

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE AGUAS BUENAS**

**AUDITORIA 2005-2006**

**30 DE JUNIO DE 2006**

OFICINA DEL COMISIONADO  
DE ASUNTOS MUNICIPALES

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**SINGLE AUDIT REPORTING PACKAGE**  
**FOR THE YEAR ENDED JUNE 30, 2006**

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
SINGLE AUDIT REPORTING PACKAGE  
FOR THE YEAR ENDED JUNE 30, 2006**

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**COMMONWEALTH OF PUERTO RICO**

**MUNICIPALITY OF AGUAS BUENAS**

**FINANCIAL STATEMENTS**

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

*Carlos R. Díaz Negrón*

Certified Public Accountant

MEMBER:

American Institute of Certified Public Accountants  
Puerto Rico Society of Certified Public Accountants

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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, 2006 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. 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, 2006, 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 November 29, 2006, 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 15 and 43 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.



November 29, 2006  
Aguas Buenas, Puerto Rico

License No. 1339  
Expire December 1, 2007

The stamp No. **2204028** of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

Management of the Municipality of Aguas Buenas of the Commonwealth of Puerto Rico (the Municipality) provides this *Management's Discussion and Analysis* (MD&A) for the readers of the Municipality's basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2006. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

## **FINANCIAL HIGHLIGHTS**

### ***Government-Wide Highlights***

- ***Assets*** – The Municipality has reported assets amounting to \$23.2 million for the governmental activities in the accompanying statement of net assets, of which the most significant are capital assets, cash and cash equivalents, and property taxes receivable amounting to \$14.9 millions, \$6.5 millions, and \$1.2 millions, respectively.
- ***Liabilities*** – The Municipality has reported liabilities amounting to \$10.8 million in the accompanying statement of net assets, of which the most significant are bonds and notes payable, unearned revenues, accounts payable, accrued compensated absences and accrued landfill post closure costs amounting to \$5.4 millions, \$1.2 millions, \$0.8 millions \$0.9 millions and \$1.4 millions respectively.
- ***Net assets*** – The assets of the Municipality exceeded its liabilities by \$12.4 millions at June 30, 2006, which is presented as “net assets” in the accompanying statement of net assets. Restricted net assets and unrestricted deficit amounted to \$5.1 millions and \$(3.6) millions, respectively. Net assets invested in capital assets amounted to \$11.0 millions.
- ***Net change in net assets*** – The Municipality's net assets increased by \$0.7 millions during fiscal year ended June 30, 2006. Net assets at June 30, 2006 amounted to \$12.4 millions. The increase in net assets represents a positive result of operations in the Municipality's overall financial position in comparison with the prior fiscal year.
- ***Revenues*** – The Municipality has reported total revenues amounting to \$13.1 millions in the accompanying statement of activities, of which the most significant are intergovernmental grants and contributions, and taxes amounting to \$5.9 millions, and \$2.6 millions, respectively.
- ***Expenses*** – The Municipality has reported total expenses amounting to \$13.2 millions in the accompanying statement of activities.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

***Governmental Funds' Highlights:***

- ***Assets*** – The Municipality's governmental funds have reported combined assets amounting to \$8.8 millions in the accompanying balance sheet – governmental funds, of which the most significant are cash, taxes receivable, due from other funds and grants and due from agencies amounting to \$6.5 millions, \$1.2 millions, \$0.5 millions and \$0.6 millions respectively.
- ***Liabilities*** – The Municipality's governmental funds have reported combined liabilities amounting to \$4.0 millions in the accompanying balance sheet – governmental funds, of which the most significant are deferred revenues, due to other funds and agencies and accounts payable and accrued liabilities amounting to \$2.4 millions, \$1.0 millions and \$0.7 millions respectively.
- ***Governmental fund balances*** – The Municipality's governmental funds reported combined fund balances amounting to \$4.7 millions, of which \$4.9 millions and \$(0.1) millions represent reserved and unreserved fund balances, respectively.
- ***Net change in governmental fund balances*** – The Municipality's governmental fund balances increased by \$2.3 millions during fiscal year ended June 30, 2006. Governmental fund balances at June 30, 2006 amounted to \$4.7 millions. The increase in net assets represents the excess of revenues and other financing sources over expenditures and other financing uses.
- ***Revenues*** – The Municipality's governmental funds have reported combined revenues amounting to \$13.1 millions in the accompanying statement of revenues, expenditures and changes in fund balances governmental funds, of which the most significant are intergovernmental grants and contributions, property taxes and municipal license taxes amounting to \$9.4 millions, \$2.0 millions and \$0.6 millions, respectively.
- ***Expenditures*** – The Municipality's governmental funds have reported combined expenditures amounting to \$13.2 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are categorized as public works, general administration, health sanitation and welfare, education and recreational and public safety amounting to \$5.0 millions, \$4.2 millions, \$2.0 millions, \$0.8 millions, and \$0.6 millions respectively.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

## **USING THIS ANNUAL REPORT**

This annual report consists of a series of new financial statements with a change in the focus from the previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

## **OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The Municipality's financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary information (budgetary schedules) and other supplementary information (combining financial statements) in addition to the basic financial statements themselves. These components are described below:

## **GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2006 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

### **Statement of Net Assets**

The statement of net *assets* presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

**Statement of Activities**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2006. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

**Fund Financial Statements**

The Municipality's fund financial statements consist of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (June 30, 2006). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has four major funds: (1) the general fund, (2) debt service fund, (3) the \$2,285,000 bond fund, and (4) section 8 fund.

**Notes to the Basic Financial Statements**

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the basic financial statements.

**Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

**INFRASTRUCTURE ASSETS**

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

As of July 1, 2003, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$12.4 millions at June 30, 2006, compared to \$11.7 millions at the end of the previous year.

The largest portion of the Municipality's net assets is invested in capital assets net of their related debt (\$10.9 millions). The Municipality's net assets is also composed of net assets amounting to \$5.0 millions that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net assets are reported net of an unrestricted deficit of \$3.6 millions.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets, are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

**CONDENSED STATEMENT OF NET ASSETS**

	<b>2006</b>	<b>2005 as restated</b>	<b>Change</b>	<b>%</b>
<b>ASSETS</b>				
Current and other assets	\$8,318,997	\$ 6,174,669	\$2,144,328	35%
Capital assets, net	14,904,972	15,274,383	(369,411)	-2%
<i>Total assets</i>	<u>\$23,223,969</u>	<u>\$21,449,052</u>	<u>\$1,774,917</u>	<u>8%</u>
<b>LIABILITIES AND NET ASSETS</b>				
Current and other liabilities	2,476,237	2,577,629	101,392	4%
Long-term debt liabilities	8,310,679	6,345,837	1,964,842	31%
<i>Total liabilities</i>	<u>10,786,916</u>	<u>8,923,466</u>	<u>1,863,450</u>	<u>21%</u>
<b>Net assets</b>				
Invested in capital assets, net of related debt	10,969,127	11,667,384	(698,257)	-6%
Restricted	5,076,972	3,005,905	2,071,067	69%
Unrestricted	(3,609,046)	(2,147,703)	(1,461,343)	49%
<b>TOTAL NET ASSETS</b>	<u>\$12,437,053</u>	<u>\$12,525,586</u>	<u>\$88,533</u>	<u>1%</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

**Changes in Net Assets**

The Municipality's net assets decreased by \$.08 millions. Approximately 20 percent of the Municipality's total revenues came from taxes, while 72 percent resulted from restricted and unrestricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for general government (32 percent), public works and sanitation (42 percent) and public housing and welfare (15 percent).

The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS:

**CONDENSED STATEMENT OF ACTIVITIES**

	2006	2005	Change	%
<b>Program Revenues</b>				
Operating Grants and Contributions	\$1,928,998	\$2,594,398	\$665,400	26%
Capital Grants and Contributions	1,562,077	2,263,633	701,556	31%
<b>General Revenues</b>				
Taxes				
Property taxes	2,018,386	1,941,577	(76,809)	-4%
Municipal taxes	614,842	508,948	(105,894)	-21%
Grants entitlements	5,942,697	6,135,805	193,108	3%
Other	1,078,943	675,686	(402,271)	-59%
<b>Total revenues</b>	<u>13,145,943</u>	<u>14,120,047</u>	<u>975,090</u>	<u>7%</u>
<b>Expenses</b>				
General administration	4,168,951	4,607,200	\$438,249	10%
Public safety	581,238	425,595	(155,643)	-37%
Education, culture and recreational	748,252	1,209,827	461,575	38%
Public works and sanitation	5,499,886	6,327,348	827,462	13%
Health and welfare	2,037,824	1,987,372	(50,452)	-3%
Interest	198,325	231,845	33,520	14%
Total general activities	<u>13,234,476</u>	<u>14,789,187</u>	<u>(2,789,474)</u>	<u>-19%</u>
Change in net assets	(88,533)	(669,140)	(579,621)	87%
Net assets at beginning	<u>12,525,586</u>	<u>13,194,726</u>	<u>(669,140)</u>	<u>-5%</u>
<b>Net assets at end</b>	<u>\$12,437,053</u>	<u>\$12,525,586</u>	<u>\$(88,533)</u>	<u>-7%</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Governmental Funds** - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable resources*. Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet of governmental funds:

**Condensed Balance Sheet-Governmental Funds  
As Of June 30, 2006 and 2005**

<b>ASSETS</b>	<b>2006</b>	<b>2005</b>	<b>Change</b>	<b>%</b>
Cash, and cash equivalents	\$3,162,899	\$2,687,292	475,607	18%
Cash with fiscal agents	3,384,324	1,193,432	2,190,892	184%
Accounts Receivable (Municipal license taxes)	26,672	26,671	(1)	0%
Due from other funds	462,457	981,698	(519,241)	-53%
Due from property taxes	1,189,486	-	1,189,486	100%
Due from agencies	555,616	1,094,910	(539,294)	-49%
	<u>\$8,781,454</u>	<u>\$5,984,003</u>	<u>\$2,797,451</u>	<u>-47%</u>
<b>LIABILITIES</b>				
Account payable and accrued expenses	\$688,927	\$1,178,223	\$(489,296)	-42%
Due to other agencies	503,015	433,926	69,089	-16%
Due to other funds	462,457	981,698	(519,241)	-53%
Deferred revenues municipal	436,037	363,534	72,503	20%
Deferred property taxes	1,172,364	-	1,172,364	100%
Deferred revenues federal financial assistance	781,953	511,721	270,132	53%
Other	-	32,628	(32,628)	-100%
	<u>4,044,753</u>	<u>3,501,730</u>	<u>542,923</u>	<u>16%</u>
<b>FUND EQUITY AND OTHER CREDITS</b>	<u>4,736,701</u>	<u>2,482,273</u>	<u>2,254,428</u>	<u>-91%</u>
	<u>\$8,781,454</u>	<u>\$5,984,003</u>	<u>\$2,797,451</u>	<u>-47%</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

The following is a condensed presentation of the Municipality's statement of revenues, expenditures and changes in fund balance of governmental funds:

**Condensed Statement of Revenues, Expenditures and Changes  
in Fund Balances-Governmental Funds  
Year ended June 30 2006 and 2005**

	<u>2006</u>	<u>2005</u>	<u>Change</u>	<u>%</u>
<b>Total Revenues</b>	\$13,145,943	\$14,085,179	(\$939,236)	-7%
<b>Total Expenditures</b>	13,176,515	\$14,875,153	(\$1,698,638)	-11%
<b>Excess of revenues over expenditures</b>	(\$30,572)	(789,974)	(759,402)	-96%
<b>Total Other financing sources(uses), net</b>	2,285,000	-	2,285,000	100%
<b>Excess of revenues and other financing Sources over expenditures and other Financing sources</b>	2,254,428	(789,974)	1,525,598	193%
<b>Fund balance, at beginning of fiscal year</b>	2,482,273	(3,272,247)	789,974	24%
<b>Fund balance, at end of fiscal year</b>	<u>\$ 4,736,701</u>	<u>\$2,482,273</u>	<u>\$2,254,428</u>	<u>91%</u>

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$24,497,924 at June 30, 2006. The related accumulated depreciation and amortization of capital assets amounted to \$9,592,952 at June 30, 2006. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$368,857 for the year ended June 30, 2006. Depreciation and amortization charges for the year totaled \$647,266.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entire for such purposes and cannot be used for any other purposes.

	2006	2005	Change	%
<b>CAPITAL ASSETS</b>				
Nondepreciable asset:				
Land	\$1,971,577	\$2,062,577	\$(91,000)	-4%
Depreciable assets:				
Infrastructure	508,617	508,617	-	0%
Buildings, parks and courts	18,033,040	17,964,113	68,927	0%
Machinery and equipment	1,949,950	1,716,956	232,994	14%
Automobiles	2,034,740	1,967,804	66,936	3%
Total capital assets	<u>24,497,924</u>	<u>24,220,069</u>	<u>277,857</u>	<u>1%</u>
Less accumulated depreciation:				
Infrastructure	30,517	10,172	20,345	200%
Buildings, parks and courts	6,908,189	6,535,575	372,614	6%
Machinery and equipment	1,067,476	923,506	143,970	16%
Automobiles	1,586,770	1,476,433	110,337	7%
	<u>9,592,952</u>	<u>8,945,686</u>	<u>647,266</u>	<u>7%</u>
Net capital assets	<u>\$14,904,972</u>	<u>\$15,274,383</u>	<u>\$(369,411)</u>	<u>-2%</u>

**Debt Administration**

The laws and regulations of the Commonwealth of Puerto Rico have established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable laws and regulations also require that in order for a municipality to be able to issue additional general obligation bonds and notes, such municipality must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in the Municipality's Redemption fund and the annual amounts collected with respect to municipality's Special Additional Tax (as defined below), as projected by the Government Development Bank for Puerto Rico, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FISCAL YEAR ENDED JUNE 30, 2006**

The Municipality is required under applicable laws and regulations to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax Levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

At year-end the Municipality had \$5,365,000 in general and special bonds and notes, an increase of 54% with respect to prior year. The main reason for this increase is that, during the current year, the Municipality issued a loan for the construction new sport facilities.

Long-term debt as of June 30, 2006 consist of:

General and special obligation bonds and notes	\$5,365,500
Composed absences	936,462
Landfill closure costs	1,360,000
Other	<u>1,320,906</u>
Total	<u>\$8,982,368</u>

**ECONOMIC FACTORS AND BUDGETS AND RATES**

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2005-2006 fiscal year. There were no significant changes between the budget for fiscal year 2004-2005 and the one for fiscal year 2005-2006. Actual revenues were less than budget by approximately 2% that is considered reasonable.

Expenditures were less than budgeted amount by approximately 6% due, among other reasons to a non-budgeted loan made to GBD. See Budgetary Comparison Schedule on page 39.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FISCAL YEAR ENDED JUNE 30, 2006**

**FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mr. José Emilio Carrasquillo, at (787) 732-2811

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
STATEMENT OF NET ASSETS  
AS OF JUNE 30, 2006**

**PRIMARY GOVERNMENT**

<b>ASSETS</b>	<b>GOVERNMENTAL ACTIVITIES</b>	<b>BUSINESS – TYPE ACTIVITIES</b>	<b>TOTAL</b>
Cash and cash equivalents	\$ 3,162,899	\$ 73,816	\$ 3,236,715
Cash with fiscal agent	3,384,324		3,384,324
Accounts receivable other agencies	555,616		555,616
Accounts receivable property tax	1,189,486		1,189,486
Other assets	26,672	36,344	63,016
Restricted cash		125,909	125,909
Capital assets, net	<u>14,904,972</u>	<u>671,757</u>	<u>15,576,729</u>
<b>Total Assets</b>	<b><u>\$23,223,969</u></b>	<b><u>\$907,826</u></b>	<b><u>\$24,131,795</u></b>
<b>LIABILITIES AND NET ASSETS</b>			
<b>Liabilities:</b>			
Accounts payable and accrued expenses	\$ 755,232	\$ 25,678	\$ 780,910
Deferred revenue	1,217,990		1,217,990
Due to other agencies	503,015		503,015
Long-term debt:			
Due within one year	317,799	32,616	350,415
Due in more than one year	<u>7,992,880</u>	<u>639,073</u>	<u>8,631,953</u>
<b>Total liabilities</b>	<b><u>10,786,916</u></b>	<b><u>697,367</u></b>	<b><u>11,484,283</u></b>
<b>Net Assets:</b>			
Invested in capital assets, net of related debt	10,969,127	68	10,969,195
Restricted for:			
Debt service	766,770		766,770
State and federal programs	4,310,202		4,310,202
Replacements and others		125,909	125,909
Unrestricted	<u>(3,609,046)</u>	<u>84,482</u>	<u>(3,524,564)</u>
<b>Total Net Assets</b>	<b><u>\$12,437,053</u></b>	<b><u>\$210,459</u></b>	<b><u>\$12,647,512</u></b>

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, 2006**

<u>FUNCTIONS AND PROGRAMS</u>	<u>EXPENSES</u>	<u>PROGRAM REVENUES</u>			<u>NET (EXPENSE)/ REVENUE</u>
		<u>CHARGE FOR SERVICES</u>	<u>OPERATING GRANTS AND CONTRIBUTIONS</u>	<u>CAPITAL GRANTS AND CONTRIBUTIONS</u>	
Governmental activities:					
General administration	\$ 4,168,951		\$ 167,068		\$(4,001,883)
Public safety	581,238		115,152		(466,086)
Education, culture and recreational	748,252		284,041		(464,211)
Public works and sanitation	5,499,886			\$1,562,077	(3,937,809)
Health and welfare	2,037,824		1,362,737		(675,087)
Interest	<u>198,325</u>				<u>(198,325)</u>
Total governmental activities	<u>13,234,476</u>		<u>1,928,998</u>	<u>1,562,077</u>	<u>(9,743,401)</u>
Business type-activities:					
Housing	<u>311,048</u>	<u>\$296,967</u>			<u>(14,081)</u>
Total	<u>\$13,545,524</u>	<u>\$296,967</u>	<u>\$1,928,998</u>	<u>\$1,562,077</u>	<u>\$(9,757,482)</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, 2006**

	<u>GOVERNMENTAL ACTIVITIES</u>	<u>BUSINESS-TYPE ACTIVITIES</u>	<u>TOTAL</u>
Net (expense)/revenue	<u>\$(9,743,401)</u>	<u>\$ (14,081)</u>	<u>\$ (9,757,482)</u>
General revenue:			
Taxes:			
Property taxes	2,018,386		2,018,386
Municipal tax	614,842		614,842
Grants and entitlements	5,942,697		5,942,697
Other	<u>1,078,943</u>		<u>1,078,943</u>
Total general revenues	<u>9,654,868</u>	_____	<u>9,654,868</u>
Changes in net assets	(88,533)	(14,081)	(102,614)
Net assets at beginning	<u>12,525,586</u>	<u>224,540</u>	<u>12,750,126</u>
Net assets at end	<u>\$12,437,053</u>	<u>\$210,459</u>	<u>\$12,647,512</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, 2006**

	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>SECTION 8</u>	<u>BOND \$2,285,000</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
<b>Cash:</b>						
Cash in bank	\$ 557.426		\$519.485		\$2,085.988	\$3,162.899
Cash with fiscal agent	68.003	\$556.378		\$2,275.665	484.278	3,384.324
<b>Receivables:</b>						
Governmental agencies	83.665				471.951	555.616
Property taxes	979.088	210.398				1,189.486
Other funds	462.457					462.457
Other	<u>26.672</u>					<u>26.672</u>
<b>Total assets</b>	<u>\$2,177,311</u>	<u>\$766,776</u>	<u>\$519,485</u>	<u>\$2,275,665</u>	<u>\$3,042,217</u>	<u>\$8,781,454</u>
<b>Liabilities:</b>						
Accounts payable and accrued expenses	\$ 406.172				\$282.755	\$ 688.927
Deferred income:						
Municipal license	436.037					436.037
Property tax	964.994	207.370				1,172.364
Federal financial assistance			509.485		272.468	781.953
Due to other fund			10,000		452.457	462.457
Due to other agency	<u>503.015</u>					<u>503.015</u>
<b>Total liabilities</b>	<u>2,310,218</u>	<u>207,370</u>	<u>519,485</u>		<u>1,007,680</u>	<u>4,044,753</u>
<b>Fund balance</b>						
Reserve for:						
Debt service		559.406				559.406
Designated capital projects				2,275,665	2,034.537	4,310.202
Unreserved	<u>(132.907)</u>					<u>(132.907)</u>
<b>Total fund balance</b>	<u>(132.907)</u>	<u>559,406</u>		<u>2,275,665</u>	<u>2,034,537</u>	<u>4,736,701</u>
<b>Total liabilities and fund balance</b>	<u>\$2,177,311</u>	<u>\$766,776</u>	<u>\$519,485</u>	<u>\$2,275,665</u>	<u>\$3,042,217</u>	<u>\$8,781,454</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, 2006**

Fund balances in governmental funds	\$4,736,701
<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.	14,904,972
Deferred property tax revenue in governmental funds financial statements whereas recorded as revenue in the governmental activities	1,172,364
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	(5,365,000)
Compensated absences	(936,462)
Estimated liability for landfill post closure cost	(1,360,000)
Accrued interest	(66,305)
Other long term debt	(649,217)
<i>Net assets of governmental activities</i>	<u>\$12,437,053</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, 2006**

	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>SECTION 8</u>	<u>BOND \$2,285,000</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
<b>Revenues:</b>						
Taxes:						
Property taxes	\$1,537,647	\$480,739				\$ 2,018,386
Municipal taxes	614,842					614,842
Grants and entitlements	5,278,131		\$1,362,737		\$2,792,904	9,433,772
Other	<u>1,065,431</u>	<u>13,512</u>	_____	_____	_____	<u>1,078,943</u>
Total Revenues	<u>8,496,051</u>	<u>494,251</u>	<u>1,362,737</u>	_____	<u>2,792,904</u>	<u>13,145,943</u>
<b>Expenditures:</b>						
General administration	3,383,473			9,335	773,170	4,165,978
Public safety	429,715				139,346	569,061
Education and recreational	436,171				345,386	781,557
Public works	3,225,450				1,779,570	5,005,020
Health sanitation and welfare	689,073		1,362,737		1,472	2,053,282
Debt service:						
Principal		412,000				412,000
Interest	_____	<u>189,617</u>	_____	_____	_____	<u>189,617</u>
Total expenditures	<u>8,163,882</u>	<u>601,617</u>	<u>1,362,737</u>	<u>9,335</u>	<u>3,038,944</u>	<u>13,176,515</u>
<b>Excess of revenue over expenditures</b>	<u>\$ 332,169</u>	<u>\$(107,366)</u>	<u>\$ _____</u>	<u>\$(9,335)</u>	<u>\$(246,040)</u>	<u>\$ (30,572)</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, 2006**

	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>SECTION 8</u>	<u>BOND \$2,285,000</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
<b>Excess of revenues over expenditures</b>	<u>\$332,169</u>	<u>\$(107,366)</u>		<u>\$ (9,335)</u>	<u>\$ (246,040)</u>	<u>\$ (30,572)</u>
<b>Other financing sources (uses):</b>						
Operating transfer in	11,903	198,016				209,919
Operating transfer out	(198,016)	(11,903)				(209,919)
Proceed form loan	_____	_____	_____	<u>2,285,000</u>		<u>2,285,000</u>
<b>Total other financing sources</b>	<u>(186,113)</u>	<u>186,113</u>	_____	<u>2,285,000</u>		<u>2,285,000</u>
<b>Excess of revenues and other financing source over expenditures and other financing sources</b>	146,056 ✓	78,747		2,275,665	(246,040)	<u>2,254,428</u>
<b>Fund balance at beginning of year</b>	<u>(278,963)</u>	<u>480,659</u>	_____	_____	<u>2,280,577</u>	<u>2,482,273</u>
<b>Fund balance at end of year</b>	<u>\$(132,907)</u> ✓	<u>\$ 559,406</u>	\$ _____	<u>\$2,275,665</u>	<u>\$2,034,537</u>	<u>\$4,736,701</u>

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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, 2006**

Net change in fund balances – total governmental funds	\$2,254,428
<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.	277,855
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.	412,000
Governmental funds report proceeds from long term debt as other financial source, where the proceeds are recorded as liability in the statement of net assets.	(2,285,000)
Change in accrued expenses which does not require the use of current financial resources:	
Interest	(8,708)
Compensating absences	(109,772)
Other long-term debts	17,930
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>(647,266)</u>
<b><i>Changes in Net Assets of Governmental Activities</i></b>	<b><u>\$ (88,533)</u></b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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 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:

**A) 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**B) 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.

**C) Section 8 Funds**

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.

**D) Bond \$2,285,000**

This fund accounts for the resources received and payment made under a general obligation bond to construction of capital improvement.

**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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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:

A) Debt/ service

Represents net assets available to finance future debt service payments.

B) 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, 2006 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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**

The personal property tax is self assessed by the taxpayer on a return, which is to be filed by May 15 of each year with the Municipal Revenue Collector Center (the CRIM), a governmental entity created by the Commonwealth of Puerto Rico. Real property tax is assessed by the CRIM on each piece of real state and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated value as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1.

The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Before the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, where by a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers.

This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a liability to the CRIM is recorded at June 30.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**3. PROPERTY TAX (CONTINUED)**

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempt amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$3,500 for which no payment is made. As part of Law No. 83 of August 30, 1991, as amended, the exempt amount to be paid by Puerto Rico Treasury Department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$50,000 of the assessed value to retailers having annual net sales of less than \$150,000.

The annual rate for fiscal year 2006 is 8.78% for real property and 6.78% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 6.0% and 4.0%, respectively, represent the Municipality's basic property tax rate, which is appropriated for general purposes and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.75% represents the special ad valorem tax restricted for debt service and accounted for in the debt service fund. The Commonwealth contributes an annual tax rate of 0.2% of the property tax collected and the remaining rate is imposed to the taxpayer.

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 \$53.215 as of June 30, 2006.

On January 26, 2000, Public Law, 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, 2006, the amount due to CRIM amounting to \$93,473 is presented as other long-term debt (see Note 9).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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, 2006, \$436,037 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.

**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 2005-2006 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**7. RESTRICTED DEPOSIT**

Restricted cash in the business-type activities consists of:

Tenant security deposits	\$ 9,089
Reserve for replacement	<u>116,820</u>
	<u>\$125,909</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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**8. CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2006 was as follows:

<b>Primary Government</b>	<b>Balance June 30, 2005</b>	<b>Increases</b>	<b>Decreases</b>	<b>Balance June 30, 2006</b>
<b>Governmental activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 2,062,577		\$91,000	\$ 1,971,577
Capital assets being depreciated:				
Infrastructure	508,617			508,617
Buildings, park and courts	17,964,113	\$ 68,927		18,033,040
Machinery and equipment	1,716,958	232,992		1,949,950
Automobiles	1,967,804	66,936		2,034,740
Total capital assets being depreciated	<u>22,157,492</u>	<u>368,855</u>		<u>22,526,347</u>
Less accumulated depreciation for:				
Infrastructure	10,172	20,345		30,517
Buildings, parks and courts	6,535,575	372,614		6,908,189
Machinery and equipment	923,506	143,970		1,067,476
Vehicles	1,476,433	110,337		1,586,770
Total	<u>8,945,686</u>	<u>647,266</u>		<u>9,592,952</u>
Total depreciable capital assets, net	<u>13,211,806</u>	<u>( 278,411)</u>		<u>12,933,395</u>
Governmental activities capital assets net	<u>\$15,274,383</u>	<u>\$(278,411)</u>	<u>\$91,000</u>	<u>\$14,904,972</u>
<b>Business-type activities:</b>				
Capital assets net being depreciated:				
Land	\$ 50,700			\$ 50,700
Capital assets being depreciated:				
Building and improvements	1,957,060			1,957,060
Equipment	81,655	10,136		91,791
	<u>2,038,715</u>	<u>10,136</u>		<u>2,048,851</u>
Less accumulated depreciation:				
Building and improvements and equipment	1,368,121	59,673		1,427,794
Total depreciation, capital, assets net	<u>670,594</u>	<u>(49,537)</u>		<u>621,057</u>
Business activities capital assets, net	<u>\$ 721,294</u>	<u>\$(49,537)</u>	<u>\$</u>	<u>\$ 671,757</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**8. CAPITAL ASSETS (CONTINUED)**

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

	<b>Governmental Activities</b>	<b>Business-Type Activities</b>
General administration	\$145,456	
Public safety	9,405	
Public works	388,435	
Education, culture and recreation	92,494	
Health, sanitation and welfare	11,476	
Housing	<u>          </u>	<u>\$59,673</u>
Total depreciation expense	<u>\$647,266</u>	<u>\$59,673</u>

**9. LONG-TERM DEBTS**

Long-term liability activity for the year ended June 30, 2006 was as follows:

<b>Primary Government Governmental activities:</b>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Due within one year</b>
Total bonds and notes	<u>\$3,492,000</u>	<u>\$2,285,000</u>	<u>\$412,000</u>	<u>\$5,365,000</u>	<u>\$299,000</u>
Other long-term debt:					
Compensated absences	826,690	109,772		936,462	
Amount due to CRIM	164,618		17,930	146,688	18,799
Landfill	1,360,000			1,360,000	
Puerto Rico Health Insurance	<u>502,529</u>			<u>502,529</u>	
	<u>2,853,837</u>	<u>109,772</u>	<u>17,930</u>	<u>2,945,679</u>	<u>18,799</u>
Total	<u>6,345,837</u>	<u>2,394,772</u>	<u>929,930</u>	<u>8,310,679</u>	<u>317,799</u>
<b>Business-type activities:</b>					
Mortgage payable	<u>701,805</u>		<u>30,116</u>	<u>671,689</u>	<u>32,616</u>
Total	<u>\$7,047,642</u>	<u>\$2,394,772</u>	<u>\$460,046</u>	<u>\$8,982,368</u>	<u>\$ 350,415</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2006**

**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%.	\$ 745,000
\$600,000 public improvement serial bonds of 1990 payable in annual installments ranging from \$29,000 to \$48,000 through January 1, 2015, plus interest at 6%.	338,000
\$400,000 bond anticipation note payable in annual installments ranging from \$20,000 to \$34,000 through January 1, 2016, plus interest at 5.62%.	262,000
\$2,285,000 general obligation bond, Serial 1998-99 payable in an annual installment from ranging from \$35,000 to \$175,000, through July 1, 2030, plus interest at 5.5%.	2,285,000
\$570,000 General Obligation Note Serial 2001-2002 due in July 1, 2006, plus interest at 7.89%.	135,000
\$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%	325,000
\$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>1,275,000</u>
	<u>\$5,365,000</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2006**

**9. LONG-TERM DEBTS (CONTINUED)**

The annual debt service requirements to maturity bonds and notes payables of June 30, 2006 are as follows:

	<u>Governmental –type Activities</u>	
<u>Year ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$299,000	\$277,260
2008	307,000	298,645
2009	331,000	280,366
2010	353,000	260,728
2011	372,000	239,791
2012-2016	1,578,000	970,643
2017-2021	780,000	572,193
2022-2026	570,000	349,375
2027-2031	<u>775,000</u>	<u>132,437</u>
	<u>\$5,365,000</u>	<u>\$3,381,438</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>
2007	\$32,616	46,176
2008	35,323	43,469
2009	38,255	40,537
2010	41,430	37,362
2011	44,869	33,423
2012-2016	286,784	107,176
2017-2020	<u>192,411</u>	<u>53,588</u>
	<u>\$671,688</u>	<u>\$361,731</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2006**

**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, 2006 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>
2007	\$18,799	5,458
2008	18,895	5,265
2009	19,017	5,575
2010	3,180	5,457
2011	1,933	5,342
2012-2016	11,649	24,728
2017-2021	15,801	20,382
2022-2026	21,426	14,870
2027-2031	29,278	7,118
2032	<u>6,710</u>	<u>325</u>
	<u>\$146,688</u>	<u>\$94,520</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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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, 2006 amounted to approximately \$166,683 and \$192,044, 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, 2006, a copy of which can be obtained from the Retirement System.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2006**

**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 net assets as prior reported have been restated to correct certain errors:

	<u>Statement of Net Assets</u>
As prior reported	\$11,716,756
Restatement: understatement of deferred income and accounts receivable, property tax.	<u>808,830</u>
	<u>\$12,525,586</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, 2006 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, 2006 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 COMPARISON  
FOR THE YEAR ENDED JUNE 30, 2006**

	<u>GENERAL FUND</u>			<b>VARIANCE WITH FINAL BUDGET FAVORABLE (UNFAVORABLE)</b>
	<u>ORIGINAL BUDGET</u>	<u>AMMENDED BUDGET</u>	<u>ACTUAL</u>	
<b>Revenues:</b>				
Taxes:				
Property taxes	\$1,846,615	\$1,846,615	\$1,537,647	\$(308,968)
Municipal tax	473,000	473,000	614,842	141,842
Grants and entitlements	5,517,640	5,517,640	5,278,131	(239,509)
Other	<u>832,600</u>	<u>832,600</u>	<u>1,077,334</u>	<u>244,734</u>
Total revenues	<u>8,669,855</u>	<u>8,669,855</u>	<u>8,508,954</u>	<u>(160,901)</u>
<b>Expenditures:</b>				
General administration	3,736,117	3,732,724	3,383,473	349,251
Public safety	448,243	430,982	429,715	1,267
Education, culture and Recreational	460,201	470,818	436,171	34,647
Public works and sanitation	3,287,790	3,327,259	3,225,450	101,809
Health and welfare	<u>737,504</u>	<u>708,072</u>	689,073	<u>18,999</u>
Total expenditures	<u>8,669,855</u>	<u>8,669,855</u>	<u>8,163,882</u>	<u>505,973</u>
<b>Excess of revenue over expenditure</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 345,072</u>	<u>\$ 345,072</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO SCHEDULE OF BUDGETARY COMPARISON**  
**JUNE 30, 2006**

**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 COMPARISON**  
**JUNE 30, 2006**

**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	\$8,496,051	\$8,163,882
Transfer in included as revenues in budgetary basis	<u>12,903</u>	<u>          </u>
Budgetary basis	<u>\$8,508,854</u>	<u>\$8,163,882</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2006**

	<u>NUMBER</u>	<u>DISBURSEMENT</u>
<b><u>US Department of Housing and Urban Development</u></b>		
Passed through:		
Municipal Service Administration:		
Community Development Block Grant	14.228	\$ 941,675
Direct Program:		
Section 8- Housing Choice Vouchers	14.871	1,364,209
 <b><u>US Department of Agriculture</u></b>		
Passed through:		
PR Department of Education:		
Child and Adult Food Program	10.558	31,663
 <b><u>US Department of Health and Human Services</u></b>		
Passes through:		
PR Department of Family:		
Child Care and Development Block Grant	93.575	248,972
 <b><u>US Department of Home and Security</u></b>		
Passes through:		
PR Office of Management and Budget (GAR)		
Public Assistance Grant	97.036	176,595
 <b><u>US Department of Justice</u></b>		
Pass through:		
Puerto Rico Department of Justice		
Police CORPS	16.712	<u>124,444</u>
		<b><u>\$2,887,558</u></b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**JUNE 30, 2006**

**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**

*Carlos R. Diaz Negrón*

Certified Public Accountant

MEMBER:

American Institute of Certified Public Accountants  
Puerto Rico Society of Certified Public Accountants

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PO BOX 408, RAFAEL LASA NO. 44, AGUAS BUENAS, PR 00703 - TEL. 787-732-8020 - FAX: 787-732-0685

**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 Legislative Body  
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, 2006 which collectively comprise the Municipality of Aguas Buenas's basic financial statements and have issued my report there on dated November 29, 2006. 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.

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL (CONTINUED):**

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.

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.



November 29, 2006  
Aguas Buenas, Puerto Rico

License No. 1339  
Expires December 1, 2007

The stamp No. 2204029 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**

*Carlos R. Diaz Negrón*

Certified Public Accountant

MEMBER:

American Institute of Certified Public Accountants  
Puerto Rico Society of Certified Public Accountants

PO BOX 408, RAFAEL LASA NO. 44, AGUAS BUENAS, PR 00703 - TEL. 787-732-8020 - FAX: 787-732-0685

**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 Legislative Body  
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, 2006. 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 \$919,947 in federal awards which is not included in the schedule during the year ended June 30, 2006. 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):

As described in the accompanying schedule of findings and questioned cost, the Municipality of Aguas Buenas did not comply with the followings requirements:

<u>FINDINGS</u>	<u>CFDA NO.</u>	<u>PROGRAM</u>	<u>COMPLIANCE REQUIREMENT</u>
01-06	14.871	Housing Choice Voucher	Special Test-HQS Inspection and HQS enforcement Eligibility
02-06	14.228	Community Development Block Grant/State Grant	Davis Bacon Act

Compliance with such requirements is necessary in our opinion for Municipality of Aguas Buenas to comply with the requirements applicable to that program.

In my opinion, except for the noncompliance described in the preceding paragraph, the 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 year ended June 30, 2006.

As described in the following items in the accompanying schedule of finding and questioned cost, the Municipality of Aguas Buenas compliance with such requirement is necessary, in our opinion for Municipality of Aguas Buenas to comply with the requirement applicable to that program.

### **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.

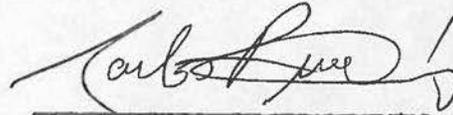
My consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce 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.

**REPORT ON COMPLIANCE WITH REQUIREMENT APPLICABLE (CONTINUED):**

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.

November 29, 2006  
Aguas Buenas, Puerto Rico

License No. 1339  
Expire December 1, 2007


CARLOS R. DIAZ NEGRON  
CONTADOR PUBLICO AUTORIZADO  
PUERTO RICO

The stamp No. **2204030** of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2006**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006**

**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 Xno
- Reportable condition(s) identified that is not considered to be material weaknesses? \_\_\_yes Xno

Noncompliance material to financial statement noted? \_\_\_yes Xno

**Federal Awards**

Internal control over major programs:

- Material weakness (es) identified? \_\_\_yes Xno
- Report condition(s) identified that are not considered to be material weakness (es) \_\_\_yes Xno

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

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

Identification of major programs:

<u>CFA Number(s)</u>	<u>Name of Federal Program</u>
14.871	Section 8 – Housing Choice Voucher
14.228	Community Development Block Grants/State's Program

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

Audit qualified as low-risk audited? Xyes \_\_\_no

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2006**

**SECTION II. – FINANCIAL STATEMENTS FINDING**

**NONE**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2006**

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

**Finding No. 01-06 – Section 8**

**Federal program**

CFDA No. 14.871 – Housing Choice Voucher

**Compliance requirement:**

Eligibility  
Special tests and provisions

**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:

	<b><u>Exceptions</u></b>
No supporting documents related to an expense deducted from annual income located for examination.	1
No documentation about the use of comparables unit to determine the reasonableness of the rent.	11
No evidence of eligibility for assistance based on citizen or eligible alien status.	25
The unit passed inspection but HQS inspect form was not complete	1
The PHA does not maintain a register of failed inspection, thus we could not verify if the HQS enforcement requirement was followed.	

**Criteria:**

24 CFR Section 982.516 establishes 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2006**

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

**Finding No. 01-06 – Eligibility Test – Section 8 (Continued)**

24 CFR Section 982.507 (b) established that PHA must determine whether the rent to owner is reasonable in comparison to rent for other comparable unassisted units. To make this determination, The PHA must consider:

- 1) The location, quality, size, unit type, and age of contract unit.
- 2) Any amenities, housing services, maintenance and utilities to be provided by the owner in accordance with the lease.

24 CFR Section 5.508 - Submission of evidence of citizenship or eligible immigration status

Establishes that each family member, regardless of age, must submit the following evidence to the responsible entity.

For US citizens or US nationals, the evidence consists of a signed declaration of US citizenship or US nationality. The responsible entity may request verification of the declaration by requiring presentation of a United States passport or other appropriate documentation as specified in HUD guidance. For no citizens who are 62 years of age or older or who will be 62 years of age or older and receiving assistance under section 214 covered program on September 30, 1996 or applying for assistance on or after that date, the evidence consists of, A signed declaration, Proof of age document. For all other no citizens, the evidence consists of a signed declaration of eligible immigration status, one of the INS documents referred to in §5.510, a signed verification consent form. (24 CFR Section 5.508 (b) ).

For each family who contends that he or she is a U.S. citizen or a no citizen with eligible immigration status, the family must submit to the responsible entity a written declaration, signed under penalty of perjury, by which the family member declares whether he or she is a US citizen or a no citizen with eligible immigration status. Adults must signed their own forms, for Childs the declaration must be signed by an adult residing in the assisted dwelling unit who is responsible for the child. (24 CFR Section 5.508 (c) ).

For applicants responsible entities must ensure that evidence of eligible status is submitted not later than the date the responsible entity participates or has knowledge that verification of other aspects of eligibility for assistance will occur. For tenants, evidence of eligible status is required to be submitted at the first regular reexamination after June 19, 1995 in accordance with program requirements. For new occupants of assisted units the required evidence shall be submitted at the first interim or regular reexamination following the person's occupancy. (24 CFR Section 5.508 (g) ).

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2006**

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

**Finding No. 01-06 – Eligibility Test – Section 8 (Continued)**

24 CFR Section 512 established that the PHA must conduct verification of eligible immigration status when the individual or family members have submitted documentation to the responsible entity in accordance with Section 5.508. The primary verification is conducted by the responsible entity through the Immigration and naturalization Service (INS) automated system.

24 CFR Section 514 establish that assistance to an applicant shall be denied, and a tenant's assistance shall be terminated if Evidence of citizenship and eligible immigration status is not submitted by the date specified in Section 5.508(g) or by the expiration of any extension granted in accordance with Section 5.508 (h). evidence of citizenship and eligible immigration status is timely submitted, but INS primary and secondary verification does not verify eligible immigration status of a family member.

24 CRF Sections 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.

24 CFR Section 982.158 (a) requires that the PHA must maintain complete and accurate accounts and others records for the Program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. The records must be in the form required by HUD, including requirements governing computerized or electronic forms of record keeping. The PHA must comply with the financial reporting requirements in 24 CFR parts 5. subpart H. (d) which requires that the PHA must prepare a unit inspection record.

**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

**Recommendation:**

I recommend that the municipality establishes an adequate internal control system to ascertain compliance with the requirements of the program. The internal control system should include at least that file should be revised the internal audit department.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF AGUAS BUENAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**  
**FOR THE YEAR ENDED JUNE 30, 2006**

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

**Finding No. 02-06 – Davis-Bacon Act**

**Federal Program**

CFDA – 14-228 – Community Development Block Grant/State's Grant

**Compliance requirement:**

Davis-Bacon Act

**Category:**

Compliance

**Condition:**

As part of my audit procedures we tested 25 disbursements to test the compliance with the Davis-Bacon Act for Community Development Block and Grant. In five disbursements amounting \$452,266.20 of a homes rehabilitation project we do not found the required documents. No copy of the payroll and statement of compliance were found. In addition, for an invoice amounting \$52,808 included in a disbursement of \$176,380, the payroll copy was not obtained.

**Criteria:**

The Davis-Bacon Act requires that all construction contracts in excess of \$2,000 financed by federal assistance funds must be paid wages not less than those established for the locality of the project.

**Effect:**

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

**Questioned cost:**

None

**Recommendation:**

I recommend that the Municipality establishes an adequate internal control system to ascertain compliance with the Davis-Bacon Act.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS**

**EXHIBIT - I**

**STATUS OF PRIOR YEAR AUDIT FINDINGS**

**AND QUESTIONED COSTS**

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



## **EXHIBIT I**

### **STATUS OF PRIOR YEAR FINDINGS**

#### Finding No. 01-05 **Elegibility Procedures**

The Municipality established the correct method to pay 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. 02-05 **Supporting evidence of disbursements and cancelled checks**

The Director of Finance implemented procedure and control for maintain documentation to support the allowabilty.

#### Finding No. 03-05 **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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF AGUAS BUENAS**

**EXHIBIT - II**

**CORRECTIVE ACTION PLAN**

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

**EXHIBIT II**

**MUNICIPALITY OF AGUAS BUENAS  
CORRECTIVE ACTION PLAN  
FOR SINGLE AUDIT FY 2006  
UPDATED FEBRUARY 16, 2007**

**Finding No. 01-06**

Certain eligibility, special test, and provision requirements of the Housing Choice Voucher Program documents were missing from case files.

<b>Program Deficiency</b>	<b>Objectives</b>	<b>Key Tasks/Action Items</b>	<b>Obstacles</b>	<b>Resources</b>	<b>Lead Staff Name and Position</b>	<b>Completion Target Date</b>	<b>Actual Completion Date</b>	<b>Implementation Progress/Comments</b>
No supporting documents related to an expense deducted from annual income located for examination. The unit passed inspection but the HQS inspect form was not complete.	The continue occurrence of the condition may result in the disallowance of program costs. In addition, the ability to manage federal awards in compliance with laws, regulations and provisions of contracts grant awards could also be questioned.	The Municipality should establish an adequate internal control system to ascertain compliance with the requirements of the program. The internal control system should include at least the file should be revised by the internal audit department.	1. Names of participants with missing files should be noted in the findings report, due to the fact that sometimes documents were present in older versions of the case file, but the auditor could not find it. 2. Outdated archiving methods	24 CFR Section 982.516. 24 CFR Section 982.158(a)	Roberto Ortiz, Madelyn Bahamonde, Concepcion Rivera, Coordinators	August 23, 2006	August 23, 2006	Due to a similar finding from the previous year, on August 23, 2006 a new case file format was implemented which allowed for more efficient reference to documents and a tighter quality control method. Documents will be organized in groups and each group will have a separate quality control sheet which will be placed on top of that group's section. Copy of the letter implementing such a change and copies of example quality control sheets have been included as attachment A.
No documentation about the use of comparables unit to determine the reasonableness of the rent.		The PHA must develop a methodology of the implementation this indicator and it must develop a Quality Control for rent reasonable assessment as a standard procedure in the	Lack of knowledge	24 CFR 982.507 (b)	Luis Gallardo, Director, Jose Cruz & Benigno Diaz, Inspectors	February 7, 2007	February 7, 2007	Due to a similar finding from a recent HUD TIER II audit, on September 19, 2006 policy was enacted as to where the Director would receive rent applications directly in order to carry out rent reasonability studies An

**EXHIBIT II (CONTINUACION)**

		administration of the program.						example study has been attached. Due to a number of doubts on how to carry out the actual studies, the policy was placed on hold until a recent HUD seminar had cleared all doubts. Currently the agency is implementing such policy.
No evidence of eligibility for assistance based on citizen or eligible alien status		N/A	N/A	24 CFR Section 5.508, 24 CFR Section 512, 24 Section 514	N/A	N/A	N/A	The Agency currently utilizes birth certificates to verify eligibility for assistance based on citizenship. 24 CFR 5.508 states "The responsible entity may request verification of the declaration by requiring presentation of a United States passport or other appropriate documentation, as specified in HUD guidance," of which the agency believes that the birth certificate is sufficient. Also, new HUD systems such as the EIV, TASS, and other Social Security based checks also verify this.
The PHA does not maintain a register of failed inspections, thus we could not verify if the HQS enforcement requirement was followed.		Establish a register of failed inspections in order to better keep up with SEMAP indicators related to the HQS and assure inspector follow-up.	Lack of practice	Section 982.158 (d)	Jose Cruz, Benigno Diaz, Inspectors	January 10, 2007	January 10, 2007	Due to a recent finding from a HUD TIER II audit, a new form will be utilized for the quality control inspections. A copy of the most recent quality control inspection round, including the new form for the first time has been included as attachment C.

**EXHIBIT II (CONTINUACIÓN)**

**Finding No. C 2-06**

In five of 25 disbursements amounting \$452,266.20 of a homes rehabilitation project there were required documents missing. No copy of the payroll and statement of compliance were found.

<b>Program Deficiency</b>	<b>Objectives</b>	<b>Key Tasks/Action Items</b>	<b>Obstacles</b>	<b>Resources</b>	<b>Lead Staff Name and Position</b>	<b>Completion Target Date</b>	<b>Actual Completion Date</b>	<b>Implementation Progress/Comments</b>
No supporting documents related to an expense deducted from annual income located for examination. The unit passed inspection but the HQS inspect form was not complete.	The Davis-Bacon Act Requires that all construction contracts in excess of \$2,000 financed by federal assistance funds must be paid wages not less than those established for the locality of the project	The Municipality must establish an adequate internal control system to ascertain compliance with the Davis Bacon Act.	1. Change of administration	1. OCAM 2. Internet (for access to forms and documentation )	Jovan Rosario, Office Clerk	Already in effect	October, 2005	The project that was audited had begun in the year 2003 and was carried out by the previous administration. The Municipality is aware that there was a lack of compliance with the Davis Bacon act and thus training was obtained by OCAM during the month of September, 2005. All practices were already put into effect in October.