LIABILITIES				
Account payable and accrued expenses	\$1,178,223	\$1,037,342	\$(140,881)	-14%
Due to other agencies	433,926	196,989	(236,937)	-120%
Due to other funds	981,698	1,532,421	550,723	36%
General obligations	-	275,000	275,000	100%
Deferred revenues municipal	363,534	447,978	84,444	19%
Deferred revenues federal financial assistance	511,721	445,170	(66,551)	-15%
Other	32,628	-	(32,628)	100%
	<u>3,501,730</u>	<u>3,934,900</u>	<u>433,170</u>	<u>11%</u>
FUND EQUITY AND OTHER CREDITS	<u>2,482,273</u>	<u>2,951,997</u>	<u>469,724</u>	<u>16%</u>
	<u>\$5,984,003</u>	<u>\$6,886,897</u>	<u>\$902,894</u>	<u>27%</u>

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

REVENUES	2005	2004	Change	%
Property taxes	\$1,941,578	\$1,978,858	\$ 37,280	2%
Municipal taxes	474,078	445,719	(28,359)	-6%
Licenses fees and permits	239,100	215,496	(23,604)	-11%
Intergovernmental	10,993,836	10,247,829	(746,007)	-7%
Rent of properties	72,808	69,282	(3,526)	-5%
Interest	37,806	46,642	8,836	19%
Other	325,973	483,351	157,378	33%
	<u>\$14,085,179</u>	<u>\$13,487,177</u>	<u>\$(598,002)</u>	<u>-4%</u>
 EXPENDITURES				
General government	\$4,688,085	\$4,470,739	\$(217,346)	-5%
Public Safety	431,454	332,721	(98,733)	-30%
Public Works	5,995,095	5,770,009	(225,086)	-4%
Health sanitation and welfare	1,982,195	2,989,488	1,007,293	34%
Education and recreation	1,124,826	178,782	(946,044)	-529%
Other	-	6,349	6,349	100%
Debt services principal retirement	434,000	1,852,441	1,418,441	77%
Debt services interest	219,498	168,475	(51,023)	-30%
	<u>\$14,875,153</u>	<u>\$15,769,004</u>	<u>\$893,851</u>	<u>6%</u>

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

THE MUNICIPALITY A WHOLE

REQUIRED FINANCIAL STATEMENTS

The financial statements of the Municipality report information of the Municipality using accounting method similar to those used by private sector companies. These statements offer short-and long-term financial information about its activities. The Statements of the Net Assets includes all of the Municipality's assets and liabilities and provides information about the nature and amounts of investment in resource.

CONDENSED STATEMENT OF NET ASSETS

	2005	2004	Change	%
ASSETS				
Current and other assets	\$5,230,755	\$5,354,476	\$ 123,721	2%
Capital assets, net	15,995,677	15,787,586	208,091	1%
<i>Total assets</i>	<u>\$21,226,432</u>	<u>\$21,142,062</u>	<u>\$331,812</u>	<u>2%</u>
LIABILITIES AND NET ASSETS				
Current and other liabilities	2,237,494	2,127,479	(110,015)	-5%
Long-term debt liabilities	7,047,642	7,347,057	299,415	4%
<i>Total liabilities</i>	<u>9,285,136</u>	<u>9,474,536</u>	<u>189,400</u>	<u>-1%</u>
Net assets				
Invested in capital assets, net of related debt	11,667,384	12,136,586	469,202	3.9%
Restricted	3,118,354	1,115,131	(2,003,223)	-180%
Unrestricted	<u>(2,844,442)</u>	<u>(1,584,191)</u>	<u>273,770</u>	<u>-80%</u>
TOTAL NET ASSETS	<u>\$11,941,296</u>	<u>\$11,667,526</u>	<u>\$(273,770)</u>	<u>-2%</u>

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

CONDENSED STATEMENT OF ACTIVITIES

	2005	2004	Change	%
Program Revenues				
Operating Grants and Contributions	\$2,594,398	\$3,048,513	\$454,115	15%
Capital Grants and Contributions	2,263,633	2,501,728	238,095	10%
Charge of services	285,565		285,565	100%
General Revenues				
Taxes				
Property taxes	1,941,577	1,978,858	37,281	2%
Municipal taxes	508,948	445,719	(63,229)	-14%
Grants entitlements	6,135,805	4,857,770	1,278,035	-38%
Other	676,672	585,304	(91,368)	-16%
Total revenues	<u>14,406,598</u>	<u>13,417,892</u>	<u>(988,706)</u>	<u>-7%</u>
Expenses				
General administration	4,607,200	4,598,636	(8,564)	0%
Public safety	425,595	333,110	(92,485)	-28%
Education, culture and recreational	1,209,827	263,661	(946,166)	-359%
Public works and sanitation	6,327,348	3,634,956	(2,692,392)	-74%
Health and welfare	1,987,372	2,994,526	1,007,154	34%
Housing	294,609		294,609	100%
Interest	231,845	168,475	(63,370)	-38%
Other	-	6,349	6,349	100%
Total general activities	<u>15,083,796</u>	<u>11,999,713</u>	<u>(3,084,083)</u>	<u>-26%</u>
Change in net assets	(667,198)	1,418,179	2,095,377	148%
Net assets at beginning	<u>12,618,494</u>	<u>10,180,065</u>	<u>(2,438,429)</u>	<u>-24%</u>
Net assets at end	<u>\$11,950,340</u>	<u>\$11,598,244</u>	<u>\$(352,096)</u>	<u>-3%</u>

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

Governmental Activities

To aid in the understanding of the Statement of Activities some additional explanation is given. Of particular interest is the format that is significantly different than a typical Statement of Revenues, Expenses, and Changes in Fund Balance. You will notice that expense are listed first with revenues from that particular program reported after. The result is a Net (Expense)/Revenue. The reason for this kind of format is to highlight the relative financial burden of each of the function on the Municipality. It also identifies how much each function draws from the general revenues or if is self-financing through fees and grants.

BUDGETARY INFORMATION

Original budget was amended by \$393,540, mainly due to a readjustment of prior years funds of \$611,501 approved by the Municipal Legislature. Actual revenues were less than budget by approximately 1%, that is considered reasonable.

Expenditures were more than budgeted amount by approximately 8% due, among other reasons to a non-budgeted loan made to GBD. See Budgetary Comparison Schedule on page 38.

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

CAPITAL ASSETS

At the end of the year June 30, 2005, the Municipality had \$15,274,383, net of depreciation invested in capital assets including land, buildings, parks, and courts, machinery and equipment, and automobiles. This represent a net decrease of 3 % percent, over the last year, due to an increase in accumulated depreciation of \$715,123 more than it respective assets.

	2005	2004	Change	%
NONDEPRECIABLE CAPITAL ASSETS				
Land	\$2,062,577	\$2,062,577	-	0%
Depreciable assets				
Infrastructure	508,617	508,617	-	0%
Buildings, parks and courts	17,964,113	17,964,113	-	0%
Machinery and equipment	1,716,956	1,531,944	185,014	12%
Automobiles	1,967,804	1,950,804	17,000	1%
Total capital assets	<u>24,220,069</u>	<u>24,018,055</u>	<u>202,014</u>	<u>1%</u>
Less accumulated depreciation				
Infrastructure	10,172	-	10,172	0%
Buildings, parks and courts	6,535,575	6,119,387	416,188	7%
Machinery and equipment	923,506	767,992	155,517	20%
Automobiles	1,476,433	1,343,180	133,253	10%
	<u>8,945,686</u>	<u>8,230,559</u>	<u>715,127</u>	<u>9%</u>
Net capital assets	<u>\$15,274,383</u>	<u>\$15,787,496</u>	<u>\$(513,113)</u>	<u>-3%</u>

**MUNICIPALITY OF AGUAS BUENAS
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

LONG TERM DEBT

At year-end, the Municipality had \$3,607,000 in general and special bonds and notes, a decrease of 8% with respect to prior year. The Municipality is required to maintain a legal debt margin of 10% of the total assessment of property located within the Municipality plus the balance of the property taxes in the debt service fund. The Municipality's outstanding debt as of June 30, 2005 is as follows:

General and special obligation bonds and notes	\$3,607,000
Compensated absences	826,690
Landfill closure costs	1,360,000
Other	1,368,952
Total	<u>\$7,163,652</u>

More detailed information about the Municipality's long term liabilities is presented in Note 9 to the financial statements.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

The financial report is designed to provide a general overview of the Municipality's finances for all those with an interest in the government's finances. For questions concerning any of the information provided in this report or requests for additional information contact the Municipality's Finance Department at (787) 732-2811.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
STATEMENT OF NET ASSETS
AS OF JUNE 30, 2005

	PRIMARY GOVERNMENT		
ASSETS	GOVERNMENTAL ACTIVITIES	BUSINESS -TYPE ACTIVITIES	TOTAL
Cash and cash equivalents	\$ 2,687,292	\$ 77,422	\$ 2,764,714
Cash with fiscal agent	1,193,432		1,193,432
Accounts receivable other agencies	1,094,910		1,094,910
Other assets	26,671	38,579	65,250
Restricted cash		112,449	112,449
Capital assets, net	<u>15,274,383</u>	<u>721,294</u>	<u>15,995,677</u>
Total Assets	<u>\$20,276,688</u>	<u>\$949,744</u>	<u>\$21,226,432</u>
LIABILITIES AND NET ASSETS			
Liabilities:			
Accounts payable and accrued expenses	\$ 1,235,820	\$ 23,399	\$ 1,259,219
Deferred revenue	544,349		544,349
Due to other agencies	433,926		433,926
Long-term debt:			
Due within one year	719,244	30,116	749,360
Due in more than one year	<u>5,626,593</u>	<u>671,689</u>	<u>6,298,282</u>
Total Liabilities	<u>8,559,932</u>	<u>725,204</u>	<u>9,285,136</u>
Net Assets:			
Invested in capital assets, net of related debt	11,667,384		11,667,384
Restricted for:			
Debt service	480,659		480,659
State and federal programs	2,525,246		2,525,246
Replacements and others		112,449	112,449
Unrestricted	<u>(2,956,533)</u>	<u>112,091</u>	<u>(2,844,442)</u>
Total Net Assets	<u>\$11,716,756</u>	<u>\$224,540</u>	<u>\$11,941,296</u>

The accompanying notes are an integral part of these financial statements

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005**

FUNCTIONS AND PROGRAMS	EXPENSES	PROGRAM REVENUES			NET (EXPENSE)/ REVENUE
		CHARGE FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS	
Governmental activities:					
General administration	\$ 4,607,200		\$457,211		\$(4,149,989)
Public safety	425,595		8,493		(417,102)
Education, culture and recreational	1,209,827		782,959		(426,868)
Public works and sanitation	6,327,348			\$2,263,633	(4,063,714)
Health and welfare	1,987,372		1,345,735		(641,637)
Interest	<u>231,845</u>				<u>(231,846)</u>
Total governmental activities	<u>14,789,187</u>		<u>2,594,398</u>	<u>2,263,633</u>	<u>(9,931,156)</u>
Business type-activities:					
Housing	<u>294,609</u>	<u>\$285,565</u>			<u>(9,044)</u>
Total business-type activities	<u>294,609</u>	<u>285,565</u>			<u>(9,044)</u>
Total	<u>\$15,083,796</u>	<u>\$285,565</u>	<u>\$2,594,398</u>	<u>\$2,263,633</u>	<u>\$(9,940,200)</u>

(Continue)

The accompanying notes are an integral part of these financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
STATEMENT OF ACTIVITIES (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

	<u>GOVERNMENTAL ACTIVITIES</u>	<u>BUSINESS-TYPE ACTIVITIES</u>	<u>TOTAL</u>
Net (expense)/revenue	<u>\$(9,931,156)</u>	<u>\$ (9,044)</u>	<u>\$(9,940,200)</u>
General revenue:			
Taxes:			
Property taxes	1,941,577		1,941,577
Municipal tax	508,948		508,948
Grants and entitlements	6,135,805		6,135,805
Other	<u>675,686</u>	<u>986</u>	<u>676,672</u>
Total general revenues	<u>9,262,016</u>	<u>986</u>	<u>9,263,002</u>
Changes in net assets	(669,140)	(8,058)	(677,198)
Net assets at beginning	<u>12,385,896</u>	<u>232,598</u>	<u>12,618,494</u>
Net assets at end	<u>\$ 11,716,756</u>	<u>\$224,540</u>	<u>\$ 11,941,296</u>

The accompanying notes are an integral part of these financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
BALANCE SHEET
GOVERNMENTAL FUNDS
AS OF JUNE 30, 2005**

	GENERAL FUND	DEBT SERVICE FUND	SECTION 8	CDGB	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Cash:						
Cash in bank			\$489,711	\$ 5,355	\$2,192,226	\$2,687,292
Cash with fiscal agent	\$ 165,420	\$480,659			547,353	1,193,432
Receivables:						
Amount due from:						
Governmental agencies	32,628			579,658	482,624	1,094,910
Other funds	981,698					981,698
Other	26,671					26,671
Total assets	<u>\$1,206,417</u>	<u>\$480,659</u>	<u>\$489,711</u>	<u>\$585,013</u>	<u>\$3,222,203</u>	<u>\$5,984,003</u>
Liabilities:						
Accounts payable and accrued expenses	\$ 655,292			\$507,931	\$ 15,000	\$1,178,223
Deferred income:						
Municipal license	363,534					363,534
Federal financial assistance			\$467,146		44,575	511,721
Other	32,628					32,628
Due to other fund			22,565	77,082	882,051	981,698
Due to other agency	433,926					433,926
Total liabilities	<u>1,485,380</u>		<u>489,711</u>	<u>585,013</u>	<u>941,626</u>	<u>3,501,730</u>
Fund balance						
Reserve for:						
Debt service		\$480,659				480,659
Designated capital projects					2,280,577	2,280,577
Unreserved	(278,963)					(278,963)
Total fund balance	<u>(278,963)</u>	<u>480,659</u>			<u>2,280,577</u>	<u>2,482,273</u>
Total liabilities and fund balance	<u>\$1,206,417</u>	<u>\$480,659</u>	<u>\$489,711</u>	<u>\$585,013</u>	<u>\$3,222,203</u>	<u>\$5,984,003</u>

The accompanying notes are an integral part of these financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO THE STATEMENT OF NET ASSETS
AS OF JUNE 30, 2005**

Fund balances in governmental funds	\$ 2,482,273
<i>Amounts reported for governmental activities in the Statement of Net Assets are different because:</i>	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	15,274,383
Deferred revenue in the governmental funds that are recorded as revenue in the statement of net assets.	363,534
Long-term liabilities and accrual expenses are not due and payable in the current period and therefore are not reported in the funds:	
Bonds and notes payable	(3,492,000)
Compensated absences	(826,690)
Estimated liability for landfill postclosure cost	(1,360,000)
Accrued interest	(57,597)
Other long term debt	(667,147)
<i>Net assets of governmental activities</i>	<u>\$11,716,756</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCE-GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2005**

	GENERAL FUND	DEBT SERVICE FUND	SECTION 8	CDBG	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Revenues:						
Taxes:						
Property taxes	\$ 1,549,200	\$392,378				\$ 1,941,578
Municipal taxes	474,078					474,078
Grants and entitlements	4,706,436		\$1,345,735	\$1,405,403	\$3,536,262	10,993,836
Other	<u>669,195</u>	<u>6,492</u>				<u>675,687</u>
Total Revenues	<u>7,398,909</u>	<u>398,870</u>	<u>1,345,735</u>	<u>1,405,403</u>	<u>3,536,262</u>	<u>14,085,179</u>
Expenditures:						
General administration	4,121,314				566,771	4,688,085
Public safety	362,177				69,277	431,454
Education and recreational	213,961				910,865	1,124,826
Public works	3,238,282			1,405,403	1,351,410	5,995,095
Health sanitation and welfare	636,460		1,345,735			1,982,195
Debt service:						
Principal		434,000				434,000
Interest		<u>219,498</u>				<u>219,498</u>
Total expenditures	<u>8,572,194</u>	<u>653,498</u>	<u>1,345,735</u>	<u>1,405,403</u>	<u>2,898,323</u>	<u>14,875,153</u>
Excess of revenue over expenditures	<u>\$(1,173,285)</u>	<u>\$ (254,628)</u>	<u>\$ _____</u>	<u>\$ _____</u>	<u>\$ 637,939</u>	<u>\$ (789,974)</u>

(Continue)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCE-GOVERNMENTAL FUNDS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

	GENERAL FUND	DEBT SERVICE FUND	SECTION 8	CDBG	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Excess of revenues over expenditures	<u>\$(1,173,285)</u>	<u>\$(254,628)</u>	_____	_____	<u>\$ 637,939</u>	<u>\$ (789,974)</u>
Other financing sources (uses):						
Operating transfer in	250,073	209,375				459,448
Operating transfer out	<u>(209,375)</u>	<u>(5,404)</u>	_____	_____	<u>(244,669)</u>	<u>(459,448)</u>
Total other financing sources	<u>40,698</u>	<u>203,971</u>	_____	_____	<u>(244,669)</u>	_____
Excess of revenues and other financing source over expenditures and other financing sources	(1,132,587)	(50,657)			393,270	(789,974)
Fund balance at beginning of year	<u>853,624</u>	<u>531,316</u>	_____	_____	<u>1,887,307</u>	<u>3,272,247</u>
Fund balance at end of year	<u>\$ (278,963)</u>	<u>\$480,659</u>	<u>\$ _____</u>	<u>\$ _____</u>	<u>\$2,280,577</u>	<u>\$2,482,273</u>

Other adjustments - Aug 2005

The accompanying notes are an integral part of these financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL
FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005**

Net change in fund balances – total governmental funds	\$(789,974)
<i>Amounts reported for Governmental Activities in the Statement of Activities are different because:</i>	
Governmental funds report capital outlays as expenditures. However, in the statement of activities and changes in net assets, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount of capital assets recorded in the current period.	202,014
Governmental funds report principal payments on long-term debts as expenditures, whereas the principal payments reduce the long-term debt in the statement of net assets.	434,000
Change in accrued expenses which does not require the use of current financial resources:	
Interest	(12,348)
Compensating absences	159,106
Other long-term debts	18,409
Deferred municipal taxes	34,870
Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in governmental funds.	<u>(715,217)</u>
<i>Changes in Net Assets of Governmental Activities</i>	<u>\$(669,140)</u>

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

1. ORGANIZATION

The Municipality of Aguas Buenas (the Municipality) is a political and legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession, existence and legal personality separate and independent from the governmental of the Commonwealth of Puerto Rico.

The municipal government is comprised of the executive and legislative bodies, which are elected every four years in the Puerto Rico general elections. The executive power is exercised by the Mayor and the legislative power by the Municipal Legislative Body, which has twelve members.

The Municipality provides the following services to its community: health, public works, education, public safety, housing, community and social services, welfare, culture and recreation, as well as many other general and administrative services.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Municipality relating to the funds included in the accompanying basic financial statements conform to accounting principles generally accepted in the United States of America applicable to state and local governments. Generally accepted accounting principles for local governments include those principles prescribed by the Governmental Accounting Standards Board (GASB), the American Institute of Certified Public Accountants in the publication entitled Audits of State and Local Governmental Units and by the Financial Accounting Standards Board (when applicable). The more significant policies of the Municipality are described below.

Reporting entity

A reporting entity consists of the primary government, component units, and other organizations that are included to ensure that financial statements are not misleading. The primary government of the Municipality consists of all funds and departments that are not legally separate from the Municipality. For the Municipality of Aguas Buenas, these include various services such as police protection, recreation (including parks), street maintenance and repair, sanitation, and general administrative services. The operation of each of these activities is directly controlled by Municipality's Legislative Body through the budgetary process.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Component units are legally separate organizations for which the Municipality is financially accountable. The Municipality has no component units.

Government wide and fund financial statements

Basic financial statements include both governments-wide and fund financial statements.

Government-wide statements

The government-wide financial statements (consists of a the statement of net assets and the statement of activities) these statements report information on all the activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities which normally are supported mainly by taxes and intergovernmental revenues are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include a) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

The Municipality reports the following major governmental funds:

1) General Fund

This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2) Debt Service Fund

This fund accounts for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

3) Section 8 Fund

This fund accounts for the resources received and payments made under the Section 8 – Housing Choices Voucher Program of the US Department of Housing and Urban Development.

4) CDBG Fund

This fund accounts for the resources received and payment made under the Community Development Block Grand of the US Department of Housing and Urban Development.

Measurement focus, basis of accounting and financial statement presentation

The government-wide financial statement of Net Assets and the Statement of Activities, both government and business like activities, are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time the liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Under this method revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, except for debt service, compensated absences and claims and judgments expenditures which are reported when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement focus, basis of accounting and financial statement presentation (continued)

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private sector guidance.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

Cash, cash equivalents, cash with fiscal agent and investment

The Municipality's finance director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts and certificates of deposit with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB). The Municipality's policy is to invest any excess cash in interest bearing deposits with institutions qualified by the PRTD. Earnings from these funds are recorded in the corresponding fund as interest income.

Cash with fiscal agent in the governmental fund consists of unused proceeds from bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Municipal Revenue Collection Center (CRIM) and restricted for the payment of the Municipality's debt service, as established by law.

The Municipality considers all investments with an original maturity of three months or less to be cash equivalents.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Interfund receivables and payables

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either due to/from other funds (i.e., the current portion of interfund loans) or advances to/from other funds (i.e., the non-current portion of interfund loans). Interfunds receivables and payables between funds within the governmental activities are eliminated in the statement of net assets.

Capital assets

Capital assets, which include property, plant, equipment, and infrastructure (which is normally immovable and of value only to the Municipality, such as roads, bridges, streets sidewalks, and drainage system), are reported in the government-wide financial statements.

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. When historical cost is not available it is estimated using historic sales of the year of the acquisition of the related capital assets.

Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

Infrastructure	50 years
Building	40 years
Improvement to land	25 years
Vehicles	7 years
Machinery and equipment	10 years
Computer and printer	3 years
Furniture	15 years

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reservation of fund balance

Reservations of fund balance represent portions of fund balances that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

1) Debt/ service

Represents net assets available to finance future debt service payments.

2) State and federal programs

Represent the reservations of amounts available for specific use under state and federal grant programs.

Risk financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2005 amounted to approximately \$117,378. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$264,880 for workers compensation insurance covering all municipal employees.

Compensated absences

Employees accumulate vacation leave at a rate of 2.5 days per month up to maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum 90 days. In the event of employee resignation, the employee is paid for accumulated vacations days up to the maximum allowed.

Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years or more of service who are entitled to sick leave pay up to the maximum allowed.

Employees' maximum allowed vacations and vested sick benefits are accounted for in the Statement of Net Assets.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of estimates

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

3. PROPERTY TAX

According to the Public Act No. 83, enacted on August 30, 1991, known as Act of Municipal Property Tax, the Municipal Revenues Collection Center (CRIM) is responsible for the assessment, administration and collection of all the real and personal property located in the Municipality.

Annually, the CRIM notifies the Municipality the estimated basic and additional special taxes to be collected during the next fiscal year and advances the Municipality the basic tax. These advances are amortized through the subsequent collection of the basic property tax and the related debt or receivable is recorded in the General fund when CRIM notifies the Municipality the final settlement.

Property taxes are levied annually over the assessed value of the property at the beginning of the calendar year, which amounts to 6.58% for the personal property and 8.58% for the real property. The assessed value of real property evolves from 1957 estimated values and of personal property from the current value at the date of the assessment. The Municipality grants business with a volume of less than \$150,000 full personal property tax exemption up to \$50,000 of the assessed value of the property.

Also, property tax laws grant, under certain circumstances, a tax exemption for the first \$15,000 of the assessment value of the principal residence occupied by its owner. Nevertheless, the Department of the Treasury pays to the Municipality the basic tax related to that \$15,000, except for properties that have an assessed value of less than \$3,500, which have full exemption. Of the total tax imposed, 1.03% belongs to the CRIM and the remaining to the Municipality. From this amount, 4% for personal property and 6% for real property is known as the basic tax and is recorded in the General fund. The remaining 1.55% is known as the additional special tax which is used to pay the public debt and is retained by the CRIM for such purposes. The additional tax is recorded as revenue in the Debt service fund when collected by the CRIM and reported to the Municipality.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

3. PROPERTY TAX (CONTINUED)

No income is recognized from property taxes levied, but not collected because the Municipality is not able to determine the amount of such receivable or if the same is collectible within the 60 days period after the balance sheet date as required by the generally accepted accounting principles applicable to governmental entities. The records of such receivable are kept and maintained by the CRIM.

Prior to 1994, the Department of the Treasury was the agency responsible for the assessment of real property and for the administration and collection of the related taxes. Amounts advanced by the Secretary of the Treasury to the Municipality of Aguas Buenas, that had not been amortized through the collections of property taxes amounted to \$70,020 as of June 30, 2005.

On January 26, 2000, Public Law 42, as amended, was enacted which authorized the CRIM to obtain a loan up to \$200 million, and for a term not exceeding 30 years, to allow for the financing of the debt that the municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year 2000-2001. The amount that the municipalities will collect from the additional property taxes resulting from the increase in the subsidy from the central government to the municipalities was assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. As of June 30, 2005, the amount due to CRIM amounting to \$94,598 is presented as other long-term debt (see Note 9).

4. VOLUME OF BUSINESS TAX

The municipal license tax is levied annually based on the volume of business of certain businesses and industrial organizations that operate in the Municipality. The tax rates are 1.50% for financing institutions and .50% for the other business institutions. The taxpayers must file a return not later than April 15 of every year and the tax is payable in two installments, due in July 1 and January 1 of the following fiscal year. The amount levied could be paid with a five percent (5%) discount if payment is made on or before the filing date. The Municipality levied and collected during the year ended June 30, 2005, \$363,534 corresponding to the following fiscal year volume of business tax. This amount was recorded as deferred revenue, and is presented as a liability in the accompanying financial statements.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

5. GRANTS AND ENTITLEMENTS REVENUE

Grants and entitlements revenue consists of contributions received from certain quasi-public corporations of the Commonwealth of Puerto Rico, such as the Puerto Rico Aqueduct and Sewer Authority and the Puerto Rico Electric Power Authority. Also, the Municipality receives some subsidies from the Commonwealth of Puerto Rico which include, among others, a subsidy for general operations and for the financing of capital improvements. The intergovernmental revenues are recorded in the General fund, except for those that are legally restricted for expenditure for specified purposes which are recorded in other governmental funds.

6. DEFERRED REVENUE

Municipal Tax

The deferred revenue related to the municipal license tax represents tax collected in the fiscal year 2004-2005 corresponding to the following fiscal year.

Federal Government

The deferred revenue presented in other governmental funds is the portion grants received for which qualifying expenditures have not been incurred.

7. RESTRICTED DEPOSIT

Restricted cash in the business-type activities consists of:

Tenant security deposits	\$ 9,021
Reserve for replacement	<u>103,428</u>
	<u>\$112,449</u>

Under the regulatory agreement, Project is required to set aside amounts for the replacement of property and other Project expenditures approved by HUD. HUD – Restricted Deposits, are held in separate accounts and generally are not available for operating purposes.

Tenant's Security Deposit and its accumulated interest are held in a separate bank savings account in the name of the Project, in compliance with USDA-RD and HUD requirements. Any amounts not returned to the tenant due to lease violations are transferred to the Project's general operating account.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

8. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005 was as follows:

Primary Government	Balance June 30, 2004	Increases	Decreases	Balance June 30, 2005
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 2,062,577	_____	_____	\$ 2,062,577
Capital assets being depreciated:				
Infrastructure	508,617			508,617
Buildings, park and courts	17,964,113			17,964,113
Machinery and equipment	1,531,944	\$185,014		1,716,958
Automobiles	<u>1,950,804</u>	<u>17,000</u>	_____	<u>1,967,804</u>
Total capital assets being depreciated	<u>21,955,478</u>	<u>202,014</u>	_____	<u>22,157,492</u>
Less accumulated depreciation for:				
Infrastructure		10,172		10,172
Buildings, parks and courts	6,119,387	416,188		6,535,575
Machinery and equipment	767,992	155,514		923,506
Vehicles	<u>1,343,090</u>	<u>133,343</u>	_____	<u>1,476,433</u>
Total	<u>8,230,469</u>	<u>715,217</u>	_____	<u>8,945,686</u>
Total depreciable capital assets, net	<u>13,725,009</u>	<u>(513,203)</u>	_____	<u>13,211,806</u>
Governmental activities capital assets net	<u>\$15,787,586</u>	<u>\$(513,203)</u>	_____	<u>\$15,274,383</u>
Business-type activities:				
Capital assets net being depreciated:				
Land	\$ 50,700	_____	_____	\$ 50,700
Capital assets being depreciated:				
Building and improvements	1,957,060			1,957,060
Equipment	77,556	\$ 4,099		81,655
	<u>2,034,616</u>	<u>4,099</u>	_____	<u>2,038,715</u>
Less accumulated depreciation:				
Building and improvements and equipment	<u>1,308,476</u>	<u>59,645</u>	_____	<u>1,368,121</u>
Total depreciation, capital, assets net	<u>726,140</u>	<u>(55,546)</u>	_____	<u>670,595</u>
Business activities capital assets, net	<u>\$ 776,840</u>	<u>\$(55,546)</u>	_____	<u>\$ 721,294</u>

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

8. CAPITAL ASSETS (CONTINUED)

Depreciation expense was charged to functions/programs of the Municipality as follows:

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>
General administration	\$130,671	
Public safety	9,094	
Public works	485,274	
Education, culture and recreation	85,001	
Health, sanitation and welfare	5,177	
Housing	<u> </u>	<u>\$59,645</u>
Total depreciation expense	<u>\$715,217</u>	<u>\$59,645</u>

9. LONG-TERM DEBTS

Long-term liability activity for the year ended June 30, 2005 was as follows:

Primary Government Governmental activities:	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due within one year</u>
Total bonds and notes	<u>\$3,926,000</u>		<u>\$430,000</u>	<u>\$3,492,000</u>	<u>\$292,000</u>
Other long-term debt:					
Compensated absences	985,796		159,106	826,690	410,038
Amount due to CRIM	572,732		408,114	164,618	17,206
Landfill	1,360,000			1,360,000	
Puerto Rico Health Insurance	<u>502,529</u>			<u>502,529</u>	
	<u>3,421,057</u>		<u>567,220</u>	<u>2,853,837</u>	<u>427,244</u>
Total	<u>7,347,057</u>		<u>1,001,220</u>	<u>6,345,837</u>	<u>719,244</u>
Business-type activities:					
Mortgage payable	<u>729,613</u>		<u>27,808</u>	<u>701,805</u>	<u>30,116</u>
Total	<u>\$8,076,670</u>		<u>\$1,029,028</u>	<u>\$7,047,642</u>	<u>\$749,360</u>

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

9. LONG-TERM DEBTS (CONTINUED)

Governmental activities:

Bonds and notes:

\$920,000 public improvement serial bond of 1995 payable in annual installments of \$25,000 to \$85,000 through July 1, 2020 plus interest at 5.925%.	\$ 770,000
\$600,000 public improvement serial bonds of 1990 payable in annual installments ranging from \$28,000 to \$48,000 through January 1, 2015, plus interest at 6%.	366,000
\$400,000 bond anticipation note payable in annual installments ranging from \$19,000 to \$34,000 through January 1, 2016, plus interest at 5.62%.	281,000
\$255,000 General Obligation Note, Serial 1998-99 payable in an annual installment from \$45,000 through July 1, 2005, plus interest at 7%.	45,000
Notes:	
\$570,000 General Obligation Note Serial 2001-2002 payable in annual installment ranging from \$120,000 to \$135,000 through July 1, 2006, plus interest at 7.89%.	255,000
\$430,000 General Obligation Note Serial 2003-04 payable in annual installments ranging from \$55,000 to \$75,000 through July 1, 2010, plus interest at 6.5%	380,000
\$1,510,000 General Obligation Bond Serial 2003-04 payable in annual installments ranging from \$115,000 to \$195,000 through July 1, 2014 plus interest at 5%.	<u>1,395,000</u>
	<u><u>\$3,492,000</u></u>

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

9. LONG-TERM DEBTS (CONTINUED)

The annual debt service requirements to maturity bonds and notes payables of June 30, 2005 are as follows:

	<u>Governmental –type Activities</u>	
<u>Year ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 292,000	\$ 146,482
2007	384,000	170,460
2008	272,000	153,533
2009	286,000	137,854
2010	308,000	121,120
2011-2015	1,506,000	359,265
2016-2020	359,000	87,134
2021	<u>85,000</u>	<u>2,818</u>
	<u>\$3,492,000</u>	<u>\$1,178,666</u>

Business-type activities:

Mortgage note payable in monthly installments of \$6,566 including interest at 8% through 2018 . The note is collateralized by land and building.

\$1,626,452

Mortgage note payable matures as follows:

	<u>Principal</u>	<u>Interest</u>
2006	\$ 30,116	\$ 48,676
2007	32,616	46,176
2008	35,323	43,469
2009	38,255	40,537
2010	41,430	37,362
2011-2015	264,805	129,155
2016-2019	<u>259,260</u>	<u>55,908</u>
	<u>\$701,805</u>	<u>\$401,283</u>

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

9. LONG-TERM DEBTS (CONTINUED)

Advances from CRIM and PR Treasury Department

These amounts represent the balance owed to CRIM and PR Treasury Department at June 30, 2005 as described in Note 3 and is payable in an aggregate monthly installment of \$24,080 through 2009 and \$7,276 thereafter including interest at 6.2%. The advances from CRIM and PR Treasury Department mature as follows:

<u>Year ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 17,206	\$ 5,893
2007	18,275	5,806
2008	18,367	5,714
2009	18,465	5,616
2010	4,565	5,511
2011-2015	10,632	25,747
2016-2020	14,419	21,960
2021-2025	19,554	16,824
2026-2030	26,520	9,859
2031-2032	<u>16,615</u>	<u>1,573</u>
	<u>\$164,618</u>	<u>\$104,503</u>

Health Reform Insurance Liability

The amount due to Puerto Rico Health Insurance Administration is related with an unpaid balance from year ended at June 30, 1997 accordingly with the implementation of Act No. 72 of September 7, 1993, which establishes contributions for the medical services covered by the Health Reform based on the operational budget of the municipalities. The unpaid balance will be amortized through the proportional participation of the municipalities to the annual increase in electronic lottery income which will be collected and withheld by the Treasury Department of Puerto Rico.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

10. RETIREMENT SYSTEM

Defined Benefit Pension Plan

The Employees' Retirement System of the Commonwealth and its instrumentalities (the "Retirement System"), created pursuant to Act. No. 447 of May 15, 1951, as amended, is a cost-sharing multiple employer defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth. All regular employees of the Municipality hired before January 1, 2000 and under 55 years of age at the date of employment became members of the Retirement System as a condition to their employment. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation. Disability benefits are available to members for occupational and non-occupational disabilities. However, a member must have at least ten years of service to receive non-occupational disability benefits.

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined, otherwise they will receive 75 percent of the average compensation, as defined.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

10. RETIREMENT SYSTEM (CONTINUED)

Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447 to establish, among others, a defined contribution savings plan program (the "Program") to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000 and former employees who participated in the defined benefit pension plan and are rehired on or after January 1, 2000 become members of a Program as a condition to their employment received a refund of their contributions. In addition, employees who at December 31, 1999 were participants of the defined pension plan, had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interests thereon to the Program.

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to his/her individual account established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant's account semi-annually.

The Municipality is required by Act No. 305 to contribute 9.275% of the participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan.

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant's spouse in case of the participant's death. Participants with a balance of \$10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in the participant's account will be paid in a lump-sum to his/her beneficiaries. Participants have the option of a lump-sum or purchasing an annuity contract in case of permanent disability.

Total employees and employer contributions to the above mentioned plans during the year ended June 30, 2004 amounted to approximately \$156,071 and \$181,538, respectively. This amount represented 100% of the required contribution for the corresponding year.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2005, a copy of which can be obtained from the Retirement System.

MUNICIPALITY OF AGUAS BUENAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2005

11. CONTINGENCIES

Amounts received or receivable from grantor agencies are subject to audit and adjustment by grantor agencies. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of the expenditures which may be disallowed by the grantor cannot be determined at this time, although the Municipality expects such amounts, if any, to be immaterial.

The Municipality is defendant and /or codefendant in several litigations arising out of the normal Municipality's operations. Most of the cases are covered by insurance. Management, after consultation with legal counsel is of the opinion that the ultimate liability, in excess of insurance coverage, if any, resulting from such pending litigations will not have a material adverse effect on the Municipality's financial position .

12. RESTATEMENT OF FUND BALANCE

The funds balance a prior reported has been restated to correct certain errors:

	<u>Debt Service Fund</u>	<u>Statement of Net Assets</u>
As prior reported	\$211,067	\$11,667,529
Restatement:		
Overstatements of liabilities	<u>320,249</u>	<u>718,367</u>
	<u>\$531,316</u>	<u>\$12,385,896</u>

13. MUNICIPAL LANDFILL

State and federal laws and regulations requires to the Municipality to carry out certain closure work when it stops accepting waste and to perform certain maintenance and monitoring functions at site in the following years. In accordance with GASB No. 18 "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs" the Municipality must has to perform a study of the closing and post closing costs in order to recognize a provision for those costs.

The Municipality operated a solid waste landfill that was closed during 1994. Total closure costs incurred as of June 30, 2005 were approximately \$1,300,000. The closure costs incurred were mostly provided by federal awards under the State Block Grant Program.

The Municipality is still in process of performing tests in the landfill site in order to assess a final settlement of closure and post-closure costs. A preliminary estimate of these costs as of June 30, 2005 amounted to \$1,360,000. Accordingly, a provision for future closure and post closed costs was recognized in the accompanying financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF BUDGETARY COMPARISSON
FOR THE YEAR ENDED JUNE 30, 2005**

	GENERAL FUND			
	ORIGINAL BUDGET	AMMENDED BUDGET	ACTUAL	VARIANCE WITH FINAL BUDGET FAVORABLE (UNFAVORABLE)
Revenues:				
Taxes:				
Property taxes	\$1,895,937	\$1,598,051	\$1,549,200	\$(48,851)
Municipal tax	410,797	410,797	474,078	63,281
Grants and entitlements	4,672,647	4,708,911	4,706,436	(2,475)
Surplus from prior years		611,501	611,501	
Other	<u>715,500</u>	<u>759,161</u>	<u>674,599</u>	<u>(84,562)</u>
Total revenues	<u>7,694,881</u>	<u>8,088,421</u>	<u>8,015,814</u>	<u>(72,607)</u>
Expenditures:				
General administration	3,807,173	3,922,179	4,121,314	(199,135)
Public safety	379,632	362,177	362,177	
Education, culture and Recreational	167,460	181,607	213,961	(32,354)
Public works and sanitation	2,697,763	2,985,998	3,238,282	(252,284)
Health and welfare	692,853	636,460	636,460	
Debt service	<u> </u>	<u> </u>	<u>209,375</u>	<u>(209,375)</u>
Total expenditures	<u>7,694,881</u>	<u>8,088,421</u>	<u>8,781,569</u>	<u>(693,148)</u>
Excess of revenue over expenditure	<u>\$ </u>	<u>\$ </u>	<u>\$ (765,755)</u>	<u>\$(765,755)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
NOTES TO SCHEDULE OF BUDGETARY COMPARISSON
JUNE 30, 2005

1. BUDGETS AND BUDGETARY ACCOUNTING

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

- 1) Formal budgetary integration is employed as a management control device during the year for the General Fund. Formal budgetary integration is not employed for special revenue funds because effective budgetary control is alternatively achieved through legal and contractual grant requirements provisions.
- 2) On or before May 15, the Mayor submits to the Municipal Legislative Body a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means for financing them.
- 3) Public hearing are conducted at the Municipal Legislative Room to obtain citizens comments.
- 4) Prior to June 13, the budget is legally enacted through passage of an ordinance.
- 5) The Municipal Legislative Body approves, by ordinance budget appropriations by functional basis. The Mayor is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total appropriations of any fund must be approved by the Municipal Legislative Body.
- 6) Unused appropriations for the annual budgeted funds lapse at the end of the year.

The budget is prepared on the budgetary basis of accounting. The actual results of operations, presented in the Statement of Revenues and Expenditures – Budget and Actual General Fund, is in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AGUAS BUENAS
NOTES TO SCHEDULE OF BUDGETARY COMPARISSON (CONTINUED)
JUNE 30, 2005**

2. RECONCILIATION OF GAAP TO BUDGETARY BASIS

Adjustments necessary to reconcile the revenues and expenditures of the General Fund at the end of the year, from the generally accepted accounting principles to budgetary basis, are as follows:

	<u>Revenues</u>	<u>Expenditures</u>
Generally accepted accounting principles (GAAP) basis	\$7,398,909	\$8,572,194
Surplus from prior years recorded as revenue for budgetary basis	611,501	
Transfer out included as expenditures in budgetary basis		209,375
Transfer in included as revenues in budgetary basis	<u>5,404</u>	<u> </u>
Budgetary basis	<u>\$8,015,814</u>	<u>\$8,781,569</u>

MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2005**

	<u>NUMBER</u>	<u>DISBURSEMENT</u>
<u>US Department of Housing and Urban Development</u>		
Passed through:		
Municipal Service Administration:		
Community Development Block Grant	14.228	\$1,405,403
Direct Program:		
Section 8- Housing Choice Vouchers	14.871	1,345,735
<u>US Department of Agriculture</u>		
Passed through:		
PR Department of Education:		
Child and Adult Food Program	10.558	25,087
<u>US Department of Health and Human Services</u>		
Passes through:		
PR Department of Family:		
Child Care and Development Block Grant	93.575	642,337
<u>US Department of Home and Security</u>		
Passes through:		
PR Office of Management and Budget (GAR)		
Public Assistance Grant	97.036	523,004
<u>US Department of Justice</u>		
Pass through:		
Puerto Rico Department of Justice		
Police CORPS	16.712	<u>59,294</u>
		<u>\$4,000,860</u>

MUNICIPALITY OF AGUAS BUENAS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2005

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Municipality of Aguas Buenas and is prepared on the modified accrual basis of accounting. Accordingly, amounts presented in the accompanying schedule agree to amounts present in the basic financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- a. The accompanying Schedule of Expenditure of Federal Awards is prepared from Municipality's accounting records and is not intended to present financial position or the results of operations.
- b. The financial transactions are recorded by the Municipality in accordance with the terms and conditions of the grants, which are consistent with generally accepted accounting principles.
- c. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

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

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

**To the Honorable Mayor and
Municipal Council
Municipality of Aguas Buenas
Aguas Buenas, Puerto Rico**

I have audited the financial statements of governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the **Municipality of Aguas Buenas, Puerto Rico**, as of and for the year ended June 30, 2005 which collectively comprise the Municipality of Aguas Buenas's basic financial statements and have issued my report there on dated October 26, 2005. I conducted my 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 my audit, I considered the Municipality of Aguas Buenas's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing my opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. 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 statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over financial reporting and its operation that I consider to be material weaknesses.

Compliance and other matters

As part of obtaining reasonable assurance about whether the Municipality of Aguas Buenas's financial statements are free of material misstatement, I performed test of its compliance with certain provisions of laws, regulations, contracts and grants 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 my audit, and accordingly, I do not express such an opinion. The results of my test disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standard.

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL (CONTINUED):

This report is intended solely for the information and use of the management and the Municipal Legislative Body of Municipality of Aguas Buenas, federal awarding agencies and passed through-entities and is not intended to be and should not be used by anyone other than these specified parties.



October 26, 2005
Aguas Buenas, Puerto Rico

License No. 1339
Expires December 1, 2007

The stamp No. **2112401** of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

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

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

**To the Honorable Mayor and
Municipal Council
Municipality of Aguas Buenas
Aguas Buenas, Puerto Rico**

Compliance

I have audited the compliance of the **Municipality of Aguas Buenas, Puerto Rico**, 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 June 30, 2005. Municipality of Aguas Buenas, Puerto Rico's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of finding and questioned costs. Compliance with the requirement of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality of Aguas Buenas, Puerto Rico's management. My responsibility is to express an opinion on the Municipality of Aguas Buenas, Puerto Rico's compliance based on my audit. Municipality of Aguas Buenas's basic financial statements include the operations of the Espiritu Santo Project (business type activities), which expensed \$933,923 in federal awards which is not included in the schedule during the year ended June 30, 2005. My audit described below did not include the operation of the business type activities because those statements were audited by other auditors.

I conducted my 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 State and Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that I plan and perform the audit to obtain reasonable assurance about whether non-compliance 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 Municipality of Aguas Buenas, Puerto Rico's compliance with those requirements and performing such other procedures as we considered necessary in the circumstance. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination on Municipality of Aguas Buenas, Puerto Rico's compliance with those requirements.

REPORT ON COMPLIANCE WITH REQUIREMENT APPLICABLE (CONTINUED):

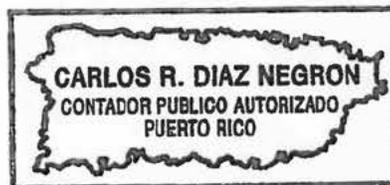
In my opinion, Municipality of Aguas Buenas, Puerto Rico, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal program for the yearended June 30, 2005. However, the results of my auditing procedures disclosed instances of noncompliance with those requirements which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 01-05 to 04-05.

Internal Control Over Compliance

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

My 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 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 noncompliance with 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. I noted no matters involving the internal control over compliance and its operation that I consider to be material weaknesses.

This report is intended solely for the information and use of the management and the Municipal Legislative Body of the Municipality of Aguas Buenas, 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.



October 26, 2005,
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2007

The stamp No. 2112402 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2005

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION I. - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued **Unqualified**

Internal control over financial reporting:

- Material weakness(es) identified? ___yes no
- Reportable condition(s) identified that are not considered to be material weaknesses? ___yes no

Noncompliance material to financial statement noted? ___yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ___yes no
- Report condition(s) identified that are not considered to be material weakness(es) ___yes no

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 I _ yes no

Identification of major programs:

CFA Number(s)

14.871
14.228
97.036
93.575

Name of Federal Program

Section 8 – Housing Choice Voucher
State Block Grant Program
Disaster Assistance
Child Care and Development Block Grant

Dollar threshold used to distinguish between type A And type B programs: \$300,000

Audit qualified as low-risk audited? _ yes no

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION II. – FINANCIAL STATEMENTS FINDING

NONE

MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

Finding No. 01-05 – Eligibility Procedures

Federal program

CFDA - No. 14.871 – Section 8 Housing Choice Voucher

Category:

Compliance/Internal Control

Compliance requirement:

Special tests and provisions

Condition found:

In testing compliance and internal control over eligibility, I selected 25 participants to examine their file. However, I noted that the Municipality pays to the owner the total rent amount in the Family Self Sufficiency Program (FSS) including when the participant has to pay part of the rent to owner. Later, the Municipality billed to the participant. In some cases, the participant did not pay this amount to the Municipality. This procedure is not in accordance with the regulations of the program because it is the responsibility of the participant to pay to the owner the amount of rent applicable.

Criteria:

The Housing Choice Voucher Program Guide Book, Chapter 23: Family Self Sufficiency (FSS) establish that: “the FSS Program provides for the establishment of an escrow account. The full amount of the escrow account in excess of any amount owed to the PHA becomes available to the family when it has fulfilled its obligations under the contract of participation and has certified that no family member is receiving welfare assistance. The amount of the escrow credit is based on increases in the family’s total tenant payment resulting from increases in family’s earned income during the term of FSS contract. As a family’s income increases the PHA calculates rent and the family pays increased rent, as does any other subsidized tenant. The PHA then makes deposit to an escrow account in the appropriate amount based on two formulas, one for very low-income families and one for low-income families.”

CFR 24 part 982.515 establish that PHA may not use housing assistance payments or other program funds (including any administrative reserve) to pay any part of the family share including the family rent to owner. Payment of the whole family share is the responsibility of the families.

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 01-05 – Eligibility Procedures

Effect:

Since these procedures are not in accordance with Federal Regulations of the program these amount would be questioned.

Questioned costs:

Undetermined

Recommendation:

I recommend the Municipality to modify the policies established to the tenants rent payments in accordance to the program requirements.

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 02-05 – Supporting Evidence of Disbursements and Cancelled Checks

Federal program

CFDA – No. 14.228 – Community Development Block Grants/State’s Program

Category:

Compliance / Internal Control

Compliance requirement:

Allowable cost/ cost principles

Condition found:

In testing compliance and internal control over allowable cost /cost principle requirement, I select 15 disbursements amounting to \$98,047 of the total disbursement of \$1,405,402 of the Community Development Block Grant (CDBG). However, the following payments vouchers were not available for examination:

CFDA – No. 14.228 – Community Development Block Grants/State’s Program

<u>Check No.</u>	<u>Date</u>	<u>Amount</u>
1136	12/17/04	\$14,799.12
1154	2/1/05	33,083.57
1170	3/30/05	14,931.49
1175	3/30/05	<u>14,628.50</u>
		<u>\$77,441.68</u>

In addition, the following cancelled checks were not available for examination:

1136	12/17/04	\$14,799.12
1171	3/30/05	<u>46,947.60</u>
		<u>\$61,746.72</u>

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 02-05 – Supporting Evidence of Disbursements and Cancelled Checks (Continued)

Criteria:

Federal regulations required that expenditures be supported by appropriate documentation such as purchase orders, receiving reports, vendors' invoice and canceled checks, and should be correctly change as to account, amount and period.

Effect:

Since no supporting document was available for examination, the Municipality could be required to reimburse federal funds to grantor.

Questioned cost:

\$124,389.28

Recommendation:

I recommend the Municipality to establish adequate procedures and controls, which should consider among other, the following:

- Maintain adequate documentation to support the allowabilty of its expenditure. The Municipality shall improve its internal control over the filing and safeguarding of documents in order to easily identify payments voucher and all related documentation.

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 03-05 – Eligibility Test – Section 8

Federal program

CFDA No. 14.871 – Housing Choice Voucher

Compliance requirement:

Eligibility

Category:

Compliance

Condition:

As part of my audit procedures I select 25 participants file to test the eligibility and special test and provision requirements of the Housing Choice Voucher Program and the following exceptions were noted:

	<u>Exceptions</u>
An annual verification of valuable assets is not required to the participant.	22
No documentation of the latest inspection was found.	1
A file was not found	1
Notification to correct deficiencies was send, but the evidence of corrections were found.	2

MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 03-05 – Eligibility Test – Section 8 (Continued)

Criteria:

24 CFR Section 982.516 established that PHA must; for both family income examinations, obtain and document in the family file third party verification of: (1) reported family annual income, (2) the value of assets, (3) expenses related to deductions from annual income and (4) others factors that affect the determination of adjusted income or income based rent.

24 CFR Section 982.158 (d) and 982.404 establish that for the units under HAP contract that fail to meet Housing Quality Standard (HQS), the PHA must require the owner to correct any life threatening HQS deficiencies within 24 hours after the inspections and all other HQS deficiencies within 30 calendar days or within a specified PHA-approved extension. If the owner does not correct the cited HQS deficiencies within the specified correction period, the PHA must stop (abate) HAPs beginning no later than the first of the month following the specified correction period or must terminate the HAP contract. The owner is not responsible for a breach of HQS as a result of the family's failure to pay for utilities for which the family is responsible under the lease or for tenant damage. For family-caused defects, if the family does not correct the cited HQS deficiencies within the specified correction period, the PHA must take prompt and vigorous action to enforce the family obligation.

24 CFR Section 982.158 (d) and 982.405 (c) require that the PHA must inspect the unit leased to a family at least annually to determine if the unit meets Housing Quality Standards (HQS) and the PHA must conduct quality control re-inspections. The PHA must prepare a unit inspection report.

Effect:

The continue occurrence of the condition may result in the disallowance of program cost. In addition, the ability to manage federal awards in compliance with laws, regulations and provision of contracts grant awards could also questioned.

Questioned costs:

None

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 03-05 – Eligibility Test – Section 8 (Continued)

Recommendation:

I recommend that the Municipality establish and adequate internal control system to ascertain that comply with the requirements of the program. The control system should include the following:

- a) The file should be reviewed by the internal audit department.
- b) The documentation requirements for the determinate of ability allowance and recommendable rent.

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 04-05 – Davis-Bacon Act

Federal Program

CFDA – 97.03 – Public Assistance Grant

Compliance requirement:

Davis-Bacon Act

Category:

Compliance

Condition:

As part of my audit procedures I select a contract to test the compliance with the Davis-Bacon Act for Public Assistance Grant. Disbursement tested for this contract to \$103,997.83 and noted that the Municipality did not obtain from contractor a copy of the payrolls and a statement of compliance.

Criteria:

The Davis-Bacon Act Requires that all construction contracts in excess of \$2,000 financial by federal assistance funds must be paid wages not less that those established for the locality of the project. In addition, the Act requires for the contractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance.

Effect:

The Municipality could be exposed to administrative action by the grantor.

Questioned cost:

None

**MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005**

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 04-05 – Davis-Bacon Act

Recommendation:

I recommend the Municipality established adequate procedures and controls which shall consider, among other, the following:

- Establish and implement within policies and procedures for all aspects of the program including controls for proper review and authorization during the processing and payments of program expenditures.
- Maintain adequate documentation to support the allowability of its expenditures.



STATEMENT OF PRIOR YEAR FINDINGS

Finding No. 04111-01 – Reportable condition over housing quality inspections.

We implemented procedures and news internal control to inspect and re inspect the units leased under the program at annually conforming HUD regulations. Also, we hired another inspector to correct deficiencies. The Department have two inspectors allow to re inspects cases when there are needs to correct deficiencies.

Finding No. 04-111-02 – Reportable condition over cash management.

The Director of Finance maintain cash forecasting for federal funds to minimize the tine lapsed between the date of transfer of funds and the disbursement dates.



CORRECTION ACTION PLAN

Finding No. 01-05 – Elegibility Procedures.

The Municipality coordinated reunion with OCAM personal to established the correct method to pays the FSS renter and provided training to implement. Also, the accounting, supportive, and executive personal shall be required to attend the training to correct the finding.

Finding No. 04-05 – Eligibility Test – Section 8.

The new quality-control checklist was implemented in order to make sure that all required documents are completed. Also, we hired another inspector to correct deficiencies. The Department have two inspectors allow to re inspects cases when there are needs to correct deficiencies.