

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

MUNICIPIO DE ARROYO
AUDITORIA 2006-2007
30 DE JUNIO DE 2007

Comptroller General
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Comptroller General

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2007

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

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

YEAR ENDED JUNE 30, 2007

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MUNICIPALITY OF ARROYO
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
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YEAR ENDED JUNE 30, 2007

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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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 Arroyo
Arroyo, 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 Arroyo, Puerto Rico (Municipality)**, as of and for the year ended June 30, 2007, 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 the 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 Arroyo**. The financial statements do not include financial data for the blended component unit, "Brisas de Arroyo Housing Project", 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 Arroyo**, Puerto Rico, as of June 30, 2007 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.

The accounting records of the **Municipality of Arroyo** related to interfund transactions are not adequate. Accordingly, we were unable to obtain sufficient evidence to support and to satisfy ourselves about the amount recorded in each major fund and the aggregate remaining fund information as due from/ due to other funds, stated at \$3,309,317 in the total governmental funds column of the Balance Sheet - governmental funds.

In our opinion, except for the effects of the matters discussed in the fourth paragraph, the fund financial statements present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information for the primary government of the **Municipality of Arroyo, Puerto Rico**, as of June 30, 2007, 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.

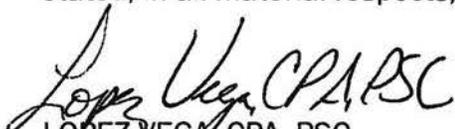
INDEPENDENT AUDITORS' REPORT (CONTINUED)

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities for the primary government of the **Municipality of Arroyo, Puerto Rico**, as of June 30, 2007, 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 December 5, 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 on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule-General Fund on page 43 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of Arroyo'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 Arroyo**. Such information 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.


LOPEZVEGA, CPA, PSC

San Juan, Puerto Rico
December 5, 2007

Stamp No 2312141 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2007

This discussion and analysis of the **Municipality of Arroyo** (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2007. 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, 2006. 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 2007 deserve special mention:

1. Total assets of the Municipality amounted to \$27,714,239 which represents a increase of (13%) compared to prior fiscal year;
2. At the end of fiscal year 2007, total liabilities amounted to \$14,183,372. Out of said amount, \$11,071,034 corresponded to long-term liabilities of which \$4,228,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
3. Total net assets of the Municipality amounted to \$13,530,867 which represents an increase of (10%) compared to prior fiscal year, as restated;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$13,069,918, derived from the following sources: \$97,820 charges for services; \$1,964,470 from operating grants and contributions; \$2,676,860 from capital grants and contributions obtained from other sources, and \$8,330,768 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$11,844,831;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$1,225,087;
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$1,443,497;
8. As the end of the current fiscal year, the Municipality's General Fund deficit amounted to \$3,739,997, compared to a deficit of \$3,862,590 in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in a favorable balance of \$636,502.

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 2007. 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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. This in turn will benefit the welfare of **Arroyo** constituents.

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, 2007, shows total expenses incurred to afford the cost of all functions and programs amounted to \$11,844,831. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$4,739,150 was derived from the following sources: \$ 97,820 charges for services; \$1,964,470 from operating grants and contributions; and \$2,676,860 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$8,330,768. When such figure is added to the \$4,739,150 previously mentioned, total revenues available for the financing of activities amounted to \$13,069,918. There was an excess of revenues over expenses in the amount of \$1,225,087, which contributed with an increase to 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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.

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 implemented the capitalization of infrastructure since 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

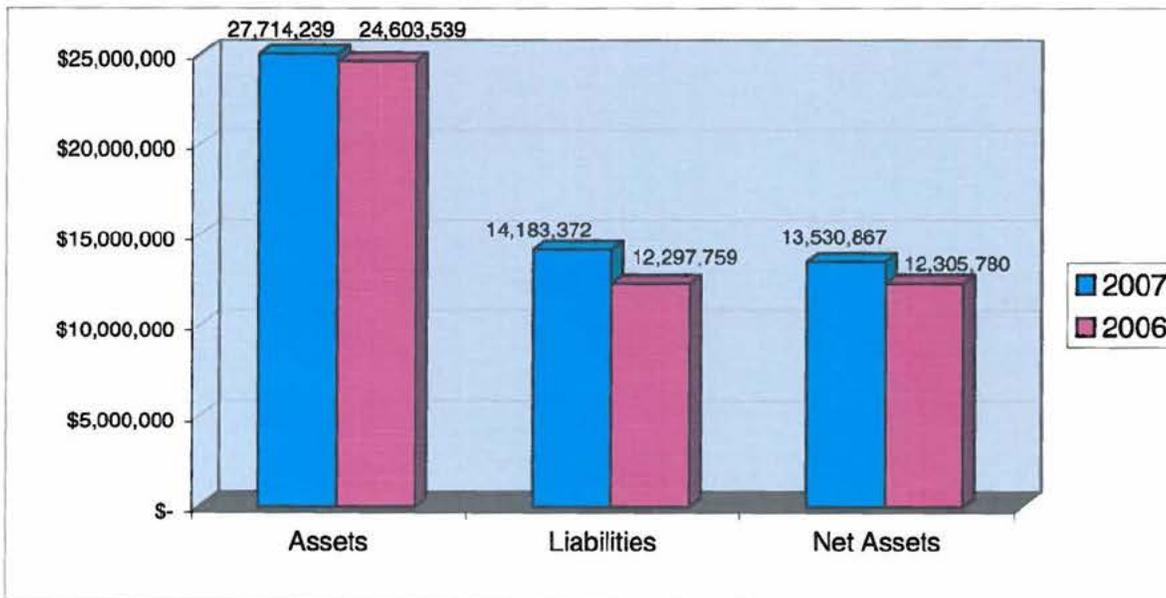
YEAR ENDED JUNE 30, 2007

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 Arroyo, primary government assets exceeded total liabilities by \$13,530,867 at the end of 2007, compared to \$12,305,780 at the end of the previous year as restated, as showed in the following condensed Statement of Net Assets of the Primary Government. Such increase in the total assets is mainly due to the capitalization of infrastructure constructed before June 30, 2002.

Condensed Statement of Net Assets	2007	2006	Change	%
Current and other assets	\$ 4,274,839	\$ 2,608,057	\$ 1,666,782	64%
Capital assets	23,439,400	21,995,482	1,443,918	7%
Total assets	27,714,239	24,603,539	3,110,700	13%
Current and other liabilities	3,112,338	3,255,891	(143,553)	(4%)
Long-term liabilities	11,071,034	9,041,868	2,029,166	22%
Total liabilities	14,183,372	12,297,759	1,885,613	15%
Invested in capital assets, net of related debt	20,381,878	20,565,960	(184,082)	(1%)
Restricted	5,096,335	3,841,648	1,254,687	33%
Unrestricted deficit	(11,947,346)	(12,101,828)	154,482	(1%)
Total net assets	\$ 13,530,867	\$ 12,305,780	\$ 1,225,087	10%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2007, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$1,225,087 increase in the Municipality's net assets. Approximately 24 percent of the Municipality's total revenue came from taxes, while 72 percent resulted from grants and contributions, including federal aid. The Municipality's expenses cover a range of services. The largest expenses were for general government, health and welfare services, 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.

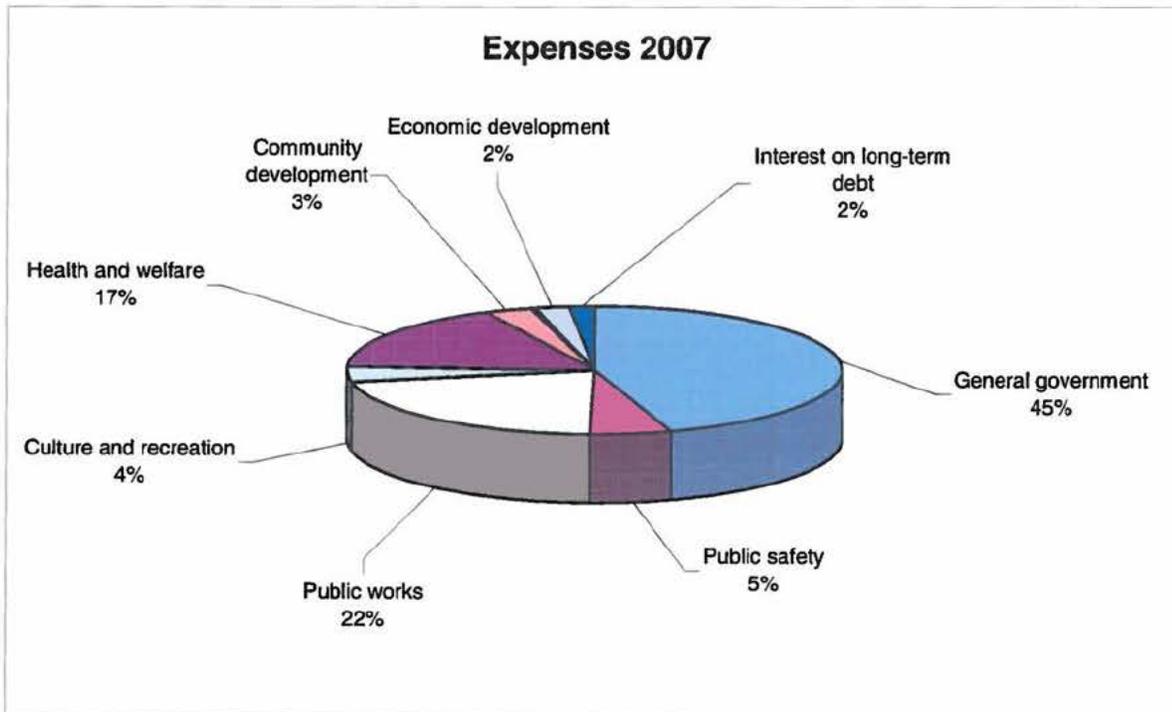
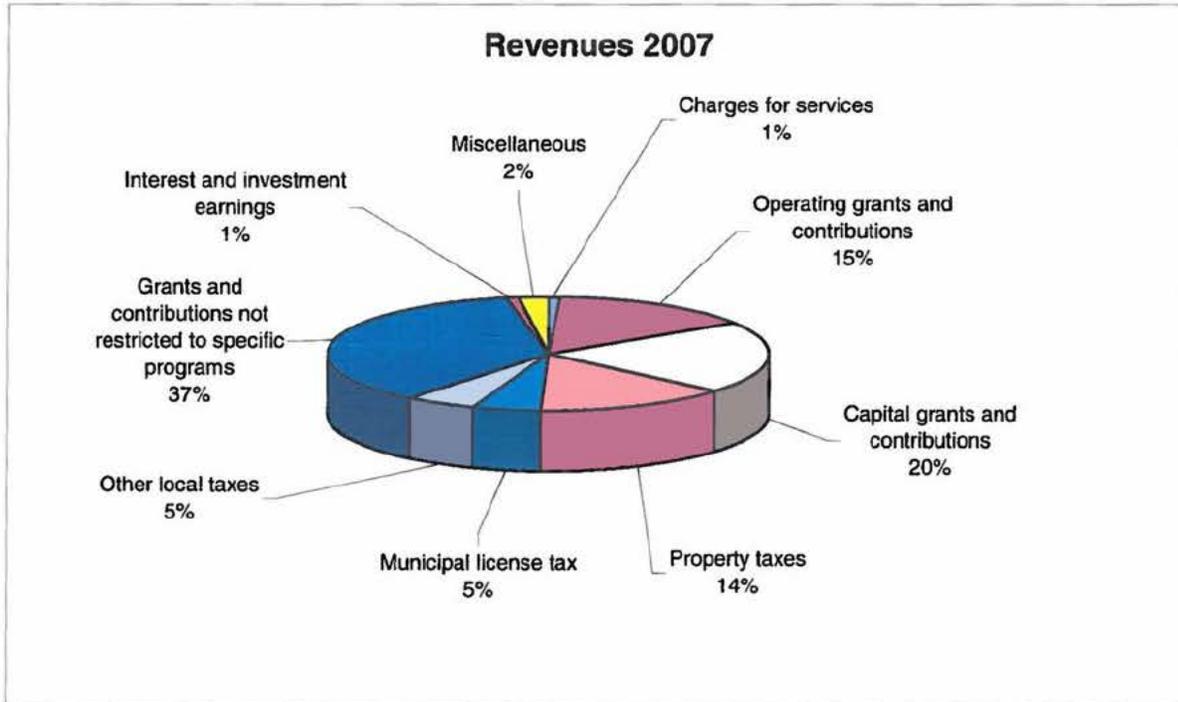
Condensed Statement of Activities	2007	2006	Change	%
Program revenues:				
Charges for services	\$ 97,820	\$ 100,998	\$ (3,178)	(3%)
Operating grants and contributions	1,964,470	2,214,485	(250,015)	(11%)
Capital grants and contributions	2,676,860	646,637	2,030,223	314%
General revenues:				
Property taxes	1,855,354	1,620,673	234,681	14%
Municipal license tax	666,476	544,306	122,170	22%
Other local taxes	674,250	290,698	383,552	132%
Grants and contributions not restricted to specific programs	4,744,151	4,645,385	98,766	2%
Interest and investment earnings	107,064	53,709	53,355	99%
Miscellaneous	283,473	187,638	95,835	51%
Total revenues	13,069,918	10,304,529	2,765,389	27%
Expenses:				
General government	5,313,762	4,733,500	580,262	12%
Public safety	647,178	643,925	3,253	1%
Public works	2,562,790	1,639,101	923,689	56%
Culture and recreation	453,201	348,190	105,011	30%
Health and welfare	2,001,758	2,222,277	(220,519)	(10%)
Community development	380,551	420,245	(39,694)	(9%)
Education	34,526	33,099	1,427	4%
Economic development	265,629	259,435	6,194	2%
Interest on long-term debt	185,436	298,661	(113,225)	(38%)
Total expenses	11,844,831	10,598,433	1,246,398	12%
Change in net assets	1,225,087	(293,904)	1,518,991	(517%)
Net assets, beginning of year, as restated	12,305,780	12,599,684	(293,904)	(2%)
Net assets, end of year	\$ 13,530,867	\$ 12,305,780	\$ 1,225,087	10%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2007

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 \$1,443,497, an increase of \$1,894,726 in comparison with the prior year, as restated. There are reservations of fund balance amounting to \$5,579,954. 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 (\$378,337), 2) to pay debt service (\$628,576), 3) to pay for capital projects (\$1,723,233) and 4) for other purposes (\$2,849,808).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2007, the general fund ended with a deficit of \$(3,739,997).

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 \$636,502.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2007, amounts to \$34,308,780, which upon deduction of accumulated depreciation of \$10,869,380 (including depreciation charges for the year totaled \$689,197), produce a net book value of \$23,439,400. 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 ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

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, 2007, the Municipality has \$1,345,310 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

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 ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

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 2007-2008.

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.

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 PO Box 477, Arroyo, Puerto Rico 00714-0477, or call (787) 839-2030.

Commonwealth of Puerto Rico
Municipality of Arroyo
Statement of Net Assets
June 30, 2007

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 1,253,067
Cash with fiscal agent	2,274,017
Accounts receivable:	
Intergovernmental	736,849
Interest	2,339
Others	8,567
Capital assets	
Land, improvements, and construction in progress	12,924,406
Other capital assets, net of depreciation	10,514,994
Total capital assets	<u>23,439,400</u>
Total assets	<u>27,714,239</u>
Liabilities	
Accounts payable and accrued liabilities	1,065,668
Due to other governmental entities	1,271,678
Deferred revenues:	
Municipal license tax	619,142
Federal grant revenues	50,568
Interest payable	105,282
Noncurrent liabilities:	
Due within one year	579,630
Due in more than one year	10,491,404
Total liabilities	<u>14,183,372</u>
Net Assets	
Invested in capital assets, net of related debt	20,381,878
Restricted for:	
Capital projects	1,723,233
Debt service	523,294
Other purposes	2,849,808
Unrestricted (deficit)	<u>(11,947,346)</u>
Total net assets	<u>\$ 13,530,867</u>

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

**Commonwealth of Puerto Rico
Municipality of Arroyo
Statement of Activities
For the Year Ended June 30, 2007**

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
General government	\$ 5,313,762	\$ -	\$ 90,779	\$ -	\$ (5,222,983)
Public safety	647,178	1,744	11,576		(633,858)
Public works	2,562,790	11,314	191,383	1,867,610	(492,483)
Health and welfare	2,001,758	372	1,322,709		(678,677)
Culture and recreation	453,201	84,390	68,405		(300,406)
Economic development	265,629		259,810		(5,819)
Community development	380,551			809,250	428,699
Education	34,526		19,808		(14,718)
Interest on long-term debt	185,436				(185,436)
Total governmental activities	\$ 11,844,831	\$ 97,820	\$ 1,964,470	\$ 2,676,860	\$ (7,105,681)
General revenues:					
Property taxes					1,855,354
Municipal license tax					666,476
Other local taxes					674,250
Grants and contributions not restricted to specific programs					4,744,151
Interest and investment earnings					107,064
Miscellaneous					283,473
Total general revenues					8,330,768
Change in net assets					1,225,087
Net assets - beginning-as restated					12,305,780
Net assets - ending					\$ 13,530,867

Commonwealth of Puerto Rico
Municipality of Arroyo
Balance Sheet
Governmental Funds
June 30, 2007

	General Fund	Special Revenue Fund - State & Local Grants	Special Revenue Fund Federal Grants	Capital Projects Fund - State & Local Grants	Other Governmental Funds	Total Governmental Funds
Assets						
Cash and cash equivalents	\$ -	\$ 534,901	\$ 117,173	\$ 450,907	\$ 150,086	\$ 1,253,067
Cash with fiscal agent	37,755		496	1,609,083	626,683	2,274,017
Accounts receivable:						
Intergovernmental	139,300	100,000	442,811	48,728	6,010	736,849
Interest					2,339	2,339
Others					8,567	8,567
Due from other funds	859,738	2,404,960	18,331	26,288		3,309,317
Total assets	\$ 1,036,793	\$ 3,039,861	\$ 578,811	\$ 2,135,006	793,685	\$ 7,584,156
Liabilities and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 315,912	\$ 14,205	\$ 178,844	\$ 241,693	\$ -	\$ 750,654
Due to other governmental entities	1,271,678					1,271,678
Due to other funds	2,430,758	339,051	297,646	170,080	71,782	3,309,317
Deferred revenues:						
Municipal license tax	619,142					619,142
Intergovernmental	139,300					139,300
Federal grant revenues			50,568			50,568
Total liabilities	4,776,790	353,256	527,058	411,773	71,782	6,140,659
Fund balances:						
Reserved for:						
Encumbrances	378,337					378,337
Capital projects				1,723,233		1,723,233
Other purposes	18,123	2,686,605	51,753			2,756,481
Reserved reported in nonmajor funds:						
Debt service fund					628,576	628,576
Other purposes					93,327	93,327
Unreserved:						
Undesigned	(4,136,457)					(4,136,457)
Total fund balances	(3,739,997)	2,686,605	51,753	1,723,233	721,903	1,443,497
Total liabilities and fund balances	\$ 1,036,793	\$ 3,039,861	\$ 578,811	\$ 2,135,006	\$ 793,685	

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	139,300
Accrual basis of accounting accounts payable recognized in government-wide financial statements	(315,014)
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	23,439,400
Long-term liabilities, including accrued interest payable, are not due and payable in the current period, and therefore, are not reported in the funds	(11,176,316)
Net assets of governmental activities	\$ 13,530,867

Commonwealth of Puerto Rico
Municipality of Arroyo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2007

	General Fund	Special Revenue Fund - State & Local Grants	Special Revenue Fund Federal Grants	Capital Projects Fund - State & Local Grants	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 1,291,906	\$ -	\$ -	\$ -	\$ 528,230	\$ 1,820,136
Municipal license taxes	639,659	26,817				666,476
Licenses, permits and other local taxes	674,470					674,470
Intergovernmental	4,833,343	477,629	15,245	1,867,610		7,193,827
Fines and forfeitures	1,744					1,744
Rent of property	92,190					92,190
Interest	107,064					107,064
Federal grants			1,210,554		981,100	2,191,654
Miscellaneous	164,517	37,120			33,506	235,143
Total revenues	7,804,893	541,566	1,225,799	1,867,610	1,542,836	12,982,704
Expenditures						
Current:						
General government	4,419,988	27,892				4,447,880
Public safety	598,551	75	11,576			610,202
Public works	1,607,619	142,079	473,111	1,224,581		3,447,390
Health and welfare	596,537	58,407	340,109		1,005,288	2,000,341
Culture and recreation	396,764	48,480		365,226		810,470
Economic development		265,629				265,629
Community development			809,250			809,250
Education		34,313				34,313
Debt service:						
Principal					217,000	217,000
Interest					155,503	155,503
Total expenditures	7,619,459	576,875	1,634,046	1,589,807	1,377,791	12,797,978
Excess (deficiency) of revenues over (under) expenditures	185,434	(35,309)	(408,247)	277,803	165,045	184,726
Other financing sources (uses)						
Transfers in					62,841	62,841
Transfers out	(62,841)					(62,841)
Long-term debt issued			460,000	1,250,000		1,710,000
Total other financing sources (uses)	(62,841)	-	460,000	1,250,000	62,841	1,710,000
Net change in fund balances	122,593	(35,309)	51,753	1,527,803	227,886	1,894,726
Fund balance, beginning as restated	(3,892,590)	2,721,914		195,430	494,017	(451,229)
Fund balance, ending	(3,769,997)	\$ 2,686,605	\$ 51,753	\$ 1,723,233	\$ 721,903	\$ 1,443,497

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Commonwealth of Puerto Rico
Municipality of Arroyo
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, 2007

Net Change in Fund Balances - Total Governmental Funds	\$ 1,894,726
<p>Amounts reported for governmental activities in the Statement of Activities are different because:</p>	
<p>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.</p>	2,133,119
<p>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.</p>	(689,197)
<p>Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets, resulting in a loss on disposal of capital assets on the Government-Wide Statement of Activities and Changes in Net Assets.</p>	(5)
<p>Interest expense on long-term debt was reported in the Government-Wide Statement of Activities and Change in Net Assets, but it did not require the use of current financial resources. Therefore, interest expense was not reported as expenditures in Governmental Funds. The following amount represented the change in accrued interest from prior year.</p>	(29,932)
<p>Bonds and notes 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 bonds and notes 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 proceeds exceed debt service principal payments.</p>	(1,493,000)
<p>Repayment of long term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long -term property tax advance debt in the Government-Wide Statement of Net Assets. The following amount represent the change in long-term property tax advance debt from prior year.</p>	111,983
<p>Repayment of long term Treasury Department debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Treasury Department from prior year.</p>	43,232
<p>Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represents the change in long-term compensated absences from prior year.</p>	(26,525)
<p>Long-term claims and judgments are reported in the Governmental-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, claims and judgments are not reported as expenditures in Government Funds. The following amount represents the change in long-term claims and judgments from prior year.</p>	(684,353)
<p>Long-term landfill obligation are reported in the Governmental-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, landfill obligation are not reported as expenditures in Government Funds. The following amount represents the change in long-term landfill obligation from prior year.</p>	50,131
<p>Repayment of long-term Department of Labor and Human Resources debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Department of Labor and Human Resources from prior year.</p>	(55,162)
<p>Repayment of long term Land Information Management System (LIMS) is an expenditure in Governmental Funds, but the repayment reduces long term LIMS in the Government-Wide Statement of Net Assets. The following amount represent the change in long term LIMS debt from prior year.</p>	24,528
<p>Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenue in the funds. The following amount represents the change in this revenues from prior year.</p>	35,218
<p>Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenses in the Governmental Funds. The following amount represents the change in this expenses from prior year.</p>	(89,676)
Change in Net Assets of Governmental Activities	\$ 1,225,087

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2007

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Arroyo** (the Municipality) was founded on the year 1855. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a twelve member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include 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 ("USGAAP") 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 ended on June 30, 2007. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

The following is a summary of the significant accounting policies of the Municipality:

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 GASB Statement No. 39. 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. USGAAP 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.

Blended Component Unit: Brisas de Arroyo Housing Project is a housing development consisting of one hundred four (104) dwelling units located in Arroyo, Puerto Rico. The Project is owned by the Municipality, but the activities on it are carried-on by a management agent unrelated to the Municipality. The housing development is designated to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The Project operated under financing from US Department of Agriculture Section 515 Rural Rental Housing Loans Program, and with a Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with US Housing and Urban Development.

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 ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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-type 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 or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 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 – State & Local 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 and state statutes.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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 - Is the general 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 Funds are used to account for revenues derived from section 8 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 - Section 8 Moderate Rehabilitation - Special Revenue Funds are used to account for revenues derived from section 8 moderate rehabilitation program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - 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 Fund - Capital Projects Fund are used to account for financial resources used for the acquisition or construction of major capital facilities.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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 ("USGAAP") 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.

Property taxes, other 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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. Also, cash with fiscal agent consists of unused proceeds of bonds and notes issued for the acquisitions of equipment and construction of major capital improvements.

- 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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 special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

- 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.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

5. **Long-term obligations-** The liabilities reported in the government-wide financial statements included 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 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. All sick leave pay and salary related benefits are accrued when incurred in the governmental-wide financial statements when the employee meets such criteria.

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 when the liability is incurred.

8. **Reservations 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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.

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 Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2007 amounted to approximately \$204,765. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$79,660 for workers compensation insurance covering all municipal employees.

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:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

		<u>Total Net Assets Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 23,439,400	
Deduct:		
Bonds payable related to capital assets	(2,654,522)	
Notes payable related to capital assets	<u>(403,000)</u>	\$ 20,381,878
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		1,723,233
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service	628,576	
Deduct:		
Interest payable	<u>(105,282)</u>	523,294
<u>Net assets restricted for other purposes</u>		
General fund - fund balance reserved for other purpose	18,123	
Special revenue fund - state & local grants - fund balance reserved for other purpose	2,686,605	
Special revenue fund - federal grants - fund balance reserved for other purpose	51,753	
Other governmental funds - fund balance reserved for other purpose	93,327	2,849,808
<u>Net assets unrestricted (deficit)</u>		
General fund - total deficit:	(3,739,997)	
Add:		
Accrued basic accounts receivable	139,300	
Deduct:		
General fund - fund balance reserved for other purpose	(18,123)	
Accrual basis accounts payable	(315,014)	
Bonds payable	(1,170,478)	
Property tax advances	(3,237,636)	
Property tax - Treasury	(129,695)	
Compensated absences	(1,184,476)	
Landfill obligation	(1,403,666)	
LIMS repayment plan	(130,046)	
Department of Labor and Human Resources	(55,162)	
Claims and judgments	<u>(702,353)</u>	<u>(11,947,346)</u>
Total net assets - governmental activities		<u>\$ 13,530,867</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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 \$534,901 in the special revenue fund - state and local grants, \$117,173 in the special revenue fund - federal grants and \$450,907 in the capital projects fund - state and local grants were fully collateralized at June 30, 2007. In the other governmental funds there were deposits with commercial banks of \$150,086 that were fully collateralized.

The deposits at GDB of \$37,755 in the general fund, the \$496 in the special revenue fund - federal grants, the \$1,609,083 in the capital projects fund - state and local grants and the \$626,683 in the other governmental funds, are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

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

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM)	\$ 139,300
Total	\$ 139,300

Intergovernmental receivable in special revenue fund - state and local grants represent expenditures incurred not yet reimbursed by a state agency. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Department of Labor and Human Resources	\$ 100,000
Total	\$ 100,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in the special revenue fund – federal grants represent expenditures incurred not yet reimbursed by the federal agencies or the pass-through grantors. Also, represents property tax receivable at June 20, 2007. Following is a detail of the intergovernmental receivable:

<u>Description</u>	<u>Amount</u>
Community Development Block Grant – State's Program	\$ 247,934
Child Care and Development Block Grant	141,351
Pre-Disaster Mitigation Competitive Grants	28,110
Others	<u>25,416</u>
Total	<u>\$ 442,811</u>

Intergovernmental receivable in the capital projects fund – state and local grants represent expenditures incurred not yet reimbursed by the state government. Following is a detail of the intergovernmental receivable:

<u>Description</u>	<u>Amount</u>
Commonwealth of Puerto Rico - Legislature	\$ <u>48,728</u>
Total	<u>\$ 48,728</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2007, and interfund transfers during the fiscal year ended at June 30, 2007, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund- Local and State Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	\$ 320,230
General Fund	Special Revenue Fund- Federal Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	297,646
General Fund	Capital Projects Fund	Reimbursable expenditures	170,080
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed, interest revenue, and other reimbursable expenditures	71,782
Special Revenue Fund - Local and State Grants	General Fund	Cash pool in the same bank account and other reimbursable expenditures	2,404,960
Special Revenue Fund- Federal Grants	Special Revenue Fund- Local and State Grants	Reimbursable expenditures	18,331
Capital Projects Fund	General Fund	Cash pool in the same bank account	25,798
Capital Projects Fund	Special Revenue Fund- Local and State Grants	Reimbursable expenditures	<u>490</u>
Total			<u>\$ 3,309,317</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Other Governmental Funds	Debt retirement	<u>\$ 62,841</u>
Total			<u>\$ 62,841</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

5. CAPITAL ASSETS

Capital assets; those with an estimated useful live 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 2007, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

Governmental Activities:	<u>Balance July 1, 2006 as restated</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2007</u>
Capital asset, not being depreciated:				
Land	\$ 9,567,674	\$ -	\$ -	\$ 9,567,674
Construction in progress	<u>1,835,166</u>	<u>1,641,591</u>	<u>(120,025)</u>	<u>3,356,732</u>
Total capital assets not being depreciated	<u>11,402,840</u>	<u>1,641,591</u>	<u>(120,025)</u>	<u>12,924,406</u>
Capital assets, being depreciated:				
Buildings	13,557,545			13,557,545
Building improvements	440,280	214,301		654,581
Infrastructure	3,407,338			3,407,338
Infrastructure improvements	653,547	29,169		682,716
Equipment	592,761	42,720	(1,299)	634,182
Furnishing	295,327	19,878	(381)	314,824
Work of Art	3,410			3,410
Computers	73,543	6,593	(455)	79,681
Vehicles	<u>1,751,205</u>	<u>298,892</u>	<u>-</u>	<u>2,050,097</u>
Total capital assets being depreciated	<u>20,774,956</u>	<u>611,553</u>	<u>(2,135)</u>	<u>21,384,374</u>
Less accumulated depreciation for:				
Buildings	(5,813,153)	(338,940)		(6,152,093)
Building improvements	(37,562)	(15,715)		(53,277)
Infrastructure	(2,035,281)	(85,183)		(2,120,464)
Infrastructure improvements	(97,610)	(44,749)		(142,359)
Equipment	(381,629)	(79,204)	1,293	(459,540)
Furnishing	(252,205)	(25,085)	381	(276,909)
Work of Art	(1,250)	(341)		(1,591)
Computers	(55,448)	(11,260)	456	(66,252)
Vehicles	<u>(1,508,175)</u>	<u>(88,720)</u>	<u>-</u>	<u>(1,596,895)</u>
Total accumulated depreciation	<u>(10,182,313)</u>	<u>(689,197)</u>	<u>2,130</u>	<u>(10,869,380)</u>
Total capital assets being depreciated, net	<u>10,592,643</u>	<u>(77,644)</u>	<u>(5)</u>	<u>10,514,994</u>
Governmental activities capital assets, net	<u>\$ 21,995,483</u>	<u>\$ 1,563,947</u>	<u>\$ (120,030)</u>	<u>\$ 23,439,400</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 340,228
Public safety	41,267
Public works	104,733
Culture and recreation	142,896
Community Development	58,218
Education	213
Health and welfare	<u>1,642</u>

Total depreciation expense-governmental activities	<u>\$ 689,197</u>
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6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2007 are summarized as follows:

Description	General Fund	Special Revenue Fund - State & Local Grants	Special Revenue Fund - Federal Grants	Capital Projects Fund - State & Local Grants	Other Governmental Fund	Total
Accounts payable	\$ 143,068	\$ 14,205	\$ 178,844	\$ 241,693	\$ -	\$ 577,810
Accrued liabilities	<u>172,844</u>	-	-	-	-	<u>172,844</u>
Total	<u>\$ 315,912</u>	<u>\$ 14,205</u>	<u>\$ 178,844</u>	<u>\$ 241,693</u>	<u>\$ -</u>	<u>\$ 750,654</u>

7. 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 Municipal Revenue Collection Center (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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

7. PROPERTY TAXES (CONTINUED)

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 liquidation noting that the collections exceeded advances by \$139,300. In the governmental funds, the entire receivable has been offset by deferred revenue since the excess was not available to pay liabilities of the current period. In the government-wide financial statements, the entire receivable is recognized as revenue.

On December 31, 1992, the Municipality entered into an agreement with the Commonwealth of Puerto Rico - Treasury Department, for the repayment of excess property tax advances. As of June 30, 2007, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$129,695.

On January 26, 2000, Public Law No. 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 No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No. 146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years.

Also, on October 11, 2002, Public Law No. 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 No. 42 enacted on January 26, 2000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

7. PROPERTY TAXES (CONTINUED)

On June 26, 1997, Public Law No. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The Government-Wide Statement of Net Assets includes an outstanding debt balance of \$2,289,637 and \$947,999 related to Law No. 42 and Law No. 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.

The annual tax rate is 8.83% for real property and 6.83% 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) 2.00% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

8. MUNICIPAL LICENSE TAX

The Municipality impose 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 Acts 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, 2007, 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 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2007, net of allowance for uncollectible.

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

9. 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>
Puerto Rico Aqueduct and Sewer Authority	\$ 263,468
General Services Administration	9,457
Puerto Rico Telephone Company	26,496
Puerto Rico Electric Power Authority (PREPA)	1,625
Commonwealth of Puerto Rico - Treasury Department	745,716
Internal Revenue Service	161,031
Retirement System Administration	<u>63,885</u>
Total	<u>\$ 1,271,678</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

9. DUE TO OTHER GOVERNMENTAL ENTITIES:

The Municipality reached agreements with other governmental entities for the payment of debts on a long-term basis. These liabilities are presented in the Statement of Net Assets as non-current liabilities.

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 \$248,774 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2007, the outstanding debt balance was \$130,046. This amount will be presented in the government wide statement of net assets.

10. DEFERRED REVENUES

- A. Municipal License Tax-** The deferred revenues of approximately \$619,142 in the general fund relates to municipal license tax collected in fiscal year 2006-07 that will be earned in fiscal year 2007-08.
- B. Intergovernmental -** The deferred revenues of approximately \$139,300 in the general fund relates to the balance owed from the Municipal Revenue Collection Center (CRIM) at June 30, 2007, as described in Note 7.
- C. Federal Government-** The deferred revenues presented in the special revenue fund - federal grants 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>
Public Safety Partnership and Community Policing Grant	\$ 22,130
Child and Adult Care Food Program	11,173
Others	<u>17,265</u>
Total	<u>\$ 50,568</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

11. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2007, was as follows:

Description	Beginning Balance (as restated)	Borrowings or Additions	Payments or Deductions	Ending Balance	Due Within One Year
Bonds Payable	\$ 2,735,000	\$ 1,250,000	\$ (160,000)	\$ 3,825,000	\$ 195,000
Notes Payable		460,000	(57,000)	403,000	60,000
Property Tax Advances	3,349,619		(111,983)	3,237,636	40,096
Property Tax – Treasury	172,927		(43,232)	129,695	43,232
Compensated absences	1,157,951	143,007	(116,482)	1,184,476	110,000
Landfill obligation	1,453,797		(50,131)	1,403,666	50,131
LIMS Repayment Plan	154,574		(24,528)	130,046	26,009
Department of Labor and Human Resources		55,162		55,162	55,162
Claims and judgments	<u>18,000</u>	<u>684,353</u>	<u>-</u>	<u>702,353</u>	<u>-</u>
Total	<u>\$9,041,868</u>	<u>\$ 2,592,522</u>	<u>\$ (563,356)</u>	<u>\$ 11,071,034</u>	<u>\$ 579,630</u>

- 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, 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. During the current year, the Municipality issued bonds for approximately \$1,250,000. Bonds payable outstanding at June 30, 2007 are as follows:

Type of bonds	Maturity Date	Original Amount	Range of Interest Rates	Balance at June 30, 2007
2000-Series	7/1/2009	\$ 1,065,000	5.00% to 8.00%	\$ 405,000
2002-Series	7/1/2026	1,410,000	2.70% to 5.60%	1,300,000
2002-Series	7/1/2026	940,000	5.00% to 7.50%	870,000
2007-Series	7/1/2031	1,250,000	6.60% to 7.00%	<u>1,250,000</u>
Total general obligation bonds				<u>\$ 3,825,000</u>

These bonds are payable from the special ad valorem property tax of 2.00% 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 ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

11. LONG-TERM LIABILITIES (CONTINUED)

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

Year Ending June 30,	Principal	Interest
2008	\$ 195,000	\$ 218,469
2009	205,000	230,470
2010	230,000	214,707
2011	85,000	203,813
2012	90,000	198,555
2013-2017	570,000	896,139
2018-2022	815,000	681,719
2023-2027	1,195,000	360,291
2028-2032	<u>440,000</u>	<u>81,550</u>
Total	<u>\$ 3,825,000</u>	<u>\$ 3,085,713</u>

- 3. Notes Payable-** The proceeds of the issuance of notes payables are used principally to pay debt incurred in prior years and to cover the expenditures of a special event. During the current year, the Municipality issued a note for approximately \$460,000. The note is payable as follows:

Type of notes	Maturity Date	Original Amount	Range of Interest rates	Balance at June 30, 2007
2006-Series	1-1-2013	\$ 460,000	4.50%	<u>\$ 403,000</u>
Total notes payable				<u>\$ 403,000</u>

This note is payable with the blended component unit source of revenues.

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

Year Ending June 30,	Principal	Interest
2008	\$ 60,000	\$ 18,337
2009	63,000	15,435
2010	65,000	12,600
2011	68,000	9,675
2012	71,000	6,615
2013-2017	<u>76,000</u>	<u>3,420</u>
Total	<u>\$ 403,000</u>	<u>\$ 66,082</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

11. LONG-TERM LIABILITIES (CONTINUED)

4. **Compensated absences-** The government-wide statement of net assets includes approximately \$886,739 of accrued sick leave benefits, and approximately \$297,737 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

5. **Landfill Obligation-** State and federal laws and regulations require the Municipality to place a final cover on its landfill site, when it stopped accepting waste, and perform certain maintenance and monitoring functions at the 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 and to comply with applicable state and federal regulations.

Based on this study, the Municipality has recognized \$1,403,666 as the Municipality's estimated current cost for landfill closure and post-closure costs as of June 30, 2007. The annual estimate of post closure costs has been assessed approximately to be \$15,500 for a period of approximately 30 years. Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. The balance of closure and post-closure costs are reported in the government-wide statement of net assets.

6. **LIMS Repayment Plan-** This amount represents the balance owed to the CRIM at June 30, 2007, as described in Note 9.

12. PENSION PLAN

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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

12. PENSION PLAN (CONTINUED)

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 Municipality contributions during the year ended June 30, 2007 amounted to approximately \$242,163. This amount represented 100% of the required contribution.

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. 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, 2007, a copy of which can be obtained from the Retirement System, Minillas Station, PO Box 42003, San Juan, PR 00940.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

13 RISK MANAGEMENT

The Property Division is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the Area of 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. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

14 COMMITMENTS AND CONTINGENCIES

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 \$702,353 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

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.

15 PRIOR PERIOD ADJUSTMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

Description	General Fund	Special Revenue Fund - State & Local Grants	Special Revenue Fund Federal Grants	Capital Projects Fund - State & Local Grants	Other Governmental Fund	Total
Fund balance, beginning	\$(3,862,590)	\$ 2,721,914	\$ -	\$ 195,430	\$ 410,008	\$ (535,238)
To reclassify prior year deferred federal grants revenues					26,124	26,124
To correct prior year due to other funds					57,885	57,885
Fund balance, beginning as restated	<u>\$(3,862,590)</u>	<u>\$ 2,721,914</u>	<u>\$ -</u>	<u>\$ 195,430</u>	<u>\$ 494,017</u>	<u>\$ (451,229)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

15 PRIOR PERIOD ADJUSTMENTS (CONTINUED)

B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS

The following restatements have been made in the governmental wide financial statements, which are reported as an adjustment to the beginning net assets:

<u>Description</u>	<u>Total</u>
Net assets, beginning	\$ 5,663,079
To reclassify prior year deferred federal grants revenues	26,124
To correct prior year due to other funds	57,885
Prior year housing project transactions	(347,938)
Implementation of the retroactive capitalization of infrastructure assets	<u>6,906,630</u>
Net assets, beginning as restated	<u>\$ 12,305,780</u>

16. SUBSEQUENT EVENTS

On July 29, 2007, an amended to Act No. 117 of July 4, 2006, known as the "Tax Fairness Act of 2006", was enacted with the purpose of establishing a mandatory sales and use tax of 1.5% at the Municipal Level. The Municipalities of Puerto Rico are responsible to collect 1% of the corresponding tax with the same exemptions and limitations that the portion collected by the Treasury Department. The Act provides an optional surtax on the un-process food. This surtax must be approved by the Municipal Legislature.

The Treasury Department is responsible to create the Municipal Development Fund (.02%), the Municipal Redemption Fund (.02%) and the Municipal Improvements Fund (.01%) with the remaining 0.5%.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with</u>
	<u>Original</u>	<u>Final</u>	<u>(Budgetary Basis)</u> <u>(See Note 1)</u>	<u>Final Budget</u> <u>Positive</u> <u>(Negative)</u>
REVENUES:				
Property taxes	\$ 1,170,586	\$ 1,170,586	\$ 1,291,905	\$ 121,319
Fines and forfeiture	10,000	10,000	1,744	(8,256)
Municipal license tax	560,500	560,500	639,658	79,158
Licenses, permits and other local taxes	1,000,199	976,503	674,469	(302,034)
Intergovernmental	4,678,546	4,678,546	4,833,343	154,797
Charges for services	103,400	103,400	134,371	30,971
Interest			107,063	107,063
Rent of property	85,000	85,000	89,689	4,689
Miscellaneous	50,000	50,000	161,003	111,003
Total revenues	<u>7,658,231</u>	<u>7,634,535</u>	<u>7,933,245</u>	<u>298,710</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	4,058,840	4,162,317	3,961,704	200,613
Public safety	613,048	599,071	588,555	10,516
Public works	1,810,498	1,726,089	1,686,315	39,774
Health and welfare	615,997	608,219	596,624	11,595
Culture and recreation	342,348	321,339	400,704	79,365
Operating transfer to other funds	<u>217,500</u>	<u>217,500</u>	<u>62,841</u>	<u>154,659</u>
Total expenditures, encumbrances and other financing uses	<u>7,658,231</u>	<u>7,634,535</u>	<u>7,296,743</u>	<u>337,792</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)				
	\$ -	\$ -	\$ 636,502	\$ 636,502
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 7,933,245
Differences-budget to GAAP:				
GAAP adjustments to revenues				<u>(128,352)</u>
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,804,893</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 7,296,743
Differences-budget to GAAP:				
GAAP adjustment to expenditures				(173,481)
Prior year encumbrances recorded as current year expenditures for GAAP basis				797,211
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(238,173)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,682,300</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2007

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 USGAAP, 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 USGAAP 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.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2007 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2007.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2007

<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:			
Direct Program:			
Community Facilities Loans and Grants	10.766		409,835
Pass-through the Commonwealth of Puerto Rico - Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	<u>\$ 35,072</u>
Total U.S. Department of Agriculture			<u>444,907</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation	14.856		610,935
Direct Program:			
Section 8 Housing Choice Vouchers Program	14.871		370,165
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs:			
Community Development Block Grants - State's Program	14.228	00-FD-07 01-FD-07 02-AB-FC-RI-07 03-AB-FC-07 04-AB-FC-07 05-AB-FC-07 06-AB-FC-07	809,250
Total U.S. Department of Housing and Urban Development			<u>1,790,350</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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 - Administration for Children and Families: Child Care and Development Block Grant	93.575	Not Available	<u>305,036</u>
Total U.S. Department of Health and Human Services			<u>305,036</u>
U.S. DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR): Disaster Grants - Public Assistance	97.036	Not Available	45,735
Pass-through the Commonwealth of Puerto Rico - Emergency Management Agency: Emergency Management Performance Grant	97.042	Not Available	7,279
Pass-through the Commonwealth of Puerto Rico Governor Office - Public Security Affairs Office: Homeland Security Grant Program	97.067	Not Available	<u>6,593</u>
Total U.S. Department of Homeland Security			<u>59,607</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$2,599,900</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2007

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Arroyo** 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 – Federal Grants and in 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 – Federal Grants	Other Governmental Funds	Total
Per Schedule of Expenditures of Federal Awards	\$ 1,618,800	\$ 981,100	\$ 2,599,900
Non federal programs Expenditures	<u>15,246</u>	<u>396,691</u>	<u>411,937</u>
Total expenditures in the general purpose financial statements	<u>\$ 1,634,046</u>	<u>\$ 1,377,791</u>	<u>\$ 3,011,837</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 Arroyo
Arroyo, 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 Arroyo, Puerto Rico**, as of and for the year ended June 30, 2007, which collectively comprise the **Municipality's** basic financial statements and have issued our report thereon dated December 5, 2007, which was unqualified at the governmental-wide financial statement level, but qualified at the fund financial statements level because we were unable to obtain sufficient evidence to support and to satisfy ourselves about the amount recorded in each major fund and the aggregate remaining fund information as due from/ due to other funds. Except as discussed in the preceding sentence, 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 Arroyo's** internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the **Municipality of Arroyo's** internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the **Municipality of Arroyo's** internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects **Municipality of Arroyo's** ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of **Municipality of Arroyo's** financial statements that is more than inconsequential will not be prevented or detected by **Municipality of Arroyo's** internal control.

**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)**

We consider the deficiencies described in the accompanying schedule of finding and questioned costs to be significant deficiencies in internal control over financial reporting, as items 07-01 through 07-03.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the **Municipality of Arroyo's** internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider item 07-02 to be material weakness.

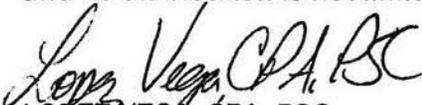
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the **Municipality of Arroyo'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 Arroyo** in a separate letter dated December 5, 2007.

The **Municipality of Arroyo's** response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the **Municipality of Arroyo's** response and, accordingly, we express no opinion on it.

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 5, 2007

Stamp No. 2312142 of the Puerto Rico
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was affixed to the record copy of this report.



López-Vega, CPA, PSC

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

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

Compliance

We have audited the compliance of the **Municipality of Arroyo** 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, 2007. The **Municipality of Arroyo'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 Arroyo's** management. Our responsibility is to express an opinion on the **Municipality of Arroyo's** compliance based on our audit.

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

In our opinion, the **Municipality of Arroyo** 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, 2007. 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 **07-04** through **07-10**.

**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 Arroyo** is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the **Municipality of Arroyo's** internal control over compliance with the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **Municipality of Arroyo's** internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items **07-04** through **07-10** to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items **07-07**, **07-08** and **07-10** to be material weaknesses.

The **Municipality of Arroyo's** response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the **Municipality of Arroyo's** response and, accordingly, we express no opinion on it.



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)

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 Arroyo** in a separate letter dated January 29, 2008.

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
January 29, 2008

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2007

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:	Unqualified, except for qualify for fund financial statements	
Internal control over financial reporting:		
Material weakness identified?	Yes X	No
Significant deficiencies 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
Significant deficiencies 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:

CFDA Number	Name of Federal Program or Cluster
10.766	Community Facilities Loans and Grants
14.871	Section 8 Housing Choice Voucher Program
14.228	Community Development Block Grants – State’s Program
93.575	Child Care and Development Block Grant

Dollar threshold used to distinguish between Type A and Type B programs	\$300,000
Auditee qualified as low-risk auditee?	Yes No X

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section II - Financial Statements Findings

Finding Reference 07-01

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). Also, the Municipality's accounting system did not provide to produce its Governmental Wide Financial Statements.

The Municipality did not include in the basic financial statements, audited financial information related to the blended component unit "Brisas de Arroyo Housing Project".

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

Also, *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 establish 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.

Also, the Municipality was unable to obtain the audited financial statements of the "Brisas de Arroyo Housing Project", a blended component unit, for the fiscal year ended June 30, 2007.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section II – Financial Statements Findings

Finding Reference **07-01 (Continued)**

Recommendation We recommend that the Municipality should implement 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.

Also, we recommend to the Municipality Management to require, timely, the audited financial statements of the “Brisas de Arroyo Housing Project”, to the component unit Management, to include them in the financial reporting entity basic financial statements for the next fiscal year.

Questioned Costs None

Management Response
and Corrective Action

The Municipality maintains two set of accounting records; a manual system and a computerized system provided in the past by the Office of the Commissioner of Municipal Affairs (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation.

Nevertheless, as part of the corrective action plan, the Commissioner of Municipal Affairs (“OCAM”) consider alternatives to improve the accounting system, including the acquisition of new accounting software, and therefore, we will hope to solve our accounting system condition in a near future. Although the Legislature of the Commonwealth Government of Puerto Rico has appropriated funds for the design and implementation of a new system, no further action has been taken on this matter.

Also, we establish a communication with the “Brisas de Arroyo Housing Project” external auditor, in order to require the audited financial statement of this project on time.

Implementation Date: January, 2009

Responsible Person: Néstor Alicea
Finance Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section II – Financial Statements Findings

Finding Reference	07-02
Requirement	Financial Reporting – Interfund Transactions
Statement of Condition	During our examination, we noted that for the fiscal year 2006-2007, the accounting records of the Municipality related to interfund transactions were not adequate.
Criteria	Article 8.010 (C) (2) and (3) of State Act Number 81 of August 30, 1991, stated that Municipality should maintain accurate accounting records and fund controls.
Cause of Condition	The Management’s controls and procedures failed to assure that the Municipality maintained accurate accounting records related to interfund transactions.
Effect of Condition	The Municipality did not maintain an adequate control of the accountability regarding interfund transactions.
Recommendation	We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to interfund transactions.
Questioned Costs	None
Management Response and Corrective Action	As part of our corrective action plan, we will review the interfund balance as of June 30, 2007, in order to determine the correct balance. This review include revise our manual accounting records, in order to determinate the correct balance of the local and state funds received by the Municipality, and realize the necessary adjustment entries to correct them. Implementation Date: January, 2009 Responsible Person: Néstor Alicea Finance Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section II - Financial Statements Findings

Finding Reference **07-03**

Requirement **Expenditures for Goods and Services and Accounts Payables-
Purchasing and receiving**

Statement of Condition We performed a cash disbursement test and examined twenty five (25) disbursements which belonged to General Fund, seven (7) which belonged to Community Facilities Loans and Grants, five (5) which belonged to Permanent Improvements account and twenty three (23) which belonged to Community Development Block Grants - State's Program (CDBG). The following will summarize the internal control exceptions noted:

- a. In five (5) General Fund's disbursement vouchers, we noted that during the fiscal year 2006-2007, the Municipality acquired fuel for a total amount of \$ 62,117. We did not obtain evidence that demonstrate the realization of a formal bid for this acquisition;
- b. In one (1) Permanent Improvements account's disbursement voucher, the amount invoiced did not agree with the amount disbursed;
- c. One (1) General Fund's disbursement voucher did not include the Mayor signature;
- d. Two (2) General Fund's disbursement vouchers did not include the three (3) quotations required by Law;
- e. Five (5) General Fund's disbursement vouchers did not include the purchase requisition;
- f. Six (6) disbursement vouchers did not include the date of the pre-intervention officer signature (five (5) related to General Fund and one (1) related to Community Facilities Loans and Grants);
- g. In four (4) disbursement vouchers (three (3) related to General Fund and one (1) related to Community Facilities Loans and Grants), several documents were not marked as paid;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section II – Financial Statements Findings

Finding Reference **07-03 (Continued)**

- h. Nine (9) General Fund's disbursement vouchers did not include the certification of the Municipality's employee who had knowledge of the receiving of the good and service;
- i. Four (4) disbursement vouchers were not available for our examination (one (1) related to General Fund and three (3) related to Permanent Improvements account);

Criteria The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico establish in the Chapter Four (4) that the Finance Director will be responsible to account and prepare disbursements through documents duly prepared and certified, including sufficient evidential matter to support the transactions.

Cause of Condition The Municipality internal control procedures failed to assure that all transactions include all the required documentation.

Effect of Condition The Municipality is not in compliance with Chapter Four (4) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.

Recommendation We recommend that the Municipality should improve its internal control and procedures in order to assure that the disbursement vouchers contain all the necessary supporting documents before making the payments.

Questioned Costs None

Management Response and Corrective Action To reduce the probability that a condition described above occurs again, we are going to instruct the Finance Department staff (including the Official Payer, the Pre-Auditor, the Department Accountant, the Department Secretary, etc.) to improve the procedures established in the regulation, in order to assure that the disbursement vouchers contain all the necessary supporting documents before making the payments.

Implementation Date: January, 2009

Responsible Person: Néstor Alicea
Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	07-04
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871); U.S. Department of Housing and Urban Development
Requirement	Special Test – Utility Allowance Schedule
Statement of Condition	The Program did not apply an update utility allowance schedule for the audit period ending June 30, 2007.
Criteria	Code of Federal Regulations 24, Subpart K, Section 982.517 states that the PHA must maintain an up-to-date utility allowance schedule. The PHA must review utility rate data for each utility category on a yearly basis and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category or fuel type since the last time utility allowance was revised.
Cause of Condition	The PHA did not follow the procedures established to review utility rate date each year.
Effect of Condition	The PHA is no in compliance with Code of Federal Regulations 24, Subpart K, and Section 982.517.
Recommendation	The PHA should evaluate utility allowance rate each year as established in the federal regulations.
Questioned Costs	None.
Management Response and Corrective Action	The Program realized a study on May 21, 2007 in order to update the utility allowance schedule, nevertheless, this study was effective for the fiscal year 2007-2008. We understand that the condition described in the finding was corrected during the current fiscal year. Implementation Date: Corrected during fiscal year 2007-2008 Responsible Person: Luis A. Torres Mariani Section 8 Program Coordinator

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	07-05
	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Selection from the Section 8 Waiting List
Statement of Condition	We performed a waiting list test of seven (7) participants admitted in the Program during the fiscal year 2006-2007. We did not obtain evidence that demonstrate if the selection of four (4) of these participants was in accordance with the waiting list policies established in the administrative plan.
Criteria	Code of Federal Regulations 24, Sections 982.54 (d) and 982.201 through 982.207 states the waiting list procedures and that the selection from the waiting list generally occurs when the PHA notifies a family, whose names reaches the top of the waiting list, to come in to verify eligibility for admission. The PHA's administrative plan states that, except for special admissions, participant will be selected from the PHA waiting list. The PHA must select participants from the waiting list on a first-come, first-served basis, in accordance with this same plan, which includes equal opportunity. Also, the Municipality will maintain information that permits proper selection from the waiting list.
Cause of Condition	The Municipality controls and procedures failed to assure that the selection of the Program's participants was in accordance with the waiting list policies established in the administrative plan.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, sections 982.54 (d), 982.201 through 982.207 and with the PHA's administrative plan.
Recommendation	We recommend management to improve monitoring procedures to assure that the participants are admitted to the program or are provided the opportunity to be admitted to the program according with the PHA administrative plan.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **07-05 (Continued)**

**Management Response
and Correction Action**

Selection from the approved "Waiting List" is based on first-come-first served basis, and/or under federal or local preferences as a results of a well-document emergency situation, such as fire, natural disaster, etc. Nevertheless, as part of our corrective action plan, we will instruct our Program staff in order to document all procedures performed to select the participants.

Implementation Date: April, 2008

Responsible Person: Luis A. Torres Mariani
Section 8 Program Coordinator

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	07-06
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
Statement of Condition	<p>We performed a Housing Quality Standards (HQS) Inspections test and examined a sample of ten (10) participant's files. The following will summarize the situation noted:</p> <p>a. In nine (9) participant's files, we noted that the quality control re-inspections were made after three (3) months of the date of the HQS inspections.</p>
Criteria	<p>Code of Federal Regulations 24, Subpart I, 982.404, 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 HQS and the PHA must conduct quality control re-inspections. Also, the PHA must prepare a unit inspection report.</p> <p>The Housing Choice Voucher Guidebook, number 7420, Chapter 10 state that a PHA supervisor or other qualified person must re-inspect a sample of units under contract during the last PHA fiscal year. Also, this guidebook state that the complete HQS inspections included in the sample must be no older than three (3) months at the time of the re-inspections.</p>
Cause of Condition	<p>The Municipality did not maintain adequate monitoring procedures to assure that the annual HQS re-inspections are properly performed.</p>
Effect of Condition	<p>The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, 982.404, Section 982.158 (d) and 982.405 (b), and with the Housing Choice Voucher Guidebook, number 7420, Chapter 10.</p>
Recommendation	<p>We recommend management to implement internal control procedures in order to assure that the HQS re-inspections are properly performed. These procedures should include that the HQS re-inspections included in the sample must be no older than three months at the time of the re-inspection.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	07-07
Program	Community Development Block Grants – State’s Program (CFDA No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Allowable Activities
Statement of Condition	<p>We performed a housing rehabilitation test of nine (9) participant files and found the following exceptions:</p> <ul style="list-style-type: none">a. In two (2) participant’s files, we did not identify evidence of the pre-rehabilitation inspection;b. In five (5) participant’s files, we did not found evidence that demonstrated if the deficiencies to be corrected were incorporated into a rehabilitation contract;c. In nine (9) participant’s files, the applicant eligibility determination was not documented;d. In nine (9) participant’s files, we did not observed evidence of the program’s inspector final visit.
Criteria	<p>Code of Federal Regulations 24, Section 570.506 (b) state that at a minimum, the grantee should maintain records demonstrating that each activity undertaken meets one of the three national objectives of the CDBG Program, i.e., benefit low- and moderate-income persons, prevent or eliminate slums or blight, or meet community development needs having a particular urgency. Also, Code of Federal Regulations 24, Section 570.506 (b) (9) states that when CDBG- State Program funds are used for residential rehabilitation activity to aid in the prevention or elimination of slums or blight in a slum or blighted area, the grantee must maintain records to support the local definition of “substandard”, must document a pre-rehabilitation inspection report describing the deficiencies in each structure to be rehabilitated, and must document the details and scope of CDBG assisted rehabilitation, by structure.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 07-07 (Continued)

Cause of Condition The Municipality's controls and procedures failed to assure that all participant's files, regarding housing rehabilitation activities, were duly documented as required by regulation.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Section 570.506 (b) and 570.506 (b) (9).

Recommendation We recommend Management to instruct and monitor program staff to follow procedures established by the Program, regarding housing rehabilitation activities. This should include completion of all eligibility and inspections forms.

Questioned Costs None

**Management Response
and Corrective Action**

As part of our correction action plan, we gave specific instructions to the program staff to assure that the procedures established by the regulation are followed.

Implementation Date: April, 2008

Responsible Person: Néstor Ramirez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	07-08
Program	Community Development Block Grants – State’s Program (CFDA No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Davis-Bacon Act
Statement of Condition	During our Davis-Bacon Act test of three (3) construction projects, we noted that the Municipality did not perform the required visits for monitoring the classifications of the workers and the wage rates paid. Also, the weekly payrolls provided by the contractor were not monitored to verify the compliance with the prevailing wage rates.
Criteria	Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Cause of Condition	The Municipality’s controls and procedures failed to apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Recommendation	We recommend management to follow monitoring system procedures developed, including obtaining contractor’s and subcontractor’s weekly payrolls to be reviewed on a weekly basis by the responsible municipal employee, and interview 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, and then, communicate contractors, promptly, about any failure in the payroll process.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **07-08 (Continued)**

**Management Response
and Corrective Action**

As part of our corrective action plan, we gave instructions to the program staff to perform the required visits to the project, in order to monitor the classifications of the workers. Also, we gave instructions to monitor the weekly payrolls provided by the contractor, in order to verify the contractor's compliance with respect to payment of prevailing wages.

Implementation Date: April, 2008

Responsible Person: Néstor Ramirez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 07-09

Program Community Development Block Grants – State’s Program (CFDA No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)

Requirement Procurement

Statement of Condition We performed a contracts provision test and examined three (3) contracts formalized by the Municipality during fiscal year 2006-2007 (two (2) for constructions and improvements, and one (1) for professional service). The following will summarize the situations noted:

- a. Two (2) contracts did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours & Safety Standards Act;
- b. One (1) contract did not include a provision for termination by grantee for default;
- c. Two (2) contracts did not include a provision for granting access to GAO or other federal agency, to books and other documents;
- d. One (1) contract did not include a provision for compliance with the Clean Air and Water Act;
- e. One (1) contract did not include a provision for compliance with Energy Policy and Conservation Act;
- f. One (1) contract did not include a provision for compliance with the Copeland “Anti-Kickback” Act;
- g. Two (2) contracts did not include a provision for retention of all required records for three (3) years;
- h. One (1) contract did not include a provision for compliance with Executive Order 11246 “Equal Employment Opportunity”;
- i. One (1) contract did not include a provision for compliance with Davis Bacon Act.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	07-09 (Continued)
Criteria	Code of Federal Regulations 24, Part 570.489 (g) requires that all purchase orders and contracts include any clauses required by Federal Statutes, executive orders and implementing regulations.
Cause of Condition	The Municipality did not maintain appropriate monitoring procedures to detect the exclusion of certain contract clauses.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Part 570.489 (g).
Recommendation	We recommend management to update the contract model, according with the federal requirements.
Questioned Costs	None
Management Response	We will establish a communication with the Municipal Secretary in order to update the contracts models related to constructions, improvements and professional services. We will identify all contracts' clauses required by the Federal regulation and then, we will prepare various models, according Program needs. Implementation Date: April, 2008 Responsible Person: Néstor Ramirez Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	07-10
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico – Family Department (ACUDEN)
Requirement	Financial Administration–Standard for Financial Management System Reporting
Statement of Condition	During our audit, we noted that the Municipality did not maintain, for the Child Care and Development Block Grant Program, a reliable set of accounting records that present the financial position of the program and the results of its operations.
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (1) and (2) states that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant. Grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.
Cause of Condition	The Program’s accounting records were maintained in Peachtree Accounting Software by an external consultant. This consultant is no longer under contract and the Municipality has not replaced him.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (1) and (2).
Recommendation	We recommend that the Municipality should implement controls and procedures in order to assure that an accurate set of accounting records are maintain for the Program, in order to record all transactions realized during the period.
Questioned Cost	None.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **07-10 (Continued)**

**Management Response
and Corrective Action**

To correct the condition reported by the external auditors, we are going to implement a new set of accounting records, that present the Program's financial position and its results of operations.

Implementation Date: June, 2008

Responsible Person: Mrs. Paulina Cruz
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2007

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
06-04	14.871	<p><u>In the Waiting List test, the auditors noted the following situation: In a sample of twenty five (25) applicants included in the Waiting List, the auditors observed that the PHA did not maintain the required information to assure that the selection of new tenants admitted to the program were in accordance with the administrative plan.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-05.</p>
06-05	14.871	<p><u>The PHA did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2006. The PHA did not perform a review of the utility rates during the fiscal year to ascertain if there has been a change of ten percent or more in a utility rate.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-04.</p>
06-06	14.228	<p><u>The auditors performed a housing rehabilitation test of ten (10) participant files and found the following exceptions: (a) In two (2) participant's files, the auditors did not observe evidence of the program's inspector visits to follow up the rehabilitation work; (b) In eight (8) participant's files, the auditors did not observe evidence of the program's inspector final visit. Also, six (6) of these files did not include photos of the completion of the rehabilitation works; (c) In one (1) participant's file, the auditors observed evidence of the program's inspector final visit; however, it did not include photos of the completion of the rehabilitation works.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-07.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
06-07	14.228	<p><u>The auditors performed a housekeeping assistance project test of ten (10) participant's files and found the following exceptions: (a) In the ten (10) participant's files, the auditors did not observe evidence of the family composition; (b) In seven (7) participant's files, the auditors noted that the Service Coordinator realized the required visits to the housing unit to ensure the quality of services; however, none of the visits were made only when the participant was in the house; (c) In one (1) participant's file, the auditors noted that the Service Coordinator did not realized the required visits to the housing unit to ensure the quality of services; (d) In seven (7) participant's files, the auditors noted that, as part of the visits procedures, the Service Coordinator did not document in the Form OCAM-AH-006, the housekeeper performance; (e) In three (3) participant's file, the auditors noted that the Form OCAM-AH-006 was not completed in all its parts. Also, this Form did not include the Service Coordinator signature.</u></p> <p>Corrective action was taken.</p>
06-08	14.228	<p><u>The auditors performed a cash disbursement test and examined twenty nine (29) disbursement vouchers which belonged to General Fund, nineteen (19) which belonged to Community Development Block Grant (CDBG)-State Program and twelve (12) which belonged to Joint Resolutions account. The following will summarize the internal control exceptions noted: (a) In ten (10) disbursement vouchers (three (3) related to General Fund, six (6) related to CDBG and one (1) related to Joint Resolutions), several documents were not marked as paid; (b) Eight (8) disbursement vouchers did not include the pre-intervention officer signature (five (5) related to General Fund and three (3) related to Joint Resolutions); (c) One (1) General Fund disbursement voucher did not include the original invoice; (d) Two (2) General Fund disbursement vouchers were not available for our examination; (e) One (1) CDBG disbursement voucher did not include the date of the pre-intervention officer signature; (f) In one (1) CDBG disbursement voucher, the purchase order was not issued before the receiving of services; (g) In one (1) Joint Resolutions disbursement voucher, the auditors noted that the invoice did not include the supplier's signature.</u></p> <p>Corrective action was taken.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
06-09	14.228	<p><u>During the Cash Management test, the auditors noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. The auditors selected a sample of thirteen (13) fund requisitions (a total of \$383,642) and found the following exceptions: (a) In four (4) fund requisitions (a total of \$173,006), the auditors observed that the Municipality made the disbursements between six (6) and twenty six (26) days after the deposits; (b) In one (1) fund requisition (a total of \$16,106), the auditors observed that the Municipality made the disbursements one hundred seventy (170) days after the deposit.</u></p> <p>Corrective action was taken.</p>
06-10	14.228	<p><u>During the Davis-Bacon Act test of two (2) construction projects, the auditors noted that the Municipality did not perform the required visits for monitoring the classifications of the workers and the wage rates paid. Also, the weekly payrolls provided by the contractor were not monitored to verify the compliance with the prevailing wage rates (for one (1) project, the contractor did not submit all the required certified payrolls).</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-08.</p>
06-11	14.228	<p><u>During the audit of the program income requirements, the auditors noted that the Municipality did not maintain internal controls to assure: (a) That the program income was properly determined or calculated in accordance with stated criteria and that program income was only collected from allowable sources; (b) That all program income was properly recorded in the accounting records; (c) That program income was used in accordance with the program requirements and other regulations applicable.</u></p> <p>Corrective action was taken.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
05-05	14.228	<p><u>The auditors performed a housing rehabilitation test of ten (10) participant files and found the following exceptions: (a) In two (2) participant files, the auditors did not observe evidence of the program's inspector visits to follow up the rehabilitation work; (b) In six (6) participant files, the auditors did not observe evidence of the program's inspector final visit. The files only include photos of the completion of works.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-07.</p>
05-06	14.228	<p><u>During the Cash Management test, the auditors noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. In a sample of fourteen (14) fund requisitions (a total of \$478,695), the auditors observed that the Municipality made the disbursements between six (6) and thirty three (33) days after the deposits.</u></p> <p>Corrective action was taken.</p>
05-07	14.228	<p><u>During the Davis-Bacon Act test, the auditors noted the following situation: For the construction project 00-FD-56-007, the Municipality did not perform the required visits for monitoring the classifications of the workers and the wage rates paid. Also, the weekly payrolls provided by the contractor were not monitored to verify the compliance with the prevailing wage rates.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-08.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
05-08	14.228	<p><u>During the audit of the program income requirements, the auditors noted that the Municipality did not maintain internal controls to assure: (a) That the program income was properly determined or calculated in accordance with stated criteria and that program income was only collected from allowable sources; (b) That all program income was properly recorded in the accounting records; (c) That program income was used in accordance with the program requirements and other regulations applicable.</u></p> <p>Corrective action was taken.</p>
05-10	14.871	<p><u>In the Waiting List test, the auditors noted the following situation: In a sample of twenty (20) applicants included in the Waiting List, the auditors observed that the PHA did not maintain the required information to assure that the selection of new tenants admitted to the program were in accordance with the administrative plan.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-05.</p>
05-11	93.575	<p><u>During the reporting test, the auditors noted that the Annual Closing Report (CC-006) for the program fiscal year ended September 30, 2004 and, the Trial Balance as of September 30, 2004 were not submitted to the Pass-through Agency during the thirty (30) days period stated in the grant agreement. The Municipality submitted those reports on January, 2005 as detailed in the closing report. Also, during the examination, the auditors noted that federal program books are maintained in Peachtree Accounting Software by an external consultant. Those books were not available for the examination. As result, the auditors could not verify the accuracy of accounting record with the closing reports submitted to the Pass-through Agency.</u></p> <p>Partially corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-10.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
04-05	14.871	<p><u>The auditors verified if five (5) participants were selected from the top of the waiting list according with the PHA's applicant selection policies. After the procedures, the auditors found that three (3) participants were not included in the waiting list.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
04-09	14.228	<p><u>In the project 01-FD-07-003 with a cost of \$1,512,000, the auditors did not found evidence supporting that the federal program staff, applied adequately the monitoring system developed to ensure contractors compliance with payment of prevailing wages rates to employees. The auditors noted the following: (a) The contract begun in October 8, 2003 to June 6, 2004 for a period of eight months and the auditors did not find in the contractor's file the contract weekly payrolls related to the period from October, 2003 to February, 2004 and; (b) the program staff performed only two interviews to the contractor's and subcontractor's laborers in March 31, 2004 and June 25, 2004. Also, the Davis Bacon file related to the project 00-FD-07-006 with a cost of \$84,505 was not available for examination.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
04-11	14.228	<p><u>During the audit of the program income requirements, the auditors noted that the Municipality did not maintain internal controls to assure: (a) That the program income was properly determined or calculated in accordance with stated criteria and that program income was only collected from allowable sources; (b) that all program income was properly recorded in the accounting records and; (c) that program income was used in accordance with the program requirements and other regulations applicable.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
04-15	93.575	<p><u>During the reporting test, the auditors noted that the Annual Closing Report (CC-006) for the program fiscal year ended September 30, 2003 and, the Trial Balance as of September 30, 2003 were not submitted to the Pass through Agency during the fifteen (15) day period stated in the grant agreement. The Municipality submitted those reports on July 8, 2004 as detailed in the closing report. Also, during the intervention, the auditors noted that federal program books are maintained in Peachtree Accounting Software by an external consultant. Those books where not available for examination. As result, the auditors could not verify the accuracy of accounting record with the closing reports submitted to the pass through agency.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>