

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL
AREA DE ARCHIVO DIGITAL

MUNICIPIO DE ARECIBO
AUDITORIA 2005-2006
30 DE JUNIO DE 2006

COMISIONADO MUNICIPAL
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2006

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

YEAR ENDED JUNE 30, 2006

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
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YEAR ENDED JUNE 30, 2006

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López-Vega, CPA, PSC

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

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
the Municipal Legislature
Municipality of Arecibo
Arecibo, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arecibo, Puerto Rico**, as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

The financial statements referred to above include only the primary government of the **Municipality of Arecibo**. The financial statements do not include financial data for the legally separated discrete component unit, "Corporación Desarrollo Cultural Teatro Oliver C.E.", which accounting principles generally accepted in the United States of America require to be reported with the financial data of the primary government. As result the primary government financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2006 and the changes in its financial position and its cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

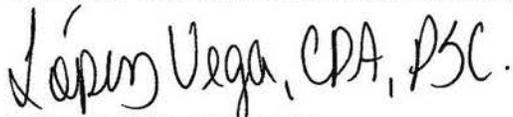
INDEPENDENT AUDITORS' REPORT (CONTINUED)

In our opinion, based on our audit the financial statements referred to above presents fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the primary government of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 7, 2007, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on page 44 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of Arecibo'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 Arecibo**. The information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 15, 2006

Stamp No. 2195978 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



Certified Public Accountants / Management Advisors

López-Vega, CPA, PSC

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2006

This discussion and analysis of the Municipality of Arecibo (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2006. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2005. This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2006 deserve special mention:

1. The Municipality net assets decrease by \$4,727,472, as restated.
2. In the fund financial statements, the governmental activities revenues decrease \$419,468 (or 0.66%) while governmental activities expenditures decreased \$13,857,276 (or 18%).
3. The general fund (the primary operating fund) reflected, on a current financial resource basis, a decrease of \$1,259,465.
4. On a budgetary basis, actual revenues exceeded actual expenditures by \$1,019,948, caused mainly due to favorable variances in various expenditures accounts

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL HIGHLIGHTS (CONTINUED)

5. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$31,494,109.
6. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$6,197,691, compared to a fund balance of \$8,169,028 in the prior fiscal year.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2006. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2006, shows total expenses incurred to afford the cost of all functions and programs amounted to \$67,105,734. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$62,378,262 was derived from the following sources: \$1,083,475 charges for services; \$18,539,338 from operating grants and contributions; and \$5,872,129 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$36,883,320. There was an excess of expenses over revenues in the amount of \$4,727,472 which decrease the figure of net assets attained at the end of the fiscal year.

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Arecibo, primary government total assets exceeded total liabilities by \$18,724,876 at the end of 2006, compared to \$24,164,220 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

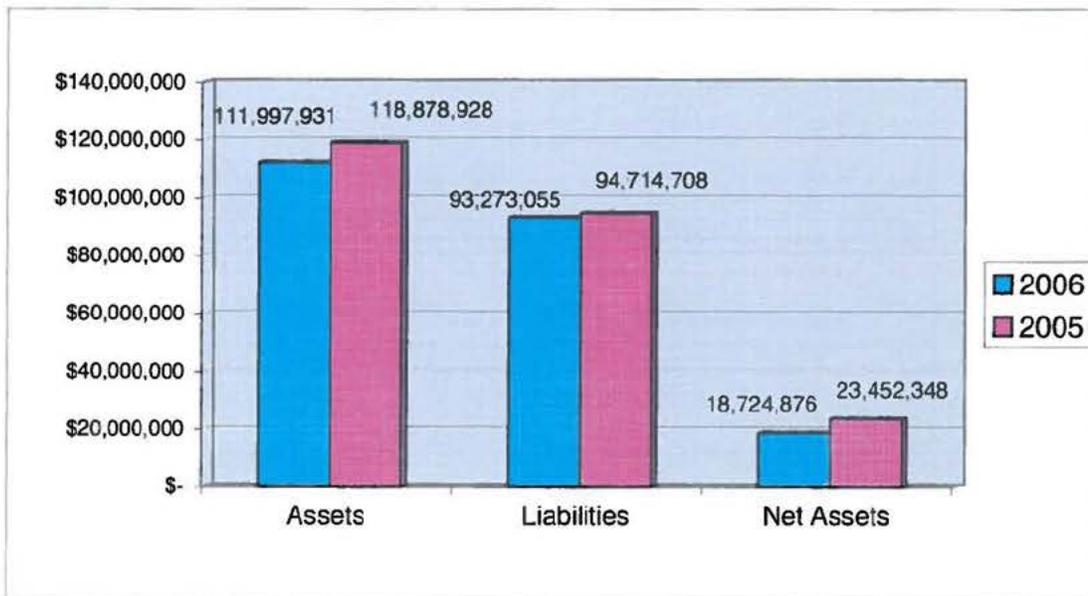
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

Condensed Statement of Net

Assets	2006	2005	Change	%
Current assets	\$49,079,632	\$52,620,370	(\$3,540,738)	(7%)
Capital assets	62,918,299	66,258,558	(3,340,259)	(5%)
Total assets	111,997,931	118,878,928	(6,880,997)	(6%)
Current liabilities	15,941,257	22,834,648	(6,893,391)	(30%)
Noncurrent liabilities	77,331,798	71,880,060	5,451,738	8%
Total liabilities	93,273,055	94,714,708	(1,441,653)	(2%)
Invested in capital assets, net of related debt	35,832,299	37,990,558	(2,158,259)	(6%)
Restricted	24,296,368	22,008,737	2,287,631	10%
Unrestricted, as restated	(41,403,791)	(36,546,947)	(4,856,844)	13%
Total net assets	\$18,724,876	\$23,452,348	(\$4,727,472)	(20%)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2006, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$4,727,472 decrease in the Municipality's net assets. Approximately 45 percent of the Municipality's total revenue came from taxes, while 51 percent resulted from grants and contributions, including federal aid. Charges for Services provided 2 percent and Interest revenue and miscellaneous 2 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general health and welfare services, general government and public works. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

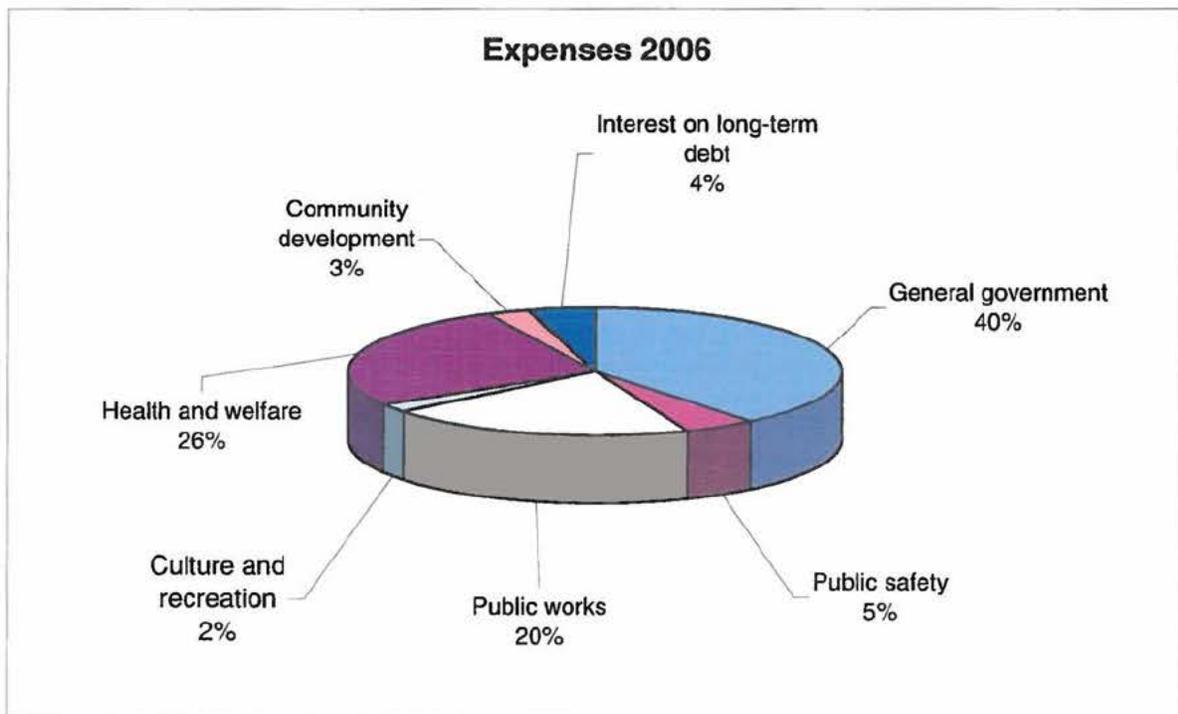
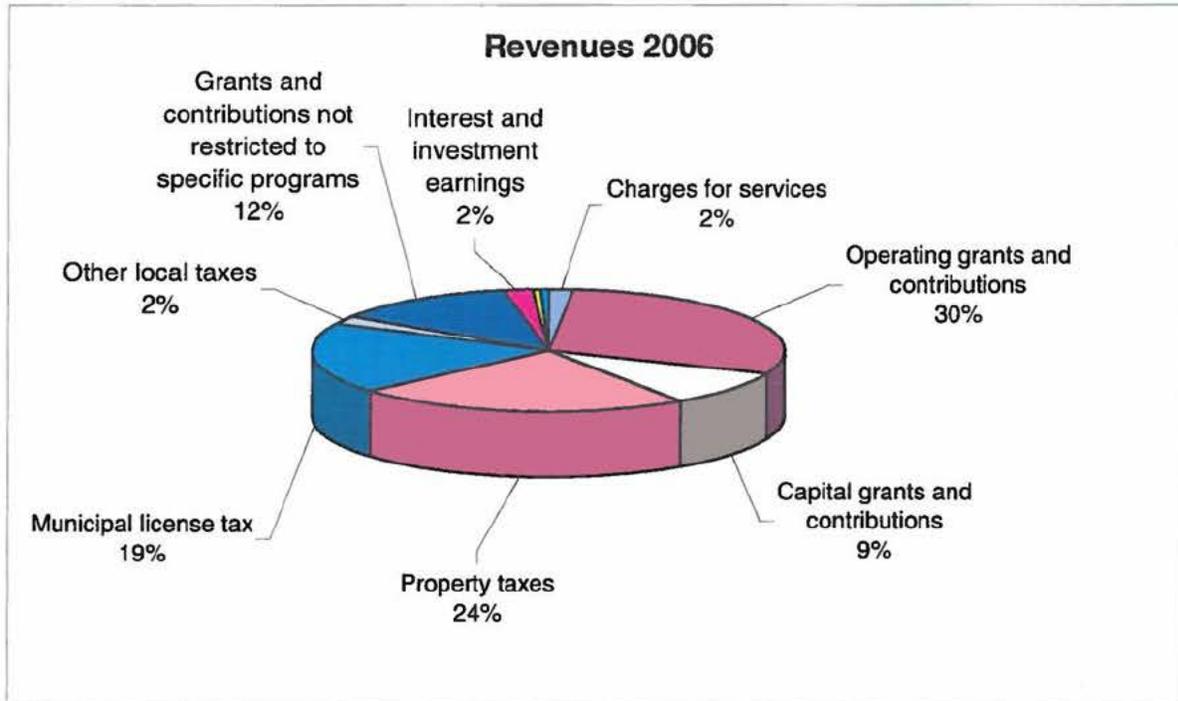
Condensed Statement of Activities	2006	2005	Change	%
Program revenues:				
Charges for services	\$1,083,475	\$1,330,980	(\$247,505)	(19%)
Operating grants and contributions	18,539,338	18,476,969	62,369	-
Capital grants and contributions	5,872,129	7,404,667	(1,532,538)	(21%)
General revenues:				
Property taxes	14,481,168	14,684,649	(203,481)	(1%)
Municipal license tax	11,887,473	13,287,813	(1,400,340)	(11%)
Other local taxes	1,234,184	881,878	352,306	40%
Grants and contributions not restricted to specific programs	7,872,164	5,494,768	2,377,396	43%
Interest and investment earnings	1,395,062	449,196	945,866	211%
Gain (loss) on retirement of capital assets	(299,990)		(299,990)	100%
Miscellaneous	313,259	927,303	(614,044)	(66%)
Total revenues	62,378,262	62,938,223	(559,961)	(1%)
Expenses:				
General government	26,304,205	23,150,231	3,153,974	14%
Public safety	3,118,645	2,601,774	516,871	20%
Public works	13,726,216	13,361,501	364,715	3%
Culture and recreation	1,394,844	79,609	1,315,235	1652%
Health and welfare	17,703,668	18,218,967	(515,299)	(3%)
Community development	1,932,822	1,089,299	843,523	77%
Urban development	50,679	35,779	14,900	42%
Education	12,342	19,339	(6,997)	(36%)
Interest on long-term debt	2,862,313	2,454,388	407,925	17%
Total expenses	67,105,734	61,010,887	6,094,847	10%
Change in net assets	(4,727,472)	1,927,336	(6,654,808)	(345%)
Net assets, beginning of year, as restated	23,452,348	21,525,012	1,927,336	9%
Net assets, end of year	\$18,724,876	\$23,452,348	(\$4,727,472)	(20%)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances 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 the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$31,494,109 an increase of \$514,828 in comparison with the prior year. There are reservations of fund balance amounting to \$26,966,849. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$1,064,540), 2) to pay debt service (\$7,475,262), 3) to pay for capital projects (\$16,875,290), 4) for other purposes (\$945,866), and, 5) for advances to other funds (\$605,891).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2006, the general fund has an undesignated fund balance of \$4,527,260.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The actual General Fund budgetary activities resulted in a favorable balance of \$1,019,948, caused mainly due to favorable variances in collections related to intergovernmental revenues.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2006, amounts to \$80,727,037 net of accumulated depreciation of \$17,808,738, leaving a net book value of \$62,918,299. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2006, the Municipality has \$2,483,266 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities. In addition, the Municipality maintains an available balance of approximately \$300,000 Line of Credit in the Government Development Bank approved by the legislature of the Commonwealth of Puerto Rico by Resolution 1726 in November 7, 2002.

Debt Administration

The Puerto Rico Legislature has 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 law also requires 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 such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2006-2007.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

On September 7, 2004, Public Law 255 was enacted amending Public Law 83 of May 2, 1941, as amended. In addition to the new formula established for the calculation of the contribution in lieu of taxes as described in Note 1 (E) (2), applicable on fiscal year 2002-2003 and each subsequent fiscal year, the Law provides for quarterly revisions to be prepared by PREPA of its estimates corresponding to the contribution in lieu of taxes for the current fiscal year.

On January, 2005 the Municipality settled with the employees dismissed in year 2001. The litigation settlement amount is \$6,500,000. The first payment of \$4,000,000 was realized on July 1, 2005. The remaining balance of \$2,500,000 was paid on April 10, 2006.

On August 12, 2005, the Municipality of Arecibo authorized the sale of the Puerto Rico Distillers for the amount of \$3,000,000. A non interest bearing Note Receivable for a period of ten (10) years was issued by contract for a total of \$2,850,000. During the month of August, 2005 the Municipality collected \$150,000 corresponding to the down payment. The remaining balance was recognized as a Note Receivable in the government-wide financial statements.

On October 4, 2006, the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$1,056,000, for the payment of a judiciary settlement against the Municipality. Repayment of the bond is scheduled from July 2007 through July, 2016.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINAL COMMENTS (CONTINUED)

On October 24, 2006, the Municipal Legislature authorized the Mayor to accept and apply the funds derived from the donation provided to the Municipality by the Commonwealth of Puerto Rico of the 2006, Series A, Public Improvement Bond Issuance of \$675,000,000. The Municipality of Arecibo will receive approximately \$1,682,000 from the issuance during the fiscal year 2006-2007. Those funds will be used to pay the cost for improvements of recreational facilities, municipal offices and streets and other construction projects.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2007. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 1086, Arecibo, Puerto Rico 00613, or call (787) 878-5612.

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Net Assets
June 30, 2006

	<u>Governmental Activities</u>
Assets	
Cash and cash equivalents	\$ 32,974,014
Cash with fiscal agent	10,309,645
Accounts receivable:	
Intergovernmental	170,262
Federal Grants	2,600,581
Others	175,130
Note receivable	2,850,000
Capital assets:	
Land, improvements, and construction in progress	12,287,019
Other capital assets, net of depreciation	50,631,280
Total capital assets	<u>62,918,299</u>
 Total assets	 <u>111,997,931</u>
 Liabilities	
Accounts payable and accrued liabilities	2,749,865
Interest payable	1,000,050
Due to other governmental entities	128,473
Deferred revenues:	
Municipal license tax	10,812,736
Federal grant revenues	1,250,133
Noncurrent liabilities:	
Due within one year	11,530,855
Due in more than one year	65,800,943
 Total liabilities	 <u>93,273,055</u>
 Net Assets	
Invested in capital assets, net of related debt	35,832,299
Restricted for:	
Capital projects	16,875,290
Debt service	6,475,212
Other purposes	945,866
Unrestricted (deficit)	<u>(41,403,791)</u>
 Total net assets	 <u>\$ 18,724,876</u>

The notes to the financial statements are an integral part of this statement.

**Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Activities
For the Year Ended June 30, 2006**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Governmental Activities:					
General government	\$ 26,304,205	\$ 508,624	\$ 771,999	\$ -	\$ (25,023,582)
Public safety	3,118,645	43,001	111,783		(2,963,861)
Public works	13,726,216	531,850		2,443,809	(10,750,557)
Health and welfare	17,703,668		17,621,006		(82,662)
Culture and recreation	1,394,844		2,150		(1,392,694)
Community development	1,932,822			3,428,320	1,495,498
Urban development	50,679		32,400		(18,279)
Education	12,342				(12,342)
Interest on long-term debt	2,862,313				(2,862,313)
Total governmental activities	\$ 67,105,734	\$ 1,083,475	\$ 18,539,338	\$ 5,872,129	\$ (41,610,792)
General revenues:					
Property taxes					14,481,168
Municipal license tax					11,887,473
Other local taxes					1,234,184
Grants and contributions not restricted to specific programs					7,872,164
Interest and investment earnings					1,395,062
Gain (loss) on sale/retirement of capital assets					(299,990)
Miscellaneous					313,259
Total general revenues					36,883,320
Change in net assets					(4,727,472)
Net assets - beginning , as restated					23,452,348
Net assets - ending					\$ 18,724,876

Commonwealth of Puerto Rico
Municipality of Arecibo
Balance Sheet
Governmental Funds
June 30, 2006

	General Fund	Special Revenue Fund Head Start	Capital Projects Fund Local and State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets						
Cash and cash equivalents	\$ 16,409,063	\$ -	\$ 14,191,413	\$ -	\$ 2,373,538	\$ 32,974,014
Cash with fiscal agent	291,493		2,668,793	7,349,359		10,309,645
Accounts receivable:						
Intergovernmental				170,262		170,262
Federal Grants		1,535,898			1,064,683	2,600,581
Other	133,560			23,570		157,130
Advances from other funds	605,891					605,891
Due from other funds	1,179,243		200,611			1,379,854
Total assets	\$ 18,619,250	\$ 1,535,898	\$ 17,060,817	\$ 7,543,191	\$ 3,438,221	\$ 48,197,377
Liabilities and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 1,323,696	\$ 702,687	\$ 185,527	\$ -	\$ 314,271	\$ 2,526,181
Due to other governmental entities	128,473					128,473
Advances to other funds					605,891	605,891
Due to other funds	156,654	783,080		67,929	372,191	1,379,854
Deferred revenues:						
Municipal license tax	10,812,736					10,812,736
Federal grant revenues		50,131			1,200,002	1,250,133
Total liabilities	12,421,559	1,535,898	185,527	67,929	2,492,355	\$ 16,703,268
Fund balances:						
Reserved for:						
Encumbrances	1,064,540					\$ 1,064,540
Capital projects			16,875,290			16,875,290
Debt service fund				7,475,262		7,475,262
Advances to other funds	605,891					605,891
Reserved reported in nonmajor funds:						
Other purposes					945,866	945,866
Unreserved for:						
Undesigned	4,527,260					4,527,260
Total fund balances	6,197,691	-	16,875,290	7,475,262	945,866	31,494,109
Total liabilities and fund balances	\$ 18,619,250	\$ 1,535,898	\$ 17,060,817	\$ 7,543,191	\$ 3,438,221	
Amounts reported for governmental activities in the statement of net assets are different because:						
Accrual basis of accounting accounts receivable recognized in government-wide financial statements						2,868,000
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.						62,918,299
Long-term liabilities, construction in progress accounts payable and accrued interest are not due and payable in the current period, and therefore, are not reported in the funds.						(78,555,532)
Net assets of governmental activities						\$ 18,724,876

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2006

	General Fund	Special Revenue Fund Head Start	Capital Projects Fund Local and State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 10,496,779	\$ -	\$ -	\$ 3,984,389	\$ -	\$ 14,481,168
Municipal license taxes	11,989,698					11,989,698
Licenses, permits and other local taxes	1,216,184					1,216,184
Charges for services	369,205					369,205
Intergovernmental	8,644,163		2,487,766		197,208	11,329,137
Rent of property	487,717		183,552			671,269
Fines and forfeitures	43,001					43,001
Interest	1,395,062					1,395,062
Federal grants		11,637,189			9,317,307	20,954,496
Miscellaneous	396,509				66,749	463,258
Total revenues	35,038,318	11,637,189	2,671,318	3,984,389	9,581,264	62,912,478
Expenditures						
Current:						
General government	19,587,113				1,460	19,588,573
Public safety	3,098,139		14,640		90,483	3,203,262
Public works	10,217,874		676,311		2,028	10,896,213
Health and welfare		11,637,189			6,049,813	17,687,002
Culture and recreation	470,775		358,777			829,552
Community development					3,428,320	3,428,320
Urban development			13,500		32,400	45,900
Education					6,609	6,609
Debt service:						
Principal				2,720,824		2,720,824
Interest				2,665,055		2,665,055
Total expenditures	33,373,901	11,637,189	1,063,228	5,385,879	9,611,113	61,071,310
Excess (deficiency) of revenues over (under) expenditures	1,664,417	-	1,608,090	(1,401,490)	(29,849)	1,841,168
Other financing sources (uses)						
Transfers in			1,631,881	1,292,001		2,923,882
Transfers out	(2,923,882)					(2,923,882)
Total other financing sources (uses)	(2,923,882)	-	1,631,881	1,292,001	-	-
Net Change in fund balances	(1,259,465)	-	3,239,971	(109,489)	(29,849)	1,841,168
Fund balances, beginning, as restated	7,457,166	-	13,635,319	7,584,751	975,715	29,652,941
Fund balances, ending	\$ 6,197,691	\$ -	\$ 16,875,290	\$ 7,475,262	\$ 945,866	\$ 31,494,109

Handwritten signature and date:
 [Signature]
 6/30/07

Commonwealth of Puerto Rico
Municipality of Arecibo
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	\$	1,841,168
Amounts reported for governmental activities in the Statement of Activities are different because:		
Prior Year Accounts Receivable reported in the Governmental Fund Financial Statements as revenues, but reversed in the Government-Wide Statement of Activities and Changes in Net Assets.		(102,225)
Accounts Receivable reported in Government-Wide Statement of Net Assets collected after year end, but not available soon enough to pay current liabilities, and therefore are not reported in the Governmental Funds.		2,868,000
Governmental Funds report capital outlays as expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.		2,680,831
Retirement of Capital assets		(3,306,422)
Depreciation Expense on Capital Assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, Depreciation expense is not reported as expenditures in Governmental Funds Financial Statements.		(2,714,668)
Interest Expense change is reported in the Government-Wide Statement of Activities and Change in Net Assets, but not require the use of current financial resources. Therefore, Interest expense change is not reported as expenditures in Governmental Funds Financial Statements.		(197,258)
Accounts payable change reported in the Government-Wide Statement of Activities and Change in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. This is the amount reported in the current period.		269,308
Long-term debt issuances are reported in the Government-Wide Statement of Net Assets, but not require the use of current financial resources. Therefore Long Term debt issuances are not reported as expenditures in Governmental Funds Financial Statements.		(6,892,868)
Long-term debt payments are reported as expenditures in the Governmental Funds Financial Statements which require the use of current financial resources. Therefore Long Term debts payments are not reported as expenditures in the Government-Wide Statement of Activities and Change in Net Assets.		634,261
Change in Landfill Accrual		(2,528,423)
Bonds proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bond principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt service principal payments exceed debt proceeds.		2,720,824
Change in Net Assets of Governmental Activities	\$	<u>(4,727,472)</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Arecibo** (the Municipality) was founded on the year 1515. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a sixteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year 2007. The Municipality has elected to delay the capitalization of infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB. As amended by the GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units, an amendment of GASB Statement 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

"Corporación Desarrollo Cultural Teatro Oliver C.E." is a non-profit organization duly organized and existent under the laws of the Commonwealth of Puerto Rico. It was established to acquire, restore and operate the Teatro Oliver of Arecibo, Puerto Rico.

The Municipality management determined as a component unit the operations of Teatro Oliver, because of the financial interdependency, ability to designate management and the ability to significantly influence operations demonstrated by the Municipality. The Theater funds becomes from private and municipal donations and the rent of the facilities.

The "Corporación Desarrollo Cultural Teatro Oliver C.E." elected the provision of Section 101 (7) of the Puerto Rico Income Tax Law for non-profit organization and all of their net revenues are exempt from the payment of income taxes.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-typed activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers of applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) 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.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

Special Revenue Fund – Head Start- is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

Capital Projects Fund – Local and State Grants- is the accounting entity in which revenues derived from local funds, state or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund - Operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund - Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Section 8 - Special Revenue Fund used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Head Start - Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Special Revenue Fund – Other Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Funds – Local, State and Federal Grants - Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

Debt Service Funds- Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a 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 Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No.20.

Governmental fund financial statements are reported 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. 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 the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property taxes, franchise taxes, licenses, rent, 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. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue 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 Municipality has elected not to follow subsequent private-sector guidance.

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, if any. 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, then unrestricted resources, as they are needed.

The preparation of the 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Assets, liabilities and net assets

- 1. Cash, cash equivalents, and cash with fiscal agent-** The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 2. Receivables and payables-** Activity 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). All other outstanding balances between funds are reported as "due to/from other funds."

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivable in the general fund relates mostly to Law 52 proposal payroll reimbursements from prior years and property taxes owed by the Municipal Revenue Collection Center ("CRIM"). Intergovernmental receivable in the debt service fund represent property taxes owed by the Municipal Revenue Collection Center ("CRIM").

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
- 4. Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

- 5. Long-term obligations-** The liabilities reported in the government-wide financial statements include to general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

- 6. Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay it is accrued when incurred in the government-wide financial statements.

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

- 7. Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

- a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
- c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
- d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
- e. **Assets not Available for Spending-** Represents the reservation of intergovernmental receivables that they are not available for appropriation and are not expandable available financial resources.

9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:

- a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
- b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

10. **Risk financing-** The Municipality carries commercial 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 CRIM for the year ended June 30, 2006 amounted to approximately \$824,315. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$879,790 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets - Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 62,918,299	
Deduct:		
Bonds payable related to capital Assets	(26,506,000)	
Notes payable related to capital assets	<u>(580,0000)</u>	
		\$ 35,832,299
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		16,875,290
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service	7,475,262	
Deduct:		
Interest Payable	<u>\$ (1,000,050)</u>	\$ 6,475,212
<u>Net assets restricted for other purposes</u>		
Other governmental funds - Fund balance restricted for other purposes		945,866
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 6,197,691	
Add:		
Accrual basis accounts receivable	2,868,000	
Deduct:		
Accrual basis accounts payable	(223,684)	
Bonds Payable related to operational debts	(22,918,647)	
Compensated absences debt	(5,508,605)	
Landfill obligation	(9,730,309)	
LIMS Repayment Plan	(1,016,761)	
Property tax debt - Law 42	(1,225,939)	
Property tax debt - Law 146	(2,227,714)	
Property tax debt - Final Liquidation 2005-2006	(355,907)	
Internal Revenue Service - Social Security Debt	(6,124,484)	
Claims and judgments debt	<u>(1,137,432)</u>	<u>(41,403,791)</u>
Total net assets - governmental activities		<u>\$ 18,724,876</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

2. DEPOSITS

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$15,909,063 and \$14,191,413 in the general fund and Capital Projects Fund-Local and State Grant, respectively, were fully collateralized at June 30, 2006. Also, in the general fund, there are \$500,000 deposited in a savings and loan institution, \$400,000 from that amount are unsecured and uncollateralized, since (COSSEC) insures up to \$100,000 of deposits in such institutions. In the other governmental funds, there were deposits with commercial banks of approximately \$2,373,538 that were fully collateralized.

The deposits at GDB of approximately \$291,493 that is unrestricted for operational expenditures in the general fund, the \$2,668,793 that is restricted principally for capital projects in the capital project fund - local and state grant, and the \$7,349,359 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2006, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 24. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2006, net of allowance for uncollectibles.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

B. *Intergovernmental Receivables*- Intergovernmental receivable in the debt service fund represents the amounts due from the CRIM resulting from the excess of the current year property tax collections over current year advances. Following is a detail of the Intergovernmental receivable:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

3. RECEIVABLES (CONTINUED)

<u>Program Description</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ <u>170,262</u>
Total	\$ <u>170,262</u>

Intergovernmental receivable in the special revenue fund – Head Start represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Head Start Program	\$ <u>1,535,898</u>
Total	\$ <u>1,535,898</u>

Intergovernmental receivable in the Other Governmental Funds represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant/Entitlement Grants	\$ 236,630
Public Assistance Grant	265,529
Community Service Block Grant	27,725
Special Program for Aging – Title III	75,734
Emergency Shelter Grant	1,012
Child Care Development Block Grant Program	235,175
HOME Program	67,269
Even Start Family Literacy Program	138,306
Rural Domestic Violence and Child Victimization Enforcement Grant Program	<u>17,303</u>
Total	\$ <u>1,064,683</u>

C. Note Receivable- In August 2005, the Municipal Legislature authorized the Mayor to sell the Puerto Rico Distiller facilities for a sale price of \$3,000,000. As of June 30, 2006, the Municipality collected a down payment of \$150,000.

The buyer could at any time make payments of the remaining balance of the note receivable of \$2,850,000, during the term of ten years, as stipulated by contract. The payments could be divided depending of the development of the project phases or could be made in a single payment as long as it is in the established term.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2006, and interfund transfers during the fiscal year ended at June 30, 2006, are summarized as follows:

a. Due from/to other fund and Advances to/from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund – Head Start	Payroll and related accruals paid and not reimbursed	\$ 783,080
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	934,125
General Fund	Debt Service Fund	Interest Revenue	67,929
Capital Projects Fund	Other Governmental Funds	Reimbursable Expenditures	43,957
Capital Projects Fund	General Fund	Reimbursable transfer of funds	<u>156,654</u>
Total			<u>\$ 1,985,745</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt Retirement	\$ 1,292,001
General Fund	Capital Projects Fund	Transfer of funds for capital outlays	<u>1,631,881</u>
Total			<u>\$ 2,923,882</u>

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2006, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2006</u>
Capital asset, not being depreciated:				
Construction in progress	\$ 8,137,368	\$ 1,598,424	\$ (3,512,104)	\$ 6,223,688
Land	<u>9,363,321</u>	<u>-</u>	<u>(3,299,990)</u>	<u>6,063,331</u>
Total capital assets not being depreciated	<u>\$ 17,500,689</u>	<u>\$ 1,598,424</u>	<u>\$ (6,812,094)</u>	<u>\$ 12,287,019</u>
Capital assets, being depreciated:				
Buildings	\$ 43,104,430	\$ 489,592		\$ 43,594,022
Buildings improvements	6,880,393	1,003,932		7,884,325
Infrastructure	1,741,661	2,404,162		4,145,823
Infrastructure improvements	256,066	215,402		471,468
Equipment	3,150,898	193,489	(80,266)	3,264,121
Furnishing	1,545,716	53,375	(15,067)	1,584,024
Computers	487,126	52,690	(16,274)	523,542
Works of Art	210,019	-	(1,100)	208,919
Vehicles	<u>6,582,256</u>	<u>181,869</u>	<u>(351)</u>	<u>6,763,774</u>
Total capital assets being depreciated	<u>\$ 63,958,565</u>	<u>\$ 4,594,511</u>	<u>\$ (113,058)</u>	<u>\$ 68,440,018</u>
Less accumulated depreciation for:				
Buildings	\$ (6,466,111)	\$ (1,083,447)	\$ -	\$ 7,549,558
Buildings improvements	(199,204)	(185,539)		384,743
Infrastructure	(82,195)	(86,290)		168,485
Infrastructure improvements	(27,964)	(23,958)		51,922
Equipment	(2,240,409)	(308,875)	77,161	2,472,123
Furnishing	(1,130,344)	(227,066)	14,858	1,342,552
Computers	(354,278)	(90,578)	13,174	431,682
Work of Art	(162,912)	(12,133)	1,100	173,945
Vehicles	<u>(4,537,279)</u>	<u>(696,782)</u>	<u>333</u>	<u>5,233,728</u>
Total accumulated depreciation	<u>\$ (15,200,696)</u>	<u>\$ (2,714,668)</u>	<u>\$ 106,626</u>	<u>\$ 17,808,738</u>
Total capital assets being depreciated, net	<u>\$ 48,757,869</u>	<u>1,879,843</u>	<u>(6,432)</u>	<u>50,631,280</u>
Governmental activities capital assets, net	<u>\$ 66,258,558</u>	<u>\$ 3,478,267</u>	<u>\$ (6,818,526)</u>	<u>\$ 62,918,299</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General Government	\$ 594,270
Public Safety	82,882
Public Works	894,968
Health and Welfare	14,921
Culture and Recreation	948,113
Community Development	169,001
Urban Development	4,779
Education	<u>5,734</u>

Total depreciation expense-governmental activities \$ 2,714,668

6. PROPERTY TAXES

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 CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

1. The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values 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. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect 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, whereby 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 payable to the CRIM is recorded at June 30. The CRIM issued the final settlement noting that advances exceeded collections by \$355,907. This balance will be retained by the CRIM during fiscal year 2007-2008. This amount is presented in the government wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 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 ended June 30, 2000.

The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are 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. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26, 1997, Public Law 21 was enacted which authorized the CRIM to sell property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. The property tax receivables were purchased by Public Financing Corporation, a subsidiary of the Government Development Bank (GDB), with proceeds of a bonds issuance. This Law imposes to the CRIM the obligation to replace any uncollectible property tax receivable with any valid property tax receivables or equivalent in money.

A high percentage of receivables were determined to be uncollectible receivables, and therefore, on October 11, 2001, Public Law 146 was enacted which authorized the CRIM to obtain a loan to pay in advance the bonds issued by the Public Financing Corporation (a GDB subsidiary), and any costs related to the transaction. Also, a term not to exceeding 30 years was authorized to the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from the sale of property tax receivables to the Public Financing Corporation (a GDB Subsidiary).

The government-wide statement of net assets includes an outstanding balance of \$1,225,939 and \$2,227,714 related to Law 42 and Law 146 respectively.

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 exempted 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 the Municipal Autonomous Law of 1991, the exempt amount to be paid by the 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

The annual tax rate is 8.58% for real property and 6.58% 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) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics 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 a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.75% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the General Fund include the following:

<u>Governmental Entity</u>	<u>Amount</u>
General Services Administration	19,084
Department of Labor and Human Resources- Chauffeur Insurance	7,634
Internal Revenue Service	2,726
Department of Labor	8,156
Treasury department and Human Resources - Unemployment	15,137
Puerto Rico Aqueduct and Sewer Authority	<u>75,736</u>
Total	<u>\$ 128,473</u>

8. DEFERRED REVENUES

A. **Municipal License Tax-** The deferred revenues of approximately \$10,812,736 in the general fund relates to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.

B. **Federal Government-** The deferred revenues presented in special revenue fund - Head Start represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Child and Adult Care Food Program	<u>\$ 50,131</u>
Total	<u>\$ 50,131</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. DEFERRED REVENUES (Continued)

The deferred revenues presented in Other Governmental Funds represent the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Voucher Program	\$ 979,004
Emergency Management Performance Grant	16,892
Federal Transit Authority	1,446
Community Development Block Grant/Entitlement Grants	56,835
Home Investment Partnership Program	7,134
Early Even Start Literacy Program	18,713
Local Law and Enforcement Block Grants	26,649
Public Assistance Grant	75,607
Child Care and Development Block Grant	10,737
Others	<u>6,985</u>
Total	<u>\$ 1,200,002</u>

9. LONG-TERM LIABILITIES

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

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$ 52,643,571	\$ -	\$ (3,218,924)	\$ 49,424,647	\$ 2,327,000
Notes Payable	700,000		(120,000)	580,000	130,000
LIMS Repayment Plan		1,168,914	(152,153)	1,016,761	161,341
Property Tax Debt - Law 42	1,091,635	228,995	(94,691)	1,225,939	94,691
Property Tax Debt - Law 146	2,227,714			2,227,714	
CRIM Final Liquidation		355,907		355,907	355,907
Compensated Absences	4,240,788	1,597,986	(330,169)	5,508,605	1,200,000
Landfill Obligation	7,201,886	2,528,423		9,730,309	
Internal Revenue Service					
Social Security Debt	3,633,418	2,491,066		6,124,484	6,124,484
Claims and Judgments	<u>141,048</u>	<u>1,050,000</u>	<u>(53,616)</u>	<u>1,137,432</u>	<u>1,137,432</u>
Total	<u>\$ 71,880,060</u>	<u>\$ 9,421,291</u>	<u>\$ (3,969,553)</u>	<u>\$ 77,331,798</u>	<u>\$ 11,530,855</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES (CONTINUED)

1. **Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.
2. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities and for the liquidation of operational debts. Bonds payable outstanding at June 30, 2006 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2006</u>
1984-Series	1-1-2009	\$675,000	5.00%	\$ 131,000
1987-Series	1-1-2012	875,000	5.00%	337,000
1989-Series	1-1-2014	500,000	5.00%	240,000
1989-Series	7-1-2008	3,000,000	5.00%	318,647
1991-Series	7-1-2006	2,060,000	6.31% to 6.36%	245,000
1994-Series	1-1-2019	400,000	4.87%	293,000
1995-Series	7-1-2020	14,975,000	5.93% to 6.63%	12,010,000
1998-Series	1-1-2023	900,000	4.75%	732,000
1999-Series	7-1-2024	7,365,000	2.89% to 5.60%	6,585,000
2001-Series	7-1-2026	10,545,000	5.00% to 8.00%	9,700,000
2002-Series	7-1-2026	5,030,000	2.89% to 5.60%	4,705,000
2003-Series	7-1-2028	4,235,000	6.00%	3,995,000
2004-Series	7-1-2013	360,000	5.00% to 7.25%	305,000
2004-Series	7-1-2028	605,000	5.00% to 7.25%	585,000
2004-Series	7-1-2013	294,000	6.00%	223,000
2004-Series	7-1-2029	410,000	4.23 to 4.73%	390,000
2004-Series	7-1-2029	1,610,000	4.00%	1,570,000
2005-Series	7-1-2014	7,670,000	5.50%	<u>7,060,000</u>
Total general obligation bonds				<u>\$49,424,647</u>

These bonds, except the 1989-Series amounting to \$3,000,000, 2001-Series amounting to 10,545,000, 2003-Series amounting to 4,235,000 and 2004-Series amounting \$294,000 are payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. LONG-TERM LIABILITIES (CONTINUED)

Annual debt service requirements to maturity for bonds payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 2,327,000	\$ 3,006,952
2008	2,213,000	2,838,520
2009	2,223,647	2,712,519
2010	2,295,000	2,584,237
2011	2,442,000	2,449,256
2012-2016	13,263,000	9,915,714
2017-2021,	13,341,000	5,998,180
2022-2026	9,780,000	2,229,596
2027-2031	<u>1,540,000</u>	<u>110,960</u>
Total	<u>\$ 49,424,647</u>	<u>\$ 31,845,934</u>

3. **Note Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2006</u>
2003-Series	7-1-2009	\$ 920,000	2.70% to 4.10%	<u>\$ 580,000</u>
Total notes payable				<u>\$ 580,000</u>

This note is payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	130,000	19,422
2008	140,000	14,858
2009	150,000	9,470
2010	<u>160,000</u>	<u>3,280</u>
Total	<u>\$ 580,000</u>	<u>\$ 47,030</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. LONG-TERM LIABILITIES (CONTINUED)

- 4. LIMS Repayment Plan-** During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System - LIMS, contracted by the CRIM. A total of \$1,636,386 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2006, the outstanding debt balance is \$1,016,761. This amount is presented in the government wide financial statements.
- 5. Property Tax Debt-** These amounts represent the balance owed to the Municipal Revenue Collection Center (CRIM) at June 30, 2006, as described in Note 6.
- 6. Compensated absences-** The government-wide statement of net assets includes \$2,692,486 of accrued sick leave benefits, and \$2,816,119 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
- 7. Landfill obligation-** State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on the future closure and post-closure care cost that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and post-closure care costs is based on the amount of landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$9,730,309 as of June 30, 2006 reported in the Government-Wide Financial Statements, which is based on 69% usage (filled) of the landfill. It is estimated that an additional \$4,426,091 will be recognized as closure and post-closure care expenses between the date of the balance sheet and the date the landfill is expected to be filled to capacity (2012). The estimated total current cost of the landfill closure and post-closure care (\$14,156,400) is based on the amount that would be paid if all equipment, facilities and services required to close, monitor, and maintain the landfill were acquired as of June 30, 2006. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. The Municipality of Arecibo maintains a certificate of deposits of \$208,942 and \$791,247 in a bank account held for landfill improvements.
- 8. Internal Revenue Service -** These amount represents interest and penalties due to Internal Revenue Service (IRS) for Social Security Debt regarding 940PR, 499 R-2/W-2 PR and W-3PR reports from years 2000 through 2002.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. LONG-TERM LIABILITIES (CONTINUED)

- 9. Claims and Judgments-** - These amounts represent the balance related to legal claims at June 30, 2006, as described in Note 13.

9. OPERATING LEASES:

The Municipality is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore the results of the lease agreements are not reflected in the Municipality's account groups.

The following is a schedule by years of future minimum rental payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2006:

<u>Year Ending June 30.</u>	<u>Total</u>
2007	\$ 556,478
2008	556,478
2009	519,482
2010	482,153
2011	<u>482,153</u>
Total minimum payments required	<u>\$2,596,744</u>

10. COMPONENT UNIT:

"Corporación Desarrollo Cultural Teatro Oliver, C.E."

Nature and Organization

"Corporación Desarrollo Cultural Teatro Oliver C.E." (non-profit organization) was organized under the laws of the Commonwealth of Puerto Rico. The Corporation was established to acquire "El Teatro Oliver of Arecibo" to be restored and operated as Municipal Theater.

Component unit financial statements of "Corporación Desarrollo Cultural Teatro Oliver C.E." were not available. As result, the component unit is not included as part of the Government-Wide Financial Statements.

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. PENSION PLAN

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

Members who have attained 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. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

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. Total employee and employer contributions during the year ended June 30, 2006 amounted to approximately **\$747,552** and **\$837,890**, respectively.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. PENSION PLAN (CONTINUED)

The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

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, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

12. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

13. COMMITMENTS AND CONTINGENCIES

A. Claims and lawsuits:

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$1,137,432 in the Government-Wide Financial Statements for awarded and anticipated unfavorable judgments. \$1,050,000 of those refers to a judiciary settlement of a claim against the Municipality by a waste disposal contractor for breach of contract and other contract violations. The Municipality will authorize the issuance of new debt to payoff the debt.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

14. BEGINNING FUND BALANCES AND NET ASSETS RESTATEMENT:

The beginning Fund Balance for General Fund has been restated by approximately \$711,872 to properly presents previously reported fund balance at June 30, 2005. The restatement is mainly due to advances to other funds that became uncollectible.

The beginning Fund Balances for Capital Projects Fund has been restated by approximately \$614,468 to properly present the previously reported fund balances at June 30, 2005. The restatement is mainly due to the cancellation by the Government Development Bank of a bond issued during fiscal year 2004-2005.

15. SUBSEQUENT EVENTS

On October 4, 2006, the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$1,056,000, for the payment of a judiciary settlement against the Municipality. Repayment of the bond is scheduled from July 2007 through July, 2016.

On October 24, 2006, the Municipal Legislature authorized the Mayor to accept and apply the funds derived from the donation provided to the Municipality by the Commonwealth of Puerto Rico of the 2006, Series A, Public Improvement Bond Issuance of \$675,000,000. The Municipality of Arecibo will receive approximately \$1,682,000 from the issuance during the fiscal year 2006-2007. Those funds will be used to pay the cost for improvements of recreational facilities, municipal offices and streets and other construction projects.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2006**

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES AND BUDGET CARRYOVER:				
Property taxes	\$ 10,496,779	\$ 10,496,779	\$ 10,496,779	\$ -
Municipal license tax	13,501,000	13,501,000	12,015,254	(1,485,746)
Licenses, permits and other local taxes	850,000	850,000	1,194,134	\$344,134
Charges for service	261,000	261,000	467,254	\$206,254
Intergovernmental	7,961,565	7,644,859	8,644,163	\$999,304
Rent of property	350,000	350,000	487,717	\$137,717
Fines and forfeitures	100,000	100,000	47,671	(\$52,329)
Interest	430,000	430,000	1,365,908	\$935,908
Miscellaneous	280,000	280,000	643,925	\$363,925
Budget Carryover (1)	-	<u>1,631,881</u>	<u>1,631,881</u>	-
Total revenues and budget carryover	<u>\$ 34,230,344</u>	<u>\$ 35,545,519</u>	<u>\$ 36,994,686</u>	<u>\$ 1,449,167</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	\$ 19,385,043	\$ 19,494,033	\$ 19,973,394	\$ (479,361)
Public safety	3,452,945	3,183,341	3,085,444	97,897
Public works	9,364,695	9,497,573	9,521,258	(23,685)
Culture and recreation	480,732	438,087	470,760	(32,673)
Operating transfer to other fund	<u>1,546,929</u>	<u>2,932,485</u>	<u>2,923,882</u>	<u>8,603</u>
Total expenditures, encumbrances and other financing uses	<u>\$ 34,230,344</u>	<u>\$ 35,545,519</u>	<u>\$ 35,974,738</u>	<u>\$ (429,219)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>-</u>	<u>-</u>	<u>\$ 1,019,948</u>	<u>\$ 1,019,948</u>
Explanation of Differences:				
Sources/Inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 36,994,686
Differences-budget to GAAP:				
Budget Carryover				(1,631,881)
Nonbudgeted revenues				<u>(324,487)</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 35,038,318</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 35,974,738
Differences-budget to GAAP:				
Prior year encumbrances recorded as current year expenditures for GAAP basis				1,126,443
Current year encumbrances recorded as expenditures for budgetary basis				(803,398)
Operating transfer to other fund				<u>(2,923,882)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 33,373,901</u>

(1) Represents fund balances carried over from prior years

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2006

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

b. Excess Expenditures, Encumbrances Over Budget

The Municipality's general fund had excess of expenditures, encumbrances and other financial uses over appropriations at the legal level of budgetary control in the following functions\programs:

Expenditures, Encumbrances and Other

Financing Uses:

	<u>Appropriations</u>	<u>Actual Amounts</u>	<u>Excess</u>
General government	\$ 19,494,033	\$ 19,973,394	\$ (479,361)
Public works	9,497,573	9,521,258	(23,685)
Culture and recreation	438,087	470,760	(32,673)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2006

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	\$ 970,195
Pass-through the Commonwealth of Puerto Rico Governor Office for the Elderly Food Distribution:			
Nutrition Program for the Elderly	10.570	Not Available	<u>16,591</u>
Total U.S. Department of Agriculture			<u>986,786</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Community Development Block Grants/Entitlement Grants	14.218		3,428,520
Direct Program:			
Emergency Shelter Grants Program	14.231		58,111
Direct Program:			
HOME Investment Partnerships Program	14.239		628,568
Direct Program:			
Section 8 Housing Choice Voucher Program	14.871		<u>3,382,858</u>
Total U.S. Department of Housing and Urban Development			<u>7,498,057</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2006

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S DEPARTMENT OF JUSTICE:			
Pass-through the Commonwealth Office of the Governor (CFWM): Rural Domestic Violence and Child Victimization Enforcement Grant Program	16.589	Not Available	<u>200,193</u>
Total U.S. Department of Justice			<u>200,193</u>
U.S. DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico Emergency Management Agency: Emergency Management Performance Grant	83.552	Not Available	<u>37,826</u>
Total U.S. Department of Homeland Security			<u>37,826</u>
U.S. DEPARTMENT OF EDUCATION			
Pass-through the Commonwealth of Puerto Rico Department of Education: Even Start Family Literacy Program	84.213	Not Applicable	<u>251,269</u>
Total U.S. Department of Education			<u>251,269</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico Governor's Office (Elderly Office):			
Special Programs for Aging – Title III, Part B – Grant for Supportive Services and Senior Centers	93.044	Not Available	156,588
Special Programs for Aging – Title III, Part C – Nutrition Services	93.045	Not Available	152,457
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ADFAN):			
Community Services Block Grant	93.569	Not Available	41,583
Head Start	93.600	Not Available	10,714,167
Child Care and Development Block Grant	93.575	Not Available	915,570
Total U.S. Department of Health and Human Services			<u>11,980,365</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 20,954,496</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2006

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Arecibo and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the fund financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund Head Start, and Other Governmental Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Description	Special Revenue Fund Head Start	Other Governmental Funds	Total
Per Schedule of Expenditures of Federal Awards	\$11,637,189	\$9,317,307	\$20,954,496
Non federal programs Expenditures	<u>-</u>	<u>293,806</u>	<u>293,806</u>
Total expenditures in the fund financial statements	<u>\$11,637,189</u>	<u>\$9,611,113</u>	<u>\$21,248,302</u>



López-Vega, CPA, PSC

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

**To the Honorable Mayor
and the Municipal Legislature
Municipality of Arecibo
Arecibo, Puerto Rico**

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arecibo, Puerto Rico**, as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated December 15, 2006, which was unqualified. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality of Arecibo's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Municipality of Arecibo's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as item **06-01**.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs is a material weakness.

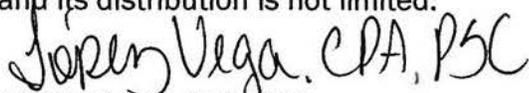
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)

Compliance and Other Matters

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

We noted certain other matters that we reported to management of the **Municipality of Arcibo** in a separate letter dated December 15, 2006.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 15, 2006

Stamp No. 2195979 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.





López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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- Puerto Rico Society of Certified Public Accountants

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

**To the Honorable Mayor
and the Municipal Legislature
Municipality of Arecibo
Arecibo, Puerto Rico**

Compliance

We have audited the compliance of the **Municipality of Arecibo** 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. The **Municipality of Arecibo's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Arecibo's** management. Our responsibility is to express an opinion on the **Municipality of Arecibo's** compliance based on our audit.

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

In our opinion, the **Municipality of Arecibo** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, 06-02 through 06-06.

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

Internal Control Over Compliance

The management of the **Municipality of Arecibo** 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 our audit, we considered the **Municipality of Arecibo's** internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality of Arecibo's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items **06-02** through **06-06**.

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. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weakness. However, of the reportable conditions described above, we consider items **06-03** and **06-04** to be material weaknesses.

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Arecibo** in a separate letter dated March 7, 2007.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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

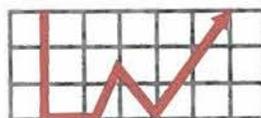
This report is intended for the information of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

López Vega, CPA, PSC.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 7, 2007

Stamp No. 2195980 of the Puerto Rico
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was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2006

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued: Unqualified, except for **adverse** for primary government financial statements

Internal control over financial reporting:

Material weakness identified? Yes No **X**

Reportable conditions identified not considered to be material weaknesses? Yes **X** None reported

Noncompliance material to financial statements noted? Yes No **X**

Federal awards

Internal Control over major programs:

Material weakness identified? Yes **X** No

Reportable conditions identified not considered to be material weaknesses? Yes **X** None reported

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

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? Yes **X** No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
10.558	Child and Adult Care Food Program
14.218	Community Development Block Grant
14.871	Section 8 Housing Choice Voucher
93.575	Child Care & Development Block Grant
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B programs \$628,635

Auditee qualified as low-risk auditee? Yes No **X**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section II – Financial Statements Findings

Finding Reference 06-01

Requirement Financial Reporting – Accounting Records

Statement of Condition During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal Funds).

The Municipality did not include in the basic financial statements, audited financial information related to the "Corporación de Desarrollo Cultural Teatro Oliver".

Criteria Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.

GASB Statement No. 14 requires that the financial information of component units not be blended with similar financial information of the primary government. Rather, such information should be presented in the basic financial statements of the financial reporting entity.

Cause of Condition The Municipality did not maintain effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.

The Municipality was unable to obtain audited financial statements of the "Corporación de Desarrollo Cultural Teatro Oliver", a Discrete Component Unit.

Effect of Condition The Municipality's accounting system did not provide updated and complete financial information that presents the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.

The Municipality is not in compliance with the *GASB Statement No. 14* requirements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section II – Financial Statements Findings

Finding Reference **06-01 (Continued)**

Recommendation We recommend that the Municipality should establish internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.

We recommend to the Municipality Management to require annual audited financial statements of the “Corporación de Desarrollo Cultural Teatro Oliver”, to the Component Unit management, to include them in the financial reporting entity basic financial statements.

Questioned Costs None

**Management Response
And Corrective Action**

The Municipality concurs with the finding. The Municipal Affairs Commissioner Office (OCAM) is in the process of acquiring a new accounting software for the municipalities of Puerto Rico during the next fiscal year and the Municipality expects that the implementation of this system will resolve this situation.

As of June 30, 2006, the “Corporación de Desarrollo Cultural Teatro Oliver” is not operating. The Municipality is evaluating the type of assistance it could give to the “Corporación”, primarily for maintenance and preservation of the building. Actually, the Municipality is considering a \$150,000 assistance package to help protect its investment in the theater. This amount will be used to pay utilities and maintenance debts.

Responsible Person: Mr. Víctor Maltés- Finance Director

Implementation date: July, 2007

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Federal Award Findings and Questioned Costs

Finding Reference	06-02
Program	Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Earmarking
Statement of Condition	During our audit procedures we identified that the actual costs obligated per accounting records for public services surpassed the cap limit of 15% by 3.74% (or \$113,661). The approved budget for public services in the program's Action Plan for the fiscal year 2005-2006 corresponded to 16% of the total grant amount.
Criteria	24 CFR section 570.201 (e), states that the amount of CDBG funds obligated during the program year for public services must not exceed 15 percent of the grant amount received for that year plus 15 percent of the program income it received during the preceding program year.
Cause of Condition	The Federal Program Department obligated more CDBG funds for its public services than established by the program's regulation.
Effect of Condition	The Municipality did not comply with 24 CFR section 570.201 (e).
Recommendation	We recommend that management should strengthen its control procedures to comply with the established earmarking of 15% cap on public services obligations for a program income.
Questioned Costs	None
Management Response And Corrective Action	The Municipality concurs with the finding. In a letter dated January 29, 2007, the Community Planning and Development Director of the San Juan Field Office determined that the Municipality exceeded by 3.74% the permissible expenditures for the public services activity and it must be reduced from the 2007 CDBG 15% statutory limit and considered in the 2007 Action Plan. Evidence on the action taken will be presented once the 2007 CDBG budget is published for public comment. Responsible Person: Mr. Hiram Cruz González, Director of the Municipal Development Office.

Implementation date: April 2, 2007

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-03
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Cash management
Statement of Condition	We observed that the program maintained an average cash balance per month of \$686,883, and in June 30, 2006 the cash balance in its bank account was \$984,697, exceeding the cash management requirements for the program. This situation was due to an average leasing rate of 74% instead a 95% as required, this means that the program did not use all vouchers approved to the Municipality.
Criteria	Housing Choice Voucher Program Guidebook, Chapter 24, Section, 24.6 stated that a PHA must lease 95 percent of its units. A PHA with a utilization rate below 95 percent will not be identified as a high performer regardless of its overall score and will not be eligible to receive new unit's allocations.
Cause of Condition	The Municipality did not maintain an occupancy rate of 95% during the year; however, it continued to receive funds consistent with a higher lease up. The program did not substitute the cancelled vouchers promptly.
Effect of Condition	The program did not maintain a leasing rate of 95% as stated in Housing Choice Voucher Program Guidebook, Chapter 24, Section, 24.6.
Recommendation	The Management must perform an exhaustive analysis of the Fair Market Rent used for HAP calculation in order to prevent an excessive cash balance in its books and to promote the program between potential unit tenants to assure the 95% leasing rate.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-03 (Continued)

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Cash Management**

Questioned Costs None

Management Response

And corrective action The Municipality concurs with the finding. In order to achieve the 95% lease up, the Housing Director kept the waiting list open in order to increase the number of vouchers issued during the year. As February 28, 2007, the Department had increased leased up from 72.12% in July 2006 to 74.73% in February 2007.

Responsible Person: Raymond Guzman – Housing Director

Implementation date: June 30, 2007

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-04

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Special Test – Housing Quality Standards Inspections and HQS Enforcement**

Statement of Condition During our verification of twenty five (25) participant files we noted the following deficiencies:

- a. We found four (4) inspections in noncompliance for electrical, plumbing and kitchen repairs. The corrections were not realized within the time established by the PHA inspectors (from fifteen (15) to thirty (30) calendar days or thereafter). The Municipality did not stop (abate) the Housing Assistance Payment.
- b. We found four (4) inspections in noncompliance in which the PHA unit inspection report (HUD-52580) detailed fire detector correction. The corrections were not realized within the time established by Regulation (twenty four (24) hours from inspection). The corrections were made from six (6) to thirty eight (38) from the initial inspection.
- c. In one (1) case the PHA unit inspection report (HUD-52580) did not state the decision made on the unit.

Criteria Code of Federal Regulations 24, Subpart I, Section 982.158 (d) and 982.405 (b) states 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. Also, the PHA must prepare a unit inspection report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **06-04 (Continued)**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Special Test – Housing Quality Standards Inspections and HQS Enforcement**

Criteria (continued) 24 CFR, Section 982.404 establishes that for units under contract that fail to meet HQS, the PHA must require the owner to correct any cited life threatening HQS deficiencies within 24 hours of the inspections and all other HQS deficiencies within 30 calendar days or within a specified PHA-approved extension. If the owner does not correct the cited HQS deficiencies within the specified correction period the PHA must stop the Housing Assistance Payment or must terminate the HAP contract.

Cause of Condition The Municipality internal control and procedures failed to assure that all inspections are properly documented in participant files.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Section and 982.404, 982.158 (d) ad 982.405 (b).

Recommendation We recommend management to improve its internal control procedures in order to assure that annual inspections are properly documented. For HQS deficiencies that are the owner's responsibility and are not corrected within the prescribed time frames, the PHA must abate housing assistance payments beginning no later than the first of the month following expiration of the PHA violation notice.

**Management Response
And corrective action**

The Municipality concurs with the finding. The Housing Director prepared a corrective action schedule identifying the 8 inspection files in default. Corrective actions will be enforced through the Program Inspectors. A final report on the status of the action taken will be provided in 30 working days.

Responsible Person: Raymond Guzman-Housing Director

Implementation date: Initial assessment:	March 8, 2007
Field inspections on the findings made:	March 21, 2007
Report on the actions taken:	March 30, 2007
Final report on the actions taken:	April 18, 2007

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	06-05
Program	Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families.
Requirement	Cash Management
Statement of Condition	We realized Cash Management Test and we found the following exceptions: a. The program did not maintain the proper documentation (Audit Trail) necessary to reconcile the funds received from the pass-through grantor with the disbursement of checks. b. The programs maintained an average cash balance per month of approximately \$123,291. c. During four (4) months the cash as per bank reconciliation was in overdraft.
Criteria	CFR 45, Subpart C, Section 92.20 (b) (7), requires a cash management system in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursements made by the grantee.
Cause of Condition	The procedures established by ACUDEN in the delegation of funds agreement do not provide a clause to comply with this requirement.
Effect of Condition	The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to require ACUDEN alternate methods to request cash in order to comply with this requirement.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference 06- 05 (Continued)

Program Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families.

Requirement Cash Management

**Management Response
And corrective action** The Municipality management agrees with the finding. The Program Coordinator will make a written request to “ACUDEN” for advice regarding this finding.

Responsible Person: Harry Marengo– Program Coordinator

Implementation date: July, 2007

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	06-06
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families
Requirement	Cash Management
Statement of Condition	We realized Cash Management Test and we found the following exceptions: <ul style="list-style-type: none">a. The program did not maintain the proper documentation (Audit Trail) necessary to reconcile the funds received from the pass-through grantor with the disbursement of checks.b. During seven (7) months the cash as per bank reconciliation was in overdraft.
Criteria	CFR 45, Subpart C, Section 92.20 (b) (7), requires a cash management system in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursements made by the grantee.
Cause of Condition	The procedures established by ACUDEN in the agreement of delegation of funds do not provide a clause to comply with this requirement.
Effect of Condition	The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to require ACUDEN alternate methods to request cash in order to comply with this requirement.
Questioned Costs	None
Management Response And Corrective Action	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. Responsible Person: Mrs. María Torres – Program Accountant Implementation date : March,2007

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-04	10.558	<p><u>The Municipality should implement controls and procedures in order to assure that each participant is subjected to an annual eligibility test to determine its classification as free, reduced or fully paid meal.</u></p> <p>Corrective action has been taken</p>
05-05	14.218	<p><u>Management should strengthen it's procedures to minimize the time elapsed between the transfer of funds from the federal agency and the disbursements made by the Municipality.</u></p> <p>Corrective action has been taken</p>
05-06	14.218	<p><u>Management should follow monitoring system procedures developed, including interviewing contractor's and subcontractor's laborers periodically (up to ten percent (10%) of the workers on long term projects) to establish the degree of compliance and the nature and extend of violations, if any. Also, management should strengthen its control procedures to assure that contractors submit certified weekly payrolls on a timely manner.</u></p> <p>Corrective action has been taken</p>
05-07	14.218	<p><u>The Program should establish the following procedures: Ascertain that the deficiencies to be corrected and approved amounts are incorporated into the rehabilitation contract. Assign a staff to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contract specifications. Assure that all participant files include all required documentation duly approved and certified. Ascertain that the projects developed are included in the program Action Plan or in an amendment to such Plan.</u></p> <p>Corrective action has been taken</p>
05-08	14.871	<p><u>The Municipality should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Corrective action has been taken</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-09	14.871	<p><u>The Management must perform an exhaustive analysis of the Fair Market Rent used for HAP calculation in order to prevent exceeding the HUD approved budget and to assure the 95% leasing rate. In addition, the management must monitor the operating reserve movement in order to avoid an overdraft in a future. The management must perform an analysis of the operating reserve balance with the cash maintained in books in order to determine the reasonability of both accounts.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-03.</p>
05-10	14.871	<p><u>The Municipality management should follow admission procedures established in the administrative plan. Also, the management will establish control procedures to maintain a waiting list with all information required by the Federal Regulation. This control must permit proper tracing of participants selected in the waiting list in order to assure the selection from the top of the waiting list.</u></p> <p>Corrective action has been taken.</p>
05-11	14.871	<p><u>The Municipality to improve its internal control and procedures to assure that appropriate documentation is duly completed and the determination of reasonable rent is maintained in participant's files.</u></p> <p>Corrective action has been taken.</p>
05-12	14.871	<p><u>Management should improve its internal control procedures in order to assure that annual inspections are properly documented. For HQS deficiencies that are the owner's responsibility and are not corrected within the prescribed time frames, the PHA must abate housing assistance payments beginning no later than the first of the month following expiration of the PHA violation notice.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-04.</p>
05-13	93.575	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-05.
05-14	93.575	<p><u>The Municipality should establish internal controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports.</u></p> <p>Corrective action has been taken.</p>
05-15	93.600	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-05.</p>
04-05	14.871	<p><u>Management must perform an exhaustive analysis of the Fair Market Rent used for HAP calculation in order to prevent exceeding the HUD approved budget and to assure the 95% leasing rate. In addition, the management must monitor the operating reserve movement in order to avoid an overdraft in a future.</u></p> <p><u>Management must perform an analysis of the operating reserve balance with the cash maintained in books in order to determine the reasonability of both accounts.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-03.</p>
04-09	14.871	<p><u>Management should follow admission procedures established in the administrative plan. Also, we recommend the management to establish control procedures to maintain a waiting list with all information required by the Federal Regulation. This control must permit proper tracing of participants selected in the waiting list in order to assure the selection from the top of the waiting list.</u></p> <p>Corrective action has been taken..</p>
04-10	14.871	<p><u>Management should improve its internal control and procedures to assure that appropriate documentation is duly completed and the determination of reasonable rent is maintained in participant's files.</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		Corrective action has been taken.
04-11	14.871	<p><u>Management should improve its internal control procedures in order to assure that annual inspections are properly documented. For HQS deficiencies that are the owner's responsibility and are not corrected within the prescribed time frames, the PHA must abate housing assistance payments beginning no later than the first of the month following expiration of the PHA violation notice.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-04.</p>
04-12	93.575	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-05.</p>
04-14	93.575	<p><u>Management should establish internal controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports. Also, Management should establish procedures in order to assure that all financial and programmatic reports are submitted on time to the agencies and are prepared in accordance with the required accounting basis.</u></p> <p>Corrective action was taken.</p>
04-15	93.600	<p><u>The Municipality should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-06.</p>
03-12	14.871	<p><u>Management should follow admission procedures established in the administrative plan. Also, we recommend the management to establish control procedures to maintain a waiting list with all information required by the Federal Regulation. This control must permit proper tracing of participants selected in the waiting list in order to assure the selection from the top of the waiting list.</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.
03-13	14.871	<p><u>Management should improve its internal control and procedures to assure that appropriate documentation is duly completed and the determination of reasonable rent is maintained in participant's files.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>
03-14	14.871	<p><u>Management should improve its internal control procedures in order to assure that annual inspections are properly documented. For HQS deficiencies that are the owner's responsibility and are not corrected within the prescribed time frames, the PHA must abate housing assistance payments beginning no later than the first of the month following expiration of the PHA violation notice.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>
03-15	93.575	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-19	93.575	<p><u>Management should establish internal controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports. Also, Management should establish procedures in order to assure that all financial and programmatic reports are submitted on time to the agencies and are prepared in accordance with the required accounting basis.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>
03-20	93.600	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>
03-25	93.600	<p><u>Management should follow the following procedures:</u></p> <p><u>Establish better communication between the Municipality Finance Department and the program accounting department related to the issuance of manual checks without notifying the program accountant.</u></p> <p><u>The program should establish controls to trace payments of obligations and identify outstanding checks at end of funding period and, if necessary, request a waiver to the Federal Agency.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>

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DE ASUNTOS MUNICIPALES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED JUNE 30, 2006

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2006

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
the Municipal Legislature
Municipality of Arecibo
Arecibo, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arecibo, Puerto Rico**, as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

The financial statements referred to above include only the primary government of the **Municipality of Arecibo**. The financial statements do not include financial data for the legally separated discrete component unit, "Corporación Desarrollo Cultural Teatro Oliver C.E., which accounting principles generally accepted in the United States of America require to be reported with the financial data of the primary government. As result the primary government financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of the **Municipality of Arecibo**, Puerto Rico, as of June 30, 2006 and the changes in its financial position and its cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

In our opinion, based on our audit the financial statements referred to above presents fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the primary government of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on pages 44 and 45 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.


LOPEZVEGA, CPA, PSC

San Juan, Puerto Rico
December 15, 2006

Stamp No. 2195951 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2006

This discussion and analysis of the Municipality of Arecibo (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2006. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2005. This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2006 deserve special mention:

1. The Municipality net assets decrease by \$4,727,472, as restated.
2. In the fund financial statements, the governmental activities revenues decrease \$419,468 (or 0.66%) while governmental activities expenditures decreased \$13,857,276 (or 18%).
3. The general fund (the primary operating fund) reflected, on a current financial resource basis, a decrease of \$1,259,465.
4. On a budgetary basis, actual revenues exceeded actual expenditures by \$1,019,948, caused mainly due to favorable variances in various expenditures accounts

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL HIGHLIGHTS (CONTINUED)

5. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$31,494,109.
6. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$6,197,691, compared to a fund balance of \$8,169,028 in the prior fiscal year.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2006. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2006, shows total expenses incurred to afford the cost of all functions and programs amounted to \$67,105,734. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$62,378,262 was derived from the following sources: \$1,083,475 charges for services; \$18,539,338 from operating grants and contributions; and \$5,872,129 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$36,883,320. There was an excess of expenses over revenues in the amount of \$4,727,472 which decrease the figure of net assets attained at the end of the fiscal year.

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Arecibo, primary government total assets exceeded total liabilities by \$18,724,876 at the end of 2006, compared to \$24,164,220 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

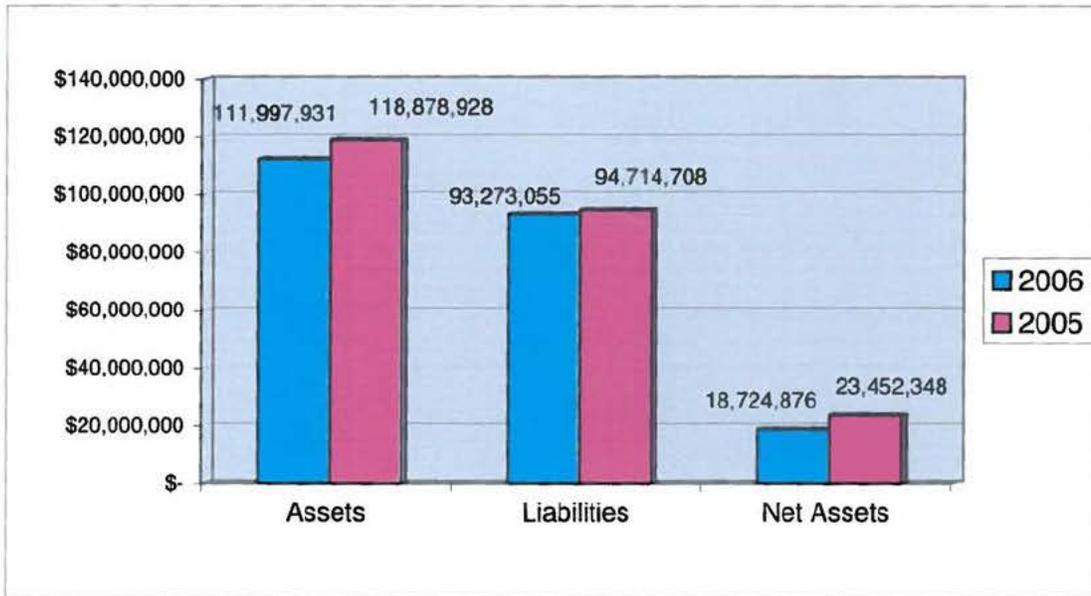
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

Condensed Statement of Net

Assets	2006	2005	Change	%
Current assets	\$49,079,632	\$52,620,370	(\$3,540,738)	(7%)
Capital assets	62,918,299	66,258,558	(3,340,259)	(5%)
Total assets	111,997,931	118,878,928	(6,880,997)	(6%)
Current liabilities	15,941,257	22,834,648	(6,893,391)	(30%)
Noncurrent liabilities	77,331,798	71,880,060	5,451,738	8%
Total liabilities	93,273,055	94,714,708	(1,441,653)	(2%)
Invested in capital assets, net of related debt	35,832,299	37,990,558	(2,158,259)	(6%)
Restricted	24,296,368	22,008,737	2,287,631	10%
Unrestricted, as restated	(41,403,791)	(36,546,947)	(4,856,844)	13%
Total net assets	\$18,724,876	\$23,452,348	(\$4,727,472)	(20%)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2006, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$4,727,472 decrease in the Municipality's net assets. Approximately 45 percent of the Municipality's total revenue came from taxes, while 51 percent resulted from grants and contributions, including federal aid. Charges for Services provided 2 percent and Interest revenue and miscellaneous 2 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general health and welfare services, general government and public works. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

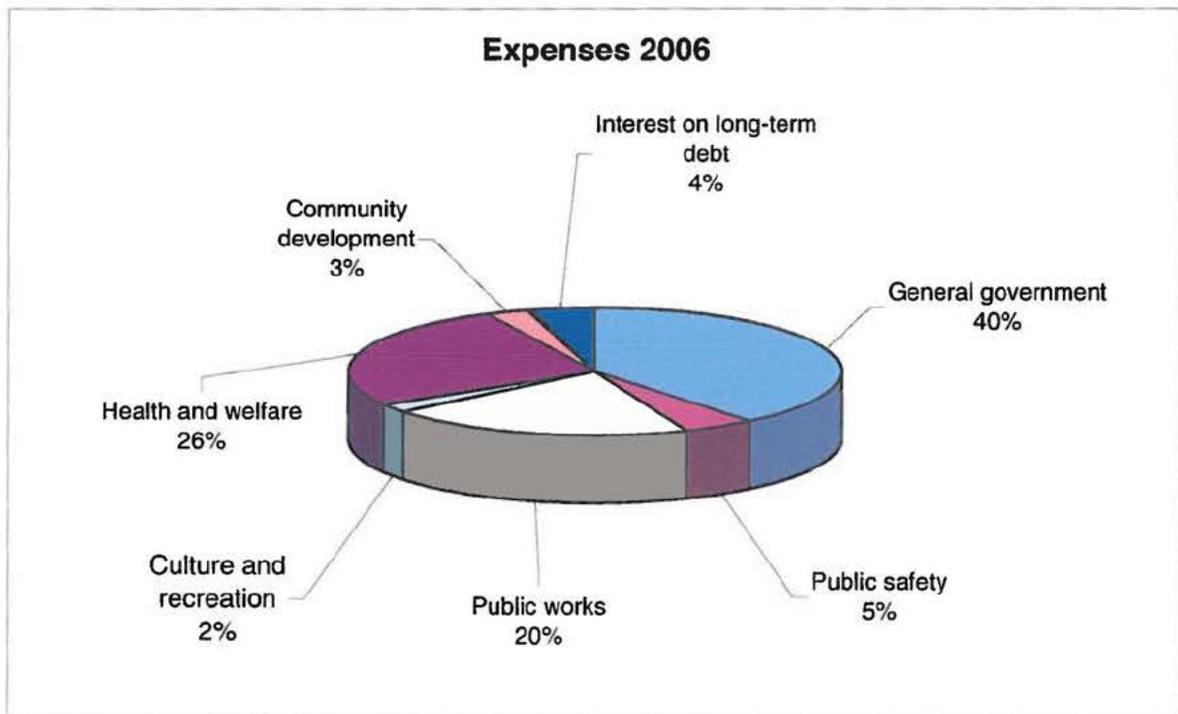
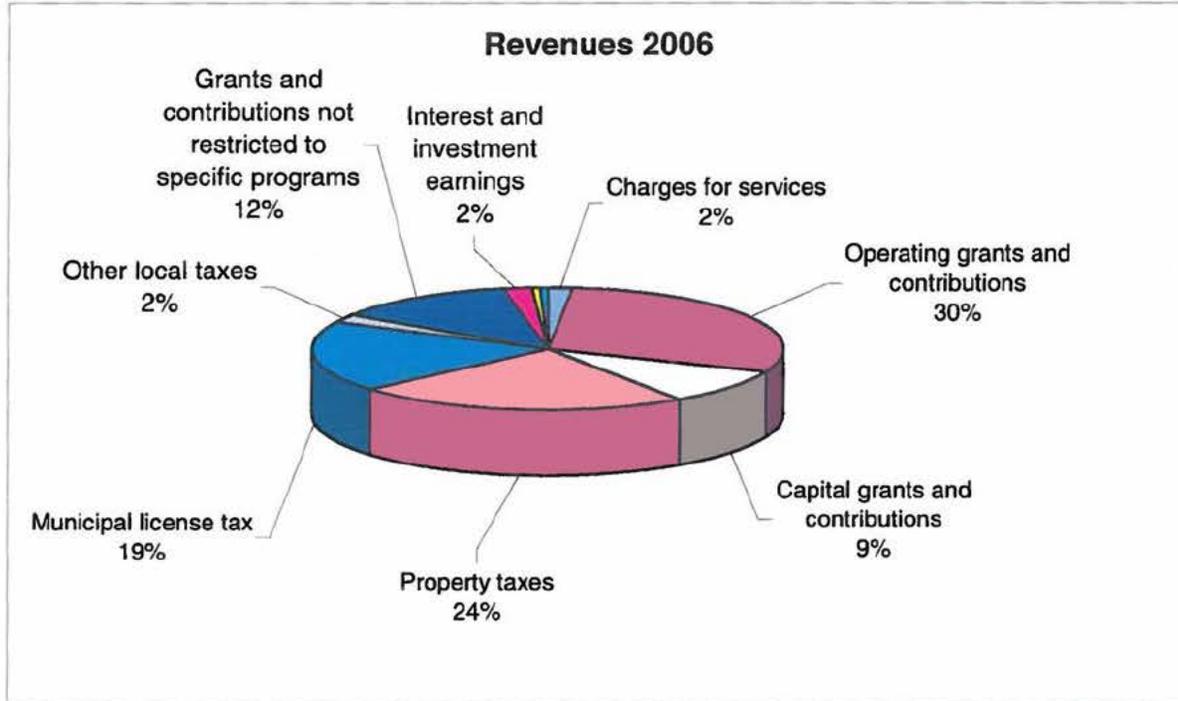
Condensed Statement of Activities	2006	2005	Change	%
Program revenues:				
Charges for services	\$1,083,475	\$1,330,980	(\$247,505)	(19%)
Operating grants and contributions	18,539,338	18,476,969	62,369	-
Capital grants and contributions	5,872,129	7,404,667	(1,532,538)	(21%)
General revenues:				
Property taxes	14,481,168	14,684,649	(203,481)	(1%)
Municipal license tax	11,887,473	13,287,813	(1,400,340)	(11%)
Other local taxes	1,234,184	881,878	352,306	40%
Grants and contributions not restricted to specific programs	7,872,164	5,494,768	2,377,396	43%
Interest and investment earnings	1,395,062	449,196	945,866	211%
Gain (loss) on retirement of capital assets	(299,990)		(299,990)	100%
Miscellaneous	313,259	927,303	(614,044)	(66%)
Total revenues	62,378,262	62,938,223	(559,961)	(1%)
Expenses:				
General government	26,304,205	23,150,231	3,153,974	14%
Public safety	3,118,645	2,601,774	516,871	20%
Public works	13,726,216	13,361,501	364,715	3%
Culture and recreation	1,394,844	79,609	1,315,235	1652%
Health and welfare	17,703,668	18,218,967	(515,299)	(3%)
Community development	1,932,822	1,089,299	843,523	77%
Urban development	50,679	35,779	14,900	42%
Education	12,342	19,339	(6,997)	(36%)
Interest on long-term debt	2,862,313	2,454,388	407,925	17%
Total expenses	67,105,734	61,010,887	6,094,847	10%
Change in net assets	(4,727,472)	1,927,336	(6,654,808)	(345%)
Net assets, beginning of year, as restated	23,452,348	21,525,012	1,927,336	9%
Net assets, end of year	\$18,724,876	\$23,452,348	(\$4,727,472)	(20%)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances 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 the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$31,494,109 an increase of \$514,828 in comparison with the prior year. There are reservations of fund balance amounting to \$26,966,849. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$1,064,540), 2) to pay debt service (\$7,475,262), 3) to pay for capital projects (\$16,875,290), 4) for other purposes (\$945,866), and, 5) for advances to other funds (\$605,891).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2006, the general fund has an undesignated fund balance of \$4,527,260.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The actual General Fund budgetary activities resulted in a favorable balance of \$1,019,948, caused mainly due to favorable variances in collections related to intergovernmental revenues.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2006, amounts to \$80,727,037 net of accumulated depreciation of \$17,808,738, leaving a net book value of \$62,918,299. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2006, the Municipality has \$2,483,266 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities. In addition, the Municipality maintains an available balance of approximately \$300,000 Line of Credit in the Government Development Bank approved by the legislature of the Commonwealth of Puerto Rico by Resolution 1726 in November 7, 2002.

Debt Administration

The Puerto Rico Legislature has 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 law also requires 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 such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2006-2007.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

On September 7, 2004, Public Law 255 was enacted amending Public Law 83 of May 2, 1941, as amended. In addition to the new formula established for the calculation of the contribution in lieu of taxes as described in Note 1 (E) (2), applicable on fiscal year 2002-2003 and each subsequent fiscal year, the Law provides for quarterly revisions to be prepared by PREPA of its estimates corresponding to the contribution in lieu of taxes for the current fiscal year.

On January, 2005 the Municipality settled with the employees dismissed in year 2001. The litigation settlement amount is \$6,500,000. The first payment of \$4,000,000 was realized on July 1, 2005. The remaining balance of \$2,500,000 was paid on April 10, 2006.

On August 12, 2005, the Municipality of Arecibo authorized the sale of the Puerto Rico Distillers for the amount of \$3,000,000. A non interest bearing Note Receivable for a period of ten (10) years was issued by contract for a total of \$2,850,000. During the month of August, 2005 the Municipality collected \$150,000 corresponding to the down payment. The remaining balance was recognized as a Note Receivable in the government-wide financial statements.

On October 4, 2006, the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$1,056,000, for the payment of a judiciary settlement against the Municipality. Repayment of the bond is scheduled from July 2007 through July, 2016.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINAL COMMENTS (CONTINUED)

On October 24, 2006, the Municipal Legislature authorized the Mayor to accept and apply the funds derived from the donation provided to the Municipality by the Commonwealth of Puerto Rico of the 2006, Series A, Public Improvement Bond Issuance of \$675,000,000. The Municipality of Arecibo will receive approximately \$1,682,000 from the issuance during the fiscal year 2006-2007. Those funds will be used to pay the cost for improvements of recreational facilities, municipal offices and streets and other construction projects.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2007. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 1086, Arecibo, Puerto Rico 00613, or call (787) 878-5612.

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Net Assets
June 30, 2006

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 32,974,014
Cash with fiscal agent	10,309,645
Accounts receivable:	
Intergovernmental	170,262
Federal Grants	2,600,581
Others	175,130
Note receivable	2,850,000
Capital assets:	
Land, improvements, and construction in progress	12,287,019
Other capital assets, net of depreciation	50,631,280
Total capital assets	62,918,299
 Total assets	 111,997,931
 Liabilities	
Accounts payable and accrued liabilities	2,749,865
Interest payable	1,000,050
Due to other governmental entities	128,473
Deferred revenues:	
Municipal license tax	10,812,736
Federal grant revenues	1,250,133
Noncurrent liabilities:	
Due within one year	11,530,855
Due in more than one year	65,800,943
 Total liabilities	 93,273,055
 Net Assets	
Invested in capital assets, net of related debt	35,832,299
Restricted for:	
Capital projects	16,875,290
Debt service	6,475,212
Other purposes	945,866
Unrestricted (deficit)	(41,403,791)
 Total net assets	 \$ 18,724,876

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Activities
For the Year Ended June 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes In Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Governmental Activities:					
General government	\$ 26,304,205	\$ 508,624	\$ 771,999	\$ -	\$ (25,023,582)
Public safety	3,118,645	43,001	111,783		(2,963,861)
Public works	13,726,216	531,850		2,443,809	(10,750,557)
Health and welfare	17,703,668		17,621,006		(82,662)
Culture and recreation	1,394,844		2,150		(1,392,694)
Community development	1,932,822			3,428,320	1,495,498
Urban development	50,679		32,400		(18,279)
Education	12,342				(12,342)
Interest on long-term debt	2,862,313				(2,862,313)
Total governmental activities	\$ 67,105,734	\$ 1,083,475	\$ 18,539,338	\$ 5,872,129	\$ (41,610,792)
General revenues:					
Property taxes					14,481,168
Municipal license tax					11,887,473
Other local taxes					1,234,184
Grants and contributions not restricted to specific programs					7,872,164
Interest and investment earnings					1,395,062
Gain (loss) on sale/retirement of capital assets					(299,990)
Miscellaneous					313,259
Total general revenues					36,883,320
Change in net assets					(4,727,472)
Net assets - beginning, as restated					23,452,348
Net assets - ending					\$ 18,724,876

Commonwealth of Puerto Rico
Municipality of Arecibo
Balance Sheet
Governmental Funds
June 30, 2006

	General Fund	Special Revenue Fund Head Start	Capital Projects Fund Local and State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets						
Cash and cash equivalents	\$ 16,409,063	\$ -	\$ 14,191,413	\$ -	\$ 2,373,538	\$ 32,974,014
Cash with fiscal agent	291,493		2,668,793	7,349,359		10,309,645
Accounts receivable:						
Intergovernmental				170,262		170,262
Federal Grants		1,535,898			1,064,683	2,600,581
Other	133,560			23,570		157,130
Advances from other funds	605,891					605,891
Due from other funds	1,179,243		200,611			1,379,854
Total assets	\$ 18,619,250	\$ 1,535,898	\$ 17,060,817	\$ 7,543,191	\$ 3,438,221	\$ 48,197,377
Liabilities and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 1,323,696	\$ 702,687	\$ 185,527	\$ -	\$ 314,271	\$ 2,526,181
Due to other governmental entities	128,473					128,473
Advances to other funds					605,891	605,891
Due to other funds	156,654	783,080		67,929	372,191	1,379,854
Deferred revenues:						
Municipal license tax	10,812,736					10,812,736
Federal grant revenues		50,131			1,200,002	1,250,133
Total liabilities	12,421,559	1,535,898	185,527	67,929	2,492,355	\$ 16,703,268
Fund balances:						
Reserved for:						
Encumbrances	1,064,540					\$ 1,064,540
Capital projects			16,875,290			16,875,290
Debt service fund				7,475,262		7,475,262
Advances to other funds	605,891					605,891
Reserved reported in nonmajor funds:						
Other purposes					945,866	945,866
Unreserved for:						
Undesigned	4,527,260					4,527,260
Total fund balances	6,197,691		16,875,290	7,475,262	945,866	31,494,109
Total liabilities and fund balances	\$ 18,619,250	\$ 1,535,898	\$ 17,060,817	\$ 7,543,191	\$ 3,438,221	

Amounts reported for governmental activities in the statement of net assets are different because:

Accrual basis of accounting accounts receivable recognized in government-wide financial statements	2,868,000
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	62,918,299
Long-term liabilities, construction in progress accounts payable and accrued interest are not due and payable in the current period, and therefore, are not reported in the funds.	(78,555,532)
Net assets of governmental activities	\$ 18,724,876

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2006

	General Fund	Special Revenue Fund Head Start	Capital Projects Fund Local and State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 10,496,779	\$ -	\$ -	\$ 3,984,389	\$ -	\$ 14,481,168
Municipal license taxes	11,989,698					11,989,698
Licenses, permits and other local taxes	1,216,184					1,216,184
Charges for services	369,205					369,205
Intergovernmental	8,644,163		2,487,766		197,208	11,329,137
Rent of property	487,717		183,552			671,269
Fines and forfeitures	43,001					43,001
Interest	1,395,062					1,395,062
Federal grants		11,637,189			9,317,307	20,954,496
Miscellaneous	396,509				66,749	463,258
Total revenues	35,038,318	11,637,189	2,671,318	3,984,389	9,581,264	62,912,478
Expenditures						
Current:						
General government	19,587,113				1,460	19,588,573
Public safety	3,098,139		14,640		90,483	3,203,262
Public works	10,217,874		676,311		2,028	10,896,213
Health and welfare		11,637,189			6,049,813	17,687,002
Culture and recreation	470,775		358,777			829,552
Community development					3,428,320	3,428,320
Urban development			13,500		32,400	45,900
Education					6,609	6,609
Debt service:						
Principal				2,720,824		2,720,824
Interest				2,665,055		2,665,055
Total expenditures	33,373,901	11,637,189	1,063,228	5,385,879	9,611,113	61,071,310
Excess (deficiency) of revenues over (under) expenditures	1,664,417		1,608,090	(1,401,490)	(29,849)	1,841,168
Other financing sources (uses)						
Transfers in			1,631,881	1,292,001		2,923,882
Transfers out	(2,923,882)					(2,923,882)
Total other financing sources (uses)	(2,923,882)		1,631,881	1,292,001		
Net Change in fund balances	(1,259,465)		3,239,971	(109,489)	(29,849)	1,841,168
Fund balances, beginning, as restated	7,457,156		13,635,319	7,584,751	975,715	29,652,941
Fund balances, ending	\$ 6,197,691		\$ 16,875,290	\$ 7,475,262	\$ 945,866	\$ 31,494,109

04-05 quote 700 872

*OR
 2/15/07
 3/15/07*

Commonwealth of Puerto Rico
Municipality of Arecibo
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 \$ 1,841,168

Amounts reported for governmental activities in the Statement of Activities are different because:

Prior Year Accounts Receivable reported in the Governmental Fund Financial Statements as revenues, but reversed in the Government-Wide Statement of Activities and Changes in Net Assets. (102,225)

Accounts Receivable reported in Government-Wide Statement of Net Assets collected after year end, but not available soon enough to pay current liabilities, and therefore are not reported in the Governmental Funds. 2,868,000

Governmental Funds report capital outlays as expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 2,680,831

Retirement of Capital assets (3,306,422)

Depreciation Expense on Capital Assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, Depreciation expense is not reported as expenditures in Governmental Funds Financial Statements. (2,714,668)

Interest Expense change is reported in the Government-Wide Statement of Activities and Change in Net Assets, but not require the use of current financial resources. Therefore, Interest expense change is not reported as expenditures in Governmental Funds Financial Statements. (197,258)

Accounts payable change reported in the Government-Wide Statement of Activities and Change in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. This is the amount reported in the current period. 269,308

Long-term debt issuances are reported in the Government-Wide Statement of Net Assets, but not require the use of current financial resources. Therefore Long Term debt issuances are not reported as expenditures in Governmental Funds Financial Statements. (6,892,868)

Long-term debt payments are reported as expenditures in the Governmental Funds Financial Statements which require the use of current financial resources. Therefore Long Term debts payments are not reported as expenditures in the Government-Wide Statement of Activities and Change in Net Assets. 634,261

Change in Landfill Accrual (2,528,423)

Bonds proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bond principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt service principal payments exceed debt proceeds. 2,720,824

Change in Net Assets of Governmental Activities \$ (4,727,472)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Arecibo** (the Municipality) was founded on the year 1515. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a sixteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year 2007. The Municipality has elected to delay the capitalization of infrastructure.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB. As amended by the GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units, an amendment of GASB Statement 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

"Corporación Desarrollo Cultural Teatro Oliver C.E." is a non-profit organization duly organized and existent under the laws of the Commonwealth of Puerto Rico. It was established to acquire, restore and operate the Teatro Oliver of Arecibo, Puerto Rico.

The Municipality management determined as a component unit the operations of Teatro Oliver, because of the financial interdependency, ability to designate management and the ability to significantly influence operations demonstrated by the Municipality. The Theater funds becomes from private and municipal donations and the rent of the facilities.

The "Corporación Desarrollo Cultural Teatro Oliver C.E." elected the provision of Section 101 (7) of the Puerto Rico Income Tax Law for non-profit organization and all of their net revenues are exempt from the payment of income taxes.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-typed activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers of applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) 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.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

Special Revenue Fund - Head Start- is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

Capital Projects Fund - Local and State Grants- is the accounting entity in which revenues derived from local funds, state or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund - Operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund - Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Section 8 - Special Revenue Fund used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Head Start - Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Special Revenue Fund – Other Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Funds – Local, State and Federal Grants - Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

Debt Service Funds- Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America (“GAAP”) as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a 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 Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No.20.

Governmental fund financial statements are reported 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. 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 the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property taxes, franchise taxes, licenses, rent, 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. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue 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 Municipality has elected not to follow subsequent private-sector guidance.

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, if any. 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, then unrestricted resources, as they are needed.

The preparation of the 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Assets, liabilities and net assets

1. Cash, cash equivalents, and cash with fiscal agent- The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 2. Receivables and payables-** Activity 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). All other outstanding balances between funds are reported as "due to/from other funds."

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivable in the general fund relates mostly to Law 52 proposal payroll reimbursements from prior years and property taxes owed by the Municipal Revenue Collection Center ("CRIM"). Intergovernmental receivable in the debt service fund represent property taxes owed by the Municipal Revenue Collection Center ("CRIM").

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
- 4. Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

- 5. Long-term obligations-** The liabilities reported in the government-wide financial statements include to general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

- 6. Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay it is accrued when incurred in the government-wide financial statements.

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

- 7. Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

- a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
- c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
- d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
- e. **Assets not Available for Spending-** Represents the reservation of intergovernmental receivables that they are not available for appropriation and are not expandable available financial resources.

9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:

- a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
- b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

10. **Risk financing-** The Municipality carries commercial 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 CRIM for the year ended June 30, 2006 amounted to approximately \$824,315. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$879,790 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets - Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 62,918,299	
Deduct:		
Bonds payable related to capital Assets	(26,506,000)	
Notes payable related to capital assets	<u>(580,000)</u>	
		\$ 35,832,299
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		16,875,290
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service	7,475,262	
Deduct:		
Interest Payable	<u>\$ (1,000,050)</u>	\$ 6,475,212
<u>Net assets restricted for other purposes</u>		
Other governmental funds - Fund balance restricted for other purposes		945,866
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 6,197,691	
Add:		
Accrual basis accounts receivable	2,868,000	
Deduct:		
Accrual basis accounts payable	(223,684)	
Bonds Payable related to operational debts	(22,918,647)	
Compensated absences debt	(5,508,605)	
Landfill obligation	(9,730,309)	
LIMS Repayment Plan	(1,016,761)	
Property tax debt - Law 42	(1,225,939)	
Property tax debt - Law 146	(2,227,714)	
Property tax debt - Final Liquidation 2005-2006	(355,907)	
Internal Revenue Service - Social Security Debt	(6,124,484)	
Claims and judgments debt	<u>(1,137,432)</u>	<u>(41,403,791)</u>
Total net assets - governmental activities		<u>\$ 18,724,876</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

2. DEPOSITS

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$15,909,063 and \$14,191,413 in the general fund and Capital Projects Fund-Local and State Grant, respectively, were fully collateralized at June 30, 2006. Also, in the general fund, there are \$500,000 deposited in a savings and loan institution, \$400,000 from that amount are unsecured and uncollateralized, since (COSSEC) insures up to \$100,000 of deposits in such institutions. In the other governmental funds, there were deposits with commercial banks of approximately \$2,373,538 that were fully collateralized.

The deposits at GDB of approximately \$291,493 that is unrestricted for operational expenditures in the general fund, the \$2,668,793 that is restricted principally for capital projects in the capital project fund - local and state grant, and the \$7,349,359 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2006, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 24. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2006, net of allowance for uncollectibles.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

B. *Intergovernmental Receivables*- Intergovernmental receivable in the debt service fund represents the amounts due from the CRIM resulting from the excess of the current year property tax collections over current year advances. Following is a detail of the Intergovernmental receivable:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

3. RECEIVABLES (CONTINUED)

<u>Program Description</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ <u>170,262</u>
Total	\$ <u>170,262</u>

Intergovernmental receivable in the special revenue fund - Head Start represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Head Start Program	\$ <u>1,535,898</u>
Total	\$ <u>1,535,898</u>

Intergovernmental receivable in the Other Governmental Funds represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant/Entitlement Grants	\$ 236,630
Public Assistance Grant	265,529
Community Service Block Grant	27,725
Special Program for Aging - Title III	75,734
Emergency Shelter Grant	1,012
Child Care Development Block Grant Program	235,175
HOME Program	67,269
Even Start Family Literacy Program	138,306
Rural Domestic Violence and Child Victimization Enforcement Grant Program	<u>17,303</u>
Total	\$ <u>1,064,683</u>

- C. **Note Receivable**- In August 2005, the Municipal Legislature authorized the Mayor to sell the Puerto Rico Distiller facilities for a sale price of \$3,000,000. As of June 30, 2006, the Municipality collected a down payment of \$150,000.

The buyer could at any time make payments of the remaining balance of the note receivable of \$2,850,000, during the term of ten years, as stipulated by contract. The payments could be divided depending of the development of the project phases or could be made in a single payment as long as it is in the established term.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2006, and interfund transfers during the fiscal year ended at June 30, 2006, are summarized as follows:

a. Due from/to other fund and Advances to/from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund – Head Start	Payroll and related accruals paid and not reimbursed	\$ 783,080
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	934,125
General Fund	Debt Service Fund	Interest Revenue	67,929
Capital Projects Fund	Other Governmental Funds	Reimbursable Expenditures	43,957
Capital Projects Fund	General Fund	Reimbursable transfer of funds	<u>156,654</u>
Total			<u>\$ 1,985,745</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt Retirement	\$ 1,292,001
General Fund	Capital Projects Fund	Transfer of funds for capital outlays	<u>1,631,881</u>
Total			<u>\$ 2,923,882</u>

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2006, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2006</u>
Capital asset, not being depreciated:				
Construction in progress	\$ 8,137,368	\$ 1,598,424	\$ (3,512,104)	\$ 6,223,688
Land	<u>9,363,321</u>	<u>-</u>	<u>(3,299,990)</u>	<u>6,063,331</u>
Total capital assets not being depreciated	\$ 17,500,689	\$ 1,598,424	\$ (6,812,094)	\$ 12,287,019
Capital assets, being depreciated:				
Buildings	\$ 43,104,430	\$ 489,592		\$ 43,594,022
Buildings improvements	6,880,393	1,003,932		7,884,325
Infrastructure	1,741,661	2,404,162		4,145,823
Infrastructure improvements	256,066	215,402		471,468
Equipment	3,150,898	193,489	(80,266)	3,264,121
Furnishing	1,545,716	53,375	(15,067)	1,584,024
Computers	487,126	52,690	(16,274)	523,542
Works of Art	210,019	-	(1,100)	208,919
Vehicles	<u>6,582,256</u>	<u>181,869</u>	<u>(351)</u>	<u>6,763,774</u>
Total capital assets being depreciated	\$ 63,958,565	\$ 4,594,511	\$ (113,058)	\$ 68,440,018
Less accumulated depreciation for:				
Buildings	\$ (6,466,111)	\$ (1,083,447)	\$ -	\$ 7,549,558
Buildings improvements	(199,204)	(185,539)		384,743
Infrastructure	(82,195)	(86,290)		168,485
Infrastructure improvements	(27,964)	(23,958)		51,922
Equipment	(2,240,409)	(308,875)	77,161	2,472,123
Furnishing	(1,130,344)	(227,066)	14,858	1,342,552
Computers	(354,278)	(90,578)	13,174	431,682
Work of Art	(162,912)	(12,133)	1,100	173,945
Vehicles	<u>(4,537,279)</u>	<u>(696,782)</u>	<u>333</u>	<u>5,233,728</u>
Total accumulated depreciation	\$ (15,200,696)	\$ (2,714,668)	\$ 106,626	\$ 17,808,738
Total capital assets being depreciated, net	\$ 48,757,869	1,879,843	(6,432)	50,631,280
Governmental activities capital assets, net	\$ 66,258,558	\$ 3,478,267	\$ (6,818,526)	\$ 62,918,299

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General Government	\$ 594,270
Public Safety	82,882
Public Works	894,968
Health and Welfare	14,921
Culture and Recreation	948,113
Community Development	169,001
Urban Development	4,779
Education	<u>5,734</u>

Total depreciation expense-governmental activities **\$ 2,714,668**

6. PROPERTY TAXES

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 CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

1. The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values 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. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect 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, whereby 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 payable to the CRIM is recorded at June 30. The CRIM issued the final settlement noting that advances exceeded collections by \$355,907. This balance will be retained by the CRIM during fiscal year 2007-2008. This amount is presented in the government wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 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 ended June 30, 2000.

The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are 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. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26, 1997, Public Law 21 was enacted which authorized the CRIM to sell property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. The property tax receivables were purchased by Public Financing Corporation, a subsidiary of the Government Development Bank (GDB), with proceeds of a bonds issuance. This Law imposes to the CRIM the obligation to replace any uncollectible property tax receivable with any valid property tax receivables or equivalent in money.

A high percentage of receivables were determined to be uncollectible receivables, and therefore, on October 11, 2001, Public Law 146 was enacted which authorized the CRIM to obtain a loan to pay in advance the bonds issued by the Public Financing Corporation (a GDB subsidiary), and any costs related to the transaction. Also, a term not to exceeding 30 years was authorized to the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from the sale of property tax receivables to the Public Financing Corporation (a GDB Subsidiary).

The government-wide statement of net assets includes an outstanding balance of \$1,225,939 and \$2,227,714 related to Law 42 and Law 146 respectively.

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 exempted 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 the Municipal Autonomous Law of 1991, the exempt amount to be paid by the 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

The annual tax rate is 8.58% for real property and 6.58% 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) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics 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 a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.75% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the General Fund include the following:

<u>Governmental Entity</u>	<u>Amount</u>
General Services Administration	19,084
Department of Labor and Human Resources- Chauffeur Insurance	7,634
Internal Revenue Service	2,726
Department of Labor	8,156
Treasury department and Human Resources - Unemployment	15,137
Puerto Rico Aqueduct and Sewer Authority	<u>75,736</u>
Total	<u>\$ 128,473</u>

8. DEFERRED REVENUES

A. **Municipal License Tax-** The deferred revenues of approximately \$10,812,736 in the general fund relates to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.

B. **Federal Government-** The deferred revenues presented in special revenue fund - Head Start represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Child and Adult Care Food Program	<u>\$ 50,131</u>
Total	<u>\$ 50,131</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. DEFERRED REVENUES (Continued)

The deferred revenues presented in Other Governmental Funds represent the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Voucher Program	\$ 979,004
Emergency Management Performance Grant	16,892
Federal Transit Authority	1,446
Community Development Block Grant/Entitlement Grants	56,835
Home Investment Partnership Program	7,134
Early Even Start Literacy Program	18,713
Local Law and Enforcement Block Grants	26,649
Public Assistance Grant	75,607
Child Care and Development Block Grant	10,737
Others	<u>6,985</u>
Total	<u>\$ 1,200,002</u>

9. LONG-TERM LIABILITIES

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

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$ 52,643,571	\$ -	\$ (3,218,924)	\$ 49,424,647	\$ 2,327,000
Notes Payable	700,000		(120,000)	580,000	130,000
LIMS Repayment Plan		1,168,914	(152,153)	1,016,761	161,341
Property Tax Debt - Law 42	1,091,635	228,995	(94,691)	1,225,939	94,691
Property Tax Debt - Law 146	2,227,714			2,227,714	
CRIM Final Liquidation		355,907		355,907	355,907
Compensated Absences	4,240,788	1,597,986	(330,169)	5,508,605	1,200,000
Landfill Obligation	7,201,886	2,528,423		9,730,309	
Internal Revenue Service Social Security Debt	3,633,418	2,491,066		6,124,484	6,124,484
Claims and Judgments	<u>141,048</u>	<u>1,050,000</u>	<u>(53,616)</u>	<u>1,137,432</u>	<u>1,137,432</u>
Total	<u>\$ 71,880,060</u>	<u>\$ 9,421,291</u>	<u>\$ (3,969,553)</u>	<u>\$ 77,331,798</u>	<u>\$ 11,530,855</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES (CONTINUED)

1. **Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.

2. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities and for the liquidation of operational debts. Bonds payable outstanding at June 30, 2006 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2006</u>
1984-Series	1-1-2009	\$675,000	5.00%	\$ 131,000
1987-Series	1-1-2012	875,000	5.00%	337,000
1989-Series	1-1-2014	500,000	5.00%	240,000
1989-Series	7-1-2008	3,000,000	5.00%	318,647
1991-Series	7-1-2006	2,060,000	6.31% to 6.36%	245,000
1994-Series	1-1-2019	400,000	4.87%	293,000
1995-Series	7-1-2020	14,975,000	5.93% to 6.63%	12,010,000
1998-Series	1-1-2023	900,000	4.75%	732,000
1999-Series	7-1-2024	7,365,000	2.89% to 5.60%	6,585,000
2001-Series	7-1-2026	10,545,000	5.00% to 8.00%	9,700,000
2002-Series	7-1-2026	5,030,000	2.89% to 5.60%	4,705,000
2003-Series	7-1-2028	4,235,000	6.00%	3,995,000
2004-Series	7-1-2013	360,000	5.00% to 7.25%	305,000
2004-Series	7-1-2028	605,000	5.00% to 7.25%	585,000
2004-Series	7-1-2013	294,000	6.00%	223,000
2004-Series	7-1-2029	410,000	4.23 to 4.73%	390,000
2004-Series	7-1-2029	1,610,000	4.00%	1,570,000
2005-Series	7-1-2014	7,670,000	5.50%	<u>7,060,000</u>
Total general obligation bonds				<u>\$49,424,647</u>

These bonds, except the 1989-Series amounting to \$3,000,000, 2001-Series amounting to 10,545,000, 2003-Series amounting to 4,235,000 and 2004-Series amounting \$294,000 are payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. LONG-TERM LIABILITIES (CONTINUED)

Annual debt service requirements to maturity for bonds payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 2,327,000	\$ 3,006,952
2008	2,213,000	2,838,520
2009	2,223,647	2,712,519
2010	2,295,000	2,584,237
2011	2,442,000	2,449,256
2012-2016	13,263,000	9,915,714
2017-2021,	13,341,000	5,998,180
2022-2026	9,780,000	2,229,596
2027-2031	<u>1,540,000</u>	<u>110,960</u>
Total	<u>\$ 49,424,647</u>	<u>\$ 31,845,934</u>

3. **Note Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2006</u>
2003-Series	7-1-2009	\$ 920,000	2.70% to 4.10%	<u>\$ 580,000</u>
Total notes payable				<u>\$ 580,000</u>

This note is payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	130,000	19,422
2008	140,000	14,858
2009	150,000	9,470
2010	<u>160,000</u>	<u>3,280</u>
Total	<u>\$ 580,000</u>	<u>\$ 47,030</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. LONG-TERM LIABILITIES (CONTINUED)

4. **LIMS Repayment Plan-** During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System - LIMS, contracted by the CRIM. A total of \$1,636,386 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2006, the outstanding debt balance is \$1,016,761. This amount is presented in the government wide financial statements.
5. **Property Tax Debt-** These amounts represent the balance owed to the Municipal Revenue Collection Center (CRIM) at June 30, 2006, as described in Note 6.
6. **Compensated absences-** The government-wide statement of net assets includes \$2,692,486 of accrued sick leave benefits, and \$2,816,119 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
7. **Landfill obligation-** State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on the future closure and post-closure care cost that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and post-closure care costs is based on the amount of landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$9,730,309 as of June 30, 2006 reported in the Government-Wide Financial Statements, which is based on 69% usage (filled) of the landfill. It is estimated that an additional \$4,426,091 will be recognized as closure and post-closure care expenses between the date of the balance sheet and the date the landfill is expected to be filled to capacity (2012). The estimated total current cost of the landfill closure and post-closure care (\$14,156,400) is based on the amount that would be paid if all equipment, facilities and services required to close, monitor, and maintain the landfill were acquired as of June 30, 2006. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. The Municipality of Arecibo maintains a certificate of deposits of \$208,942 and \$791,247 in a bank account held for landfill improvements.
8. **Internal Revenue Service -** These amount represents interest and penalties due to Internal Revenue Service (IRS) for Social Security Debt regarding 940PR, 499 R-2/W-2 PR and W-3PR reports from years 2000 through 2002.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. LONG-TERM LIABILITIES (CONTINUED)

9. Claims and Judgments- - These amounts represent the balance related to legal claims at June 30, 2006, as described in Note 13.

9. OPERATING LEASES:

The Municipality is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore the results of the lease agreements are not reflected in the Municipality's account groups.

The following is a schedule by years of future minimum rental payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2006:

<u>Year Ending</u> <u>June 30,</u>	<u>Total</u>
2007	\$ 556,478
2008	556,478
2009	519,482
2010	482,153
2011	<u>482,153</u>
Total minimum payments required	<u>\$2,596,744</u>

10. COMPONENT UNIT:

"Corporación Desarrollo Cultural Teatro Oliver, C.E.

Nature and Organization

"Corporación Desarrollo Cultural Teatro Oliver C.E." (non-profit organization) was organized under the laws of the Commonwealth of Puerto Rico. The Corporation was established to acquire "El Teatro Oliver of Arecibo" to be restored and operated as Municipal Theater.

Component unit financial statements of "Corporación Desarrollo Cultural Teatro Oliver C.E." were not available. As result, the component unit is not included as part of the Government-Wide Financial Statements.

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. PENSION PLAN

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

Members who have attained 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. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

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. Total employee and employer contributions during the year ended June 30, 2006 amounted to approximately **\$747,552** and **\$837,890**, respectively.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. PENSION PLAN (CONTINUED)

The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

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, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

12. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

13. COMMITMENTS AND CONTINGENCIES

A. Claims and lawsuits:

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$1,137,432 in the Government-Wide Financial Statements for awarded and anticipated unfavorable judgments. \$1,050,000 of those refers to a judiciary settlement of a claim against the Municipality by a waste disposal contractor for breach of contract and other contract violations. The Municipality will authorize the issuance of new debt to payoff the debt.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

14. BEGINNING FUND BALANCES AND NET ASSETS RESTATEMENT:

The beginning Fund Balance for General Fund has been restated by approximately \$711,872 to properly presents previously reported fund balance at June 30, 2005. The restatement is mainly due to advances to other funds that became uncollectible.

The beginning Fund Balances for Capital Projects Fund has been restated by approximately \$614,468 to properly present the previously reported fund balances at June 30, 2005. The restatement is mainly due to the cancellation by the Government Development Bank of a bond issued during fiscal year 2004-2005.

15. SUBSEQUENT EVENTS

On October 4, 2006, the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$1,056,000, for the payment of a judiciary settlement against the Municipality. Repayment of the bond is scheduled from July 2007 through July, 2016.

On October 24, 2006, the Municipal Legislature authorized the Mayor to accept and apply the funds derived from the donation provided to the Municipality by the Commonwealth of Puerto Rico of the 2006, Series A, Public Improvement Bond Issuance of \$675,000,000. The Municipality of Arecibo will receive approximately \$1,682,000 from the issuance during the fiscal year 2006-2007. Those funds will be used to pay the cost for improvements of recreational facilities, municipal offices and streets and other construction projects.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2006**

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES AND BUDGET CARRYOVER:				
Property taxes	\$ 10,496,779	\$ 10,496,779	\$ 10,496,779	\$ -
Municipal license tax	13,501,000	13,501,000	12,015,254	(1,485,746)
Licenses, permits and other local taxes	850,000	850,000	1,194,134	\$344,134
Charges for service	261,000	261,000	467,254	\$206,254
intergovernmental	7,961,565	7,644,859	8,644,163	\$999,304
Rent of property	350,000	350,000	487,717	\$137,717
Fines and forfeitures	100,000	100,000	47,671	(\$52,329)
Interest	430,000	430,000	1,365,908	\$935,908
Miscellaneous	280,000	280,000	643,925	\$363,925
Budget Carryover (1)	-	<u>1,631,881</u>	<u>1,631,881</u>	-
Total revenues and budget carryover	<u>\$ 34,230,344</u>	<u>\$ 35,545,519</u>	<u>\$ 36,994,686</u>	<u>\$ 1,449,167</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	\$ 19,385,043	\$ 19,494,033	\$ 19,973,394	\$ (479,361)
Public safety	3,452,945	3,183,341	3,085,444	97,897
Public works	9,364,695	9,497,573	9,521,258	(23,685)
Culture and recreation	480,732	438,087	470,760	(32,673)
Operating transfer to other fund	<u>1,546,929</u>	<u>2,932,485</u>	<u>2,923,882</u>	<u>8,603</u>
Total expenditures, encumbrances and other financing uses	<u>\$ 34,230,344</u>	<u>\$ 35,545,519</u>	<u>\$ 35,974,738</u>	<u>\$ (429,219)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>-</u>	<u>-</u>	<u>\$ 1,019,948</u>	<u>\$ 1,019,948</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 36,994,686
Differences-budget to GAAP:				
Budget Carryover				(1,631,881)
Nonbudgeted revenues				(324,487)
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 35,038,318</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 35,974,738
Differences-budget to GAAP:				
Prior year encumbrances recorded as current year expenditures for GAAP basis				1,126,443
Current year encumbrances recorded as expenditures for budgetary basis				(803,398)
Operating transfer to other fund				(2,923,882)
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 33,373,901</u>

(1) Represents fund balances carried over from prior years

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
NOTES TO BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
YEAR ENDED JUNE 30, 2006

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

b. Excess Expenditures, Encumbrances Over Budget

The Municipality's general fund had excess of expenditures, encumbrances and other financial uses over appropriations at the legal level of budgetary control in the following functions\programs:

<u>Expenditures, Encumbrances and Other</u>	<u>Appropriations</u>	<u>Actual Amounts</u>	<u>Excess</u>
<u>Financing Uses:</u>			
General government	\$ 19,494,033	\$ 19,973,394	\$ (479,361)
Public works	9,497,573	9,521,258	(23,685)
Culture and recreation	438,087	470,760	(32,673)