

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

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

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE CAGUAS**

**AUDITORIA 2006-2007**

**30 DE JUNIO DE 2007**



COLEGIO DEL COMISIONADO  
MUNICIPALES

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Accountants &  
business advisers

RECIBIDO  
UNIDAD DE CORREO

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS**

**FINANCIAL STATEMENTS**  
(with Independent Auditors' Report Thereon)

**FISCAL YEAR ENDED  
JUNE 30, 2007**

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## INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and  
Members of the Municipal Legislature  
Commonwealth of Puerto Rico  
Municipality of Caguas  
Caguas, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico, Municipality of Caguas as of and for the fiscal 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 an opinion 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 the Government Auditing Standards, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico, Municipality of Caguas as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

To the Honorable Mayor and  
Members of the Municipal Legislature  
Commonwealth of Puerto Rico  
Municipality of Caguas  
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In accordance with Government Auditing Standards, we have also issued our report dated December 1, 2007 on our consideration of the Municipality of Caguas'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 should be considered in assessing the results of our audit.

The Management's Discussion and Analysis and budgetary comparison information for the general fund, as listed in the table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



PKF, LLP  
License No. 22  
Expires December 1, 2007

December 1, 2007  
San Juan, Puerto Rico



To the Citizens and the Municipal Legislature  
of the Municipality of Caguas

### **Management's Discussion and Analysis**

As management of the Autonomous Municipality of Caguas (hereafter the Municipality), we offer readers of the Municipality's financial statements this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2007. We encourage readers to read the information presented here in conjunction with the basic financial statements.

#### Financial Highlights

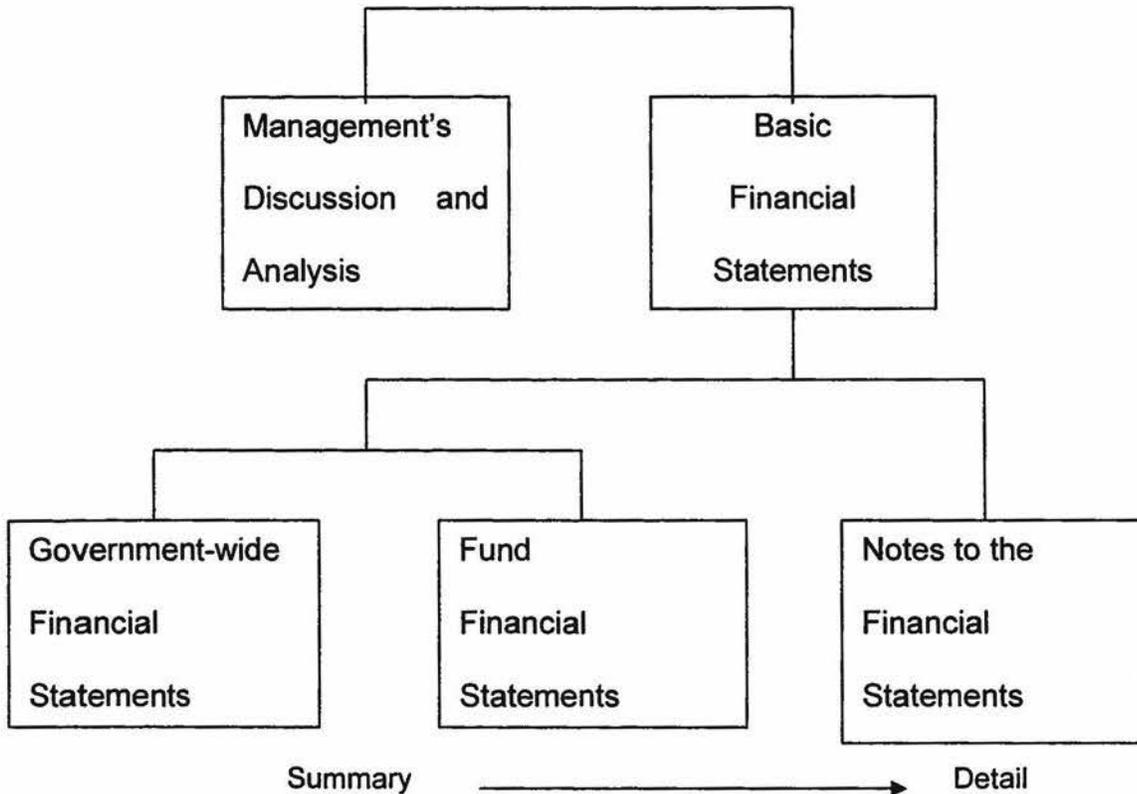
- The assets of the Municipality exceeded its liabilities at the close of the fiscal year by \$374,195,794 (*net assets*).
- The government's total net assets increased by \$117,925,681, primarily due to retroactive adjustment to recognize infrastructure assets, as required by government accepted standard board number 34 (GASB-34).
- As of the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$86,534,666, after a net decrease in fund balance of \$2,800,961, as restated. The amount of \$2,642,968 is available for spending at the government's discretion (*unreserved fund balance*).
- At the end of the current fiscal year, unreserved fund balance for the General Fund was \$1,955,885, or 1.93 percent of total general fund expenditures for the fiscal year.
- The Municipality's total general long-term debt increased by \$17,729,617 (11.5%) during the current fiscal year. The key factors to this increase were the \$18.305 million in bonds issuance and \$8.575 million of special loans used for infrastructure development.

#### Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to The Municipality's basic financial statements. The Municipality's basic financial statements consist of three components; 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements (see Figure 1). The basic financial statements present two different views of the Municipality through the use of government-wide statements and fund financial statements. In addition to the basic financial statements, this report contains other supplemental information that will enhance the reader's understanding of the financial condition of the Municipality.

## Required Components of Annual Financial Report

Figure 1



### Basic Financial Statements

The first two statements (Pages 16 through 18) in the basic financial statements are the **Government-wide Financial Statements**. They provide both short and long-term information about the Municipality's financial status.

The next statements (Pages 19 through 29) are **Fund Financial Statements**. These statements focus on the activities of the individual parts of the Municipality's government. These statements provide more detail than the government-wide statements. There are three parts to the Fund Financial Statements: 1) the governmental funds statements; 2) the budgetary comparison statements; and 3) the proprietary fund statements.

The next section of the basic financial statements is the **notes to the financial statements**. The notes to the financial statements explain in detail some of the data contained in those statements.

#### Government-wide Financial Statements

The government-wide financial statements are designed to provide the reader with a broad overview of the Municipality's finances, similar in format to a financial statement of a private-sector business. The government-wide statements provide short and long-term information about the Municipality's financial status as a whole.

The two government-wide statements report the Municipality's net assets and how they have changed. Net assets are the difference between the Municipality's total assets and total liabilities. Measuring net assets is one way to gage the Municipality's financial condition.

The government-wide statements are divided into two categories: 1) governmental activities; and 2) business-type activities. The governmental activities include most of the Municipality's basic services such as public safety, parks and recreation, and general administration. Property taxes and state and federal grant funds finance most of these activities. The business-type activities are those that the Municipality charges directly to users to provide the service. These include Community Development Bank and Multi-tenant fund.

The government-wide financial statements are included from pages 16 through 18 of this report.

### Fund Financial Statements

The fund financial statements provide a more detailed look at the Municipality's most significant activities. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like all other governmental entities in the Commonwealth of Puerto Rico, uses fund accounting to ensure and reflect compliance (or non-compliance) with finance-related legal requirements, such as the General Statutes or the Municipality's budget ordinance. All of the funds of the Municipality can be divided into two categories: governmental funds and proprietary funds.

**Governmental Funds** – Governmental funds are used to account for those functions reported as governmental activities in the government-wide financial statements. Most of the Municipality's basic services are accounted for in governmental funds. These funds focus on how assets can readily be converted into cash flow in and out, and what monies are left at year-end that will be available for spending in the next year. Governmental funds are reported using an accounting method called *modified accrual accounting*. This method also has a current financial resources focus. As a result, the governmental fund financial statements give the reader a detailed short-term view that helps him or her determine if there are more or less financial resources available to finance the Municipality's programs. The relationship between government activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds is described in a reconciliation that is a part of the fund financial statements (see page 21).

The Municipality adopts an annual budget for its General Fund, as required by the General Statutes. The budget is a legally adopted document that incorporates input from the citizens of the Municipality, the management of the Municipality, and the decisions of the Board about which services to provide and how to pay for them. It also authorizes the Municipality to obtain funds from identified sources to finance these current period activities. The budgetary statement provided for the General Fund demonstrates how well the Municipality complied with the budget ordinance and whether or not the Municipality succeeded in providing the services as planned when the budget was adopted. The budgetary comparison statement uses the budgetary basis of accounting and is presented using the same format, language, and classifications as the legal budget document. The statement shows four columns: 1) the original budget as adopted by the municipal legislature; 2) the final budget as amended by the municipal legislator; 3) the actual resources, charges to appropriations, and ending balances in the General Fund; and 4) the difference or variance between the final budget and the actual resources and charges (see page 25).

**Proprietary Funds** – The Municipality has one kind of proprietary fund. *Enterprise Funds* are used to report the same functions presented as business-type activities in the government-wide financial statements. The Municipality uses enterprise funds to account for its Government Development Bank activity and for its multi-tenant operations. These funds are the same as those separate activities shown in the business-type activities in the Statement of Net Assets and the Statement of Activities (see Pages 26 through 29).

**Notes to the Financial Statements** – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements start on pages 30 through 65 of this report.

### Government-Wide Financial Analysis

As noted earlier, net assets may serve over time as one useful indicator of a government's financial condition. The assets of the Municipality exceeded liabilities by \$374,195,794 as of June 30, 2007. The Municipality's net assets increased by \$117,925,681 for the fiscal year ended June 30, 2007. One of the largest portions (80.4%) reflects the Municipality's investment in capital assets (e.g. land, buildings, infrastructure, and equipment), less any related debt still outstanding that was issued to acquire those items. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since the capital assets cannot be used to liquidate these liabilities. An additional portion of the Municipality's net assets (17.23%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of \$8,873,193 is unrestricted.

### **The Municipality's Net Assets**

**Figure 2**

	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
Current and other assets	\$ 134,915,373	\$ 132,743,458	\$ 3,414,352	\$ 4,148,947	\$ 138,329,725	\$ 136,892,405
Capital assets	465,859,960	326,229,982	7,754,461	7,475,356	473,614,421	333,705,338
Loan receivable, net	-	-	2,400,575	1,552,614	2,400,575	1,562,614
<b>Total assets</b>	<b>600,775,333</b>	<b>458,973,440</b>	<b>13,569,388</b>	<b>13,186,917</b>	<b>614,344,721</b>	<b>472,160,357</b>
Current liabilities	56,949,576	57,405,839	157,931	490,223	57,107,507	57,896,062
Other liabilities	182,761,986	157,600,631	279,435	393,551	183,041,421	157,994,182
<b>Total liabilities</b>	<b>239,711,562</b>	<b>215,006,470</b>	<b>437,366</b>	<b>883,774</b>	<b>240,148,928</b>	<b>215,890,244</b>
<b>Net assets:</b>						
Invested in capital assets, net of related debt	293,057,489	184,676,300	7,754,461	7,813,633	300,811,950	192,489,933
Restricted	59,133,090	52,943,537	5,377,561	2,052,485	64,510,651	54,996,022
Unrestricted	8,873,193	6,347,133	-	2,437,025	8,873,193	8,784,158
<b>Total net assets</b>	<b>\$ 361,063,772</b>	<b>\$ 243,966,970</b>	<b>\$ 13,132,022</b>	<b>\$ 12,303,143</b>	<b>\$ 374,195,794</b>	<b>\$ 256,270,113</b>

Some particular aspects of the Municipality's financial operations slightly increased the total unrestricted governmental net assets:

- Use of general funds to complete capital project investments.
- Increase in general governmental operational costs.

## The Municipality's Changes in Net Assets

### Figure 3

	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
<b>Revenues:</b>						
Program revenues:						
Charges for services	\$ 4,626,334	\$ 5,656,459	\$ 510,408	\$ 345,031	\$ 5,136,742	\$ 6,001,490
Operating grants and contributions	31,160,366	43,037,022	-	-	31,160,366	43,037,022
Capital grants and contributions	17,467,339	6,164,373	1,710,000	653,223	19,177,339	6,817,596
General revenues:						
Property taxes	53,882,740	52,536,437	-	-	53,882,740	52,536,437
Other taxes	48,939,143	36,808,387	-	-	48,939,143	36,808,387
Licenses and permits	8,902,337	9,374,513	-	-	8,902,337	9,374,513
Interest and investment income	3,135,304	2,369,454	105,112	37,035	3,240,416	2,406,489
Other	-	-	-	-	-	-
<b>Total revenues</b>	<b>168,113,563</b>	<b>155,945,645</b>	<b>2,325,520</b>	<b>1,035,289</b>	<b>170,439,073</b>	<b>156,980,934</b>
<b>Expenses:</b>						
General government	53,886,597	38,310,363	-	-	53,886,597	38,310,363
Public safety	9,272,095	8,797,955	-	-	9,272,095	8,797,955
Public works	41,441,711	24,489,027	-	-	41,441,711	24,489,027
Cultural and recreation	7,804,848	8,276,237	-	-	7,804,848	8,276,237
Health and welfare	7,836,447	9,295,701	-	-	7,836,447	9,295,701
Economic development	6,327,654	4,133,619	-	-	6,327,654	4,133,619
Sanitation and environmental	13,263,809	12,633,171	-	-	13,263,809	12,633,171
Housing	10,959,641	11,737,150	-	-	10,959,641	11,737,150
Education	14,076,737	15,234,980	-	-	14,076,737	15,234,980
Debt service	10,472,894	7,767,626	-	-	10,472,894	7,767,626
Community Development Bank	-	-	249,921	234,539	249,921	234,539
Multitenant	-	-	165,216	128,914	165,216	128,914
<b>Total expenses</b>	<b>175,342,433</b>	<b>140,655,829</b>	<b>415,137</b>	<b>363,453</b>	<b>175,757,570</b>	<b>141,019,282</b>
Increase (decrease) in net assets before transfer	(7,228,880)	15,289,816	1,910,383	671,836	(5,318,497)	15,961,652
Transfer	(547,075)	-	547,075	-	-	-
<b>Net increase (decrease) in net assets</b>	<b>(7,775,955)</b>	<b>15,289,816</b>	<b>2,457,458</b>	<b>671,836</b>	<b>(5,318,497)</b>	<b>15,961,652</b>
Net assets, beginning as previously reported	243,966,970	150,019,996	12,303,143	10,080,729	256,270,113	160,100,725
Prior period adjustments	124,872,757	78,657,158	(1,628,579)	1,550,578	123,244,178	80,207,736
<b>Net assets, beginning as restated</b>	<b>368,839,727</b>	<b>228,677,154</b>	<b>10,674,564</b>	<b>11,631,307</b>	<b>379,514,291</b>	<b>240,308,461</b>
<b>Net assets, ending</b>	<b>\$ 361,063,772</b>	<b>\$ 243,966,970</b>	<b>\$ 13,132,022</b>	<b>\$ 12,303,143</b>	<b>\$ 374,195,794</b>	<b>\$ 256,270,113</b>

**Governmental activities.** Governmental activities increased the Municipality's net assets (as restated) by \$117,096,802, thereby accounting for 99.2% of the total growth in the net assets of the Municipality. Key elements of this increase are as follows:

- Total revenues increased 7.72% over prior year reported.
  - Increase in other taxes (including the newly adopted city tax)
  - Increase in property tax, due primarily, to an increase in collection of delinquent property taxes and the assessment of segregated real property.
- Total expenses increased by 24.6% over prior year
  - Major increases in expense includes: general government \$19.5 million and Public works \$16.3 million.
- A material retroactive incorporation in books of infrastructure assets values as per GASB 34.

**Business-type activities:** Business-type activities increased the Municipality's net assets by \$828,879, accounting for .8% of the total growth in the government's net assets. Key elements of this increase are as follows:

- Increase in charges for services and an increase in capital grants and contributions.

### **Financial Analysis of the Municipality's Funds**

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

**Governmental Funds.** The focus of The Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing the Municipality's financing requirements. Specifically, unreserved fund balance can be a useful measure of a government's net resources available for spending at the end of the fiscal year.

The General Fund is the chief operating fund of the Municipality. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$1,955,885, while total fund balance reached \$8,873,193. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 1.93 percent of total General Fund expenditures, while total fund balance represents 8.78 percent of that same amount.

At June 30, 2007, the governmental funds of the Municipality reported a combined fund balance of \$86,534,666, as restated. This amount represents a decrease of 3.14 percent over last year. The primary reasons were the increase in general government operational cost, public works expenditures and other accounting adjustments by external auditors.

**General Fund Budgetary Highlights:** During the fiscal year, the Municipality revised the budget on several occasions. Generally, budget amendments fall into one of three categories: 1) amendments made to adjust the estimates that are used to prepare the original budget ordinance once exact information is available; 2) amendments made to recognize new funding amounts from external sources, such as Federal and State grants; and 3) increases in appropriations as a result of cash surplus from prior period to supplement capital projects funding and general government activities. Total amendments to the General Fund increase revenues by \$15,572,363.

**THE MUNICIPALITY'S BUDGET ACTIVITY  
FIGURE 4**

	Original	Orders	Transfers	Final
<b>Resources:</b>				
Property taxes	\$ 33,321,742	-	-	33,321,742
Volume of business taxes	26,200,000	-	-	26,200,000
Sales taxes	11,400,000	858,000	-	12,258,000
Licenses and permits	6,028,000	-	-	6,028,000
Fines and penalties	250,000	-	-	250,000
Interest and investment income	750,000	-	-	750,000
Intergovernmental	9,106,899	-	-	9,106,899
Parking lot fees	177,600	-	-	177,600
Rent and other resources	10,948,359	14,714,363	-	25,662,722
Amounts available for appropriation	<u>98,182,600</u>	<u>15,572,363</u>	<u>-</u>	<u>113,754,963</u>
<b>Expenditures charged to appropriations:</b>				
Culture and recreation	6,877,244	371,700	(573,936)	6,675,008
Economic and social development	4,574,428	3,350,812	(540,559)	7,384,681
Education	2,238,293	-	256,804	2,495,097
General government	41,540,539	3,391,587	4,611,793	49,543,919
Health and welfare	4,086,879	-	(104,952)	3,981,927
Housing	829,958	-	60,492	890,450
Sanitation and environmental	14,367,332	-	(809,055)	13,558,277
Public safety	9,258,147	125,000	(888,274)	8,494,873
Public works	14,409,780	8,333,264	(2,012,313)	20,730,731
Total charges to appropriations	<u>98,182,600</u>	<u>15,572,363</u>	<u>-</u>	<u>113,754,963</u>
Excess of resources over appropriations	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

- The Municipal Legislature amended the budget during the year by \$14,714,363, mainly by unreserved resources plus an adjustment of \$858,000.

Actual budgetary transactions generated an excess of resources over appropriations of \$1,158,990 due to the following:

- Actual collections exceeded final budgeted amounts by \$1,105,174, primary by an increase in collections on volume of business, sales tax and license and permits.
- Actual disbursements decreased by \$53,816 (.05%), primary by a decrease in public works and general government.

**Proprietary Funds.** The Municipality's proprietary funds provide the same type of information found in the government-wide statements but in more detail. Unrestricted net assets of the Community Development Bank at the end of the fiscal year amounted to \$3,982,028, and those of the Multi-tenant Fund equaled \$1,394,533. The total growth in net assets for both funds was \$468,370 and \$1,989,088 respectively. Other factors concerning the finances of these funds have already been addressed in the discussion of the Municipality's business-type activities.

#### Capital Asset and Debt Administration

**Capital assets.** The Municipality's capital assets for its governmental and business – type activities as of June 30, 2007, totals \$473,614,421 (net of accumulated depreciation). These assets include buildings, roads and bridges, land, machinery and equipment, park facilities, and vehicles.

Major capital asset transactions during the year include:

- Addition of construction in progress for infrastructure, buildings and facilities
- Land acquisition and improvements
- Purchased new equipment and vehicles for the Municipality as a whole
- Disposal of old equipment
- In addition to major capital assets transactions, a material retroactive adjustment of infrastructure assets was made, related to bridges and parks and recreational facilities, including the related accumulated depreciation. The adjustment was made as a requirement of the government accepted standard board number 34. The required inclusions of infrastructure assets by GASB 34, have been substantially recorded during fiscal years 2002-2003 to 2006-2007.

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## The Municipality's Capital Assets

(net of depreciation)

Figure 5

	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
Land	\$ 36,595,449	\$ 36,448,098	\$ 2,982,254	\$ 2,982,654	\$ 41,577,703	\$ 39,431,752
Buildings and system	9,733,835	8,357,237	2,814,408	3,670,289	12,348,243	12,027,526
Facilities	31,332,568	27,001,167	-	-	31,332,568	27,001,167
Machinery and equipment	18,314,484	14,103,066	1,718	32,413	16,316,200	14,135,479
Infrastructure	286,988,498	154,273,273	-	-	286,988,498	154,273,273
Works of art	2,989,541	2,620,541	-	-	2,989,541	2,620,541
Construction in progress	79,905,585	83,380,600	2,156,083	790,000	82,061,668	84,150,800
<b>Total</b>	<b>\$ 485,859,980</b>	<b>\$ 326,184,982</b>	<b>\$ 7,754,461</b>	<b>\$ 7,475,356</b>	<b>\$ 473,614,421</b>	<b>\$ 333,840,338</b>

Additional information on the Municipality's capital assets can be found in note 6 of the Basic Financial Statements.

Major additions to constructions in progress (disbursements of more than \$1,000,000) as of June 30, 2007 are as follows:

Project	Amount
PARQUE PASIVO CRIOLLO Y JARDIN BOTANICO	\$ 11,410,285
AVE. LUIS MUÑOZ MARIN: MEJORAS FASE IIA	3,175,214
DESARROLLO DE VIVIENDAS IDAMARIS APARTMENTS II	2,860,644
PUENTE ENTRADA SECTOR LAS CAROLINAS	2,691,097
PORTAL ESTE DE LA CIUDAD PUENTE CARTAGENA PR183	2,391,274
PASEO DE LAS ARTES FASE II AREA CARGA Y DESCARGA	1,524,842
PASEO DE LAS ARTES FASE II A ( MEJORAS CALLES )	1,321,500
PORTAL OESTE DE LA CIUDAD FASE III(MEJORAS PR 156)	1,083,063
	<u>\$ 26,457,918</u>

**Long-term Debt.** As of June 30, 2007, The Municipality had total bonded debt outstanding of \$173,166,453 all of which is debt backed by the full faith and credit of the Municipality.

### The Municipality's Outstanding Debt General Obligation Bonds

Figure 6

	Governmental Activities		Business-type Activities		Total	
	2007	2006	2007	2006	2007	2006
General obligation bonds	\$ 114,153,680	\$ 101,853,030	\$ 363,982	\$ 489,871	\$ 114,517,662	\$ 102,342,901
Federal loans and notes	8,605,000	9,560,000	-	-	8,605,000	9,560,000
Special loans	50,043,791	43,884,824	-	-	50,043,791	43,684,824
<b>Total</b>	<b>\$ 172,802,471</b>	<b>\$ 155,097,854</b>	<b>\$ 363,982</b>	<b>\$ 489,871</b>	<b>\$ 173,166,453</b>	<b>\$ 155,587,725</b>

The Municipality's total debt increased by \$17,578,728 (11.31 percent) during the past fiscal year, primarily due to the \$18,305,650 bond anticipation notes issued for infrastructure development and the \$8,575,000 issued in special loans for infrastructure development.

The Commonwealth of Puerto Rico limits the amount of general obligation debt that a unit of government can issue to 10 percent of the total assessed value of taxable property located within that government's boundaries. The total legal debt margin for the Municipality is approximately \$121,810,146. The Municipality has \$500,000 in bonds authorized issued, but not yet collected as of June 30, 2007.

Additional information regarding the Municipality's long-term debt can be found in note 7 beginning on page 51 of this audited financial report.

### Economic Factors and Next Year's Budgets and Rates

The following key economic indicators reflect the growth and prosperity of the Municipality.

- This year the unemployment increase by 1.8%. However, the city's unemployment remains lower than the state unemployment average.
- New housing developments created new jobs in the last year bringing 310 new jobs to our Municipality.

### **Summary of Local Economy**

Caguas is the fifth largest City in Puerto Rico, out of 78 municipalities, accounting for roughly 3.7% of the Commonwealth's population. The 10% of the largest commercial centers are located in Caguas. The City is situated in the heart of Puerto Rico, at the intersection of three major highways, PR 1, PR 52, and PR 30. It's geographical area includes the communities of: Bairoa, Beatriz, Cañaboncito, Cañabon, Borinquén, Pueblo, Rio Cañas, San Antonio, San Salvador, Tomás de Castro and Turabo.

The largest employers in Caguas are the State government, the Municipal government, Pfizer, Mova, Avon, Wal-Mart, Sam's Club and Amigo Supermarket retail chain, Banco Popular, San Pablo-HIMA Hospital, Mylan, St. Jude Medical and Atento ( a marketing enterprise).

The City's economy has an industry composition somewhat similar to the rest of the island's largest Municipalities. In the 1960s textile's manufacturing and agriculture made up the largest amount of the local economy, but by the mid seventies the manufacturing share of employment had declined to a lower percentage.

### **Major Industries and Services (including government)**

**Government Services:** The governmental service is the largest source of employment in the Municipality, accounting for the largest amount of the civilian employment in FY/07. This sector had a moderate grow at city level but it is being reduced at the State level since the last quarter of the fiscal year due to the economical weakness of the State. It is a diverse sector that includes jobs in the areas of education, electric power service, water supply, police, public works, culture and recreation, health, legal service and others.

**Health Services:** As a major regional medical center, the medical services industry is one of the largest employers in the area. It includes HIMA-San Pablo Hospital and the former Regional Hospital, now named San Juan Bautista, operated by the private sector. The health services industry had been one of the fastest growing sectors in the Caguas area. During the fiscal year 2007, Hospital HIMA-San Pablo almost completed the construction of a modern medical building and parking lot facilities.

**Trade (retail and wholesale):** The trade sector is the strongest growing sector in the area. Many major national chains such as Wal-Mart, Costco, Walgreen's, Bets Buy have expanded into the area, helping maintain relatively stable levels of consumer spending.

**Manufacturing - Pharmaceutical and Medical Devices and Technology:**

Caguas pharmaceutical products and medical devices manufacturing sector accounts for a very important amount of employment of the private sector.

**Construction:** The construction in the private sector, an important source of economic growth in Caguas, had a decline during 2007 as well as the rest of the country. Employment and gross receipts in construction has been stable during the year with Los Prados Shopping Center development - located at both sides of Jardín Criollo - and other multi and single family developments. During this year other smaller shopping centers were completed as well as other developments such as Montefiori, River Glance, River Park I, Mansiones del Golf and other single-family housing developments such as Apartamentos de Notre Dame and Jardín de las Catalinas. Actual capital investments in those projects were over \$200 million and actual investment in social interest projects of single and multi- family developments exceeds \$30 million for a total investment of more than \$250 millions. Social interest projects include 218 units for the elderly and 209 for low and moderate-income families.

Governmental initiative such as Jardín Botánico y Cultural and other infrastructure development mentioned above, had to maintain this economic sector. However, the inventory of new homes remains almost unsold at year end. The total revenue of construction permits decrease in comparison to prior year.

For fiscal year 2007 the city employment decreases by 2,700. The following table represents the distribution of employment by class of industry:

## City Employment (in thousands)

NAICS CATEGORY	
Total Employment (does not include military)	49.300
Natural Resources and Mining and Construction	0.448
Manufacturing	7.542
Trade, Transportation, and Utilities	14.952
Information	0.898
Financial Activities	0.886
Aggregate of Services	24.726
Professional and Business Services	4.360
Educational and Health Services	2.975
Leisure and Hospitality	3.625
Other Services	1.145
Government	2.500
MILITARY	0.300

Source: Federal Department of Labor

**Budget Highlights for the Fiscal Year Ending June 30, 2008**

**Governmental Activities:** Property taxes (benefiting from residential and industrial developments), city tax, and revenues from permits and fees are expected to lead the increase in revenue projections by 11 percent (without considering any inter-fund transfer) or \$11.2 million. The Municipality will use these increases in revenues to finance programs currently in place.

Budgeted expenditures in the General Fund are expected to rise approximately 15% to \$8.029 million. The largest increments are in employee compensation, including funding compensation and benefits adjustments, Capital Outlays and Public Works.

***Requests for Information***

This report is designed to provide an overview of the Municipality's finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to: Municipality of Caguas, Office of the Mayor, P.O. Box 907, Caguas, Puerto Rico, 00726-0907, or <http://www.caguas.gov.pr>.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Net Assets  
June 30, 2007

	Governmental Activities	Business-Type Activities	Total
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and cash equivalents	\$ 77,570,515	\$ 4,014,152	\$ 81,584,667
Cash with fiscal agent	17,190,006	-	17,190,006
Volume of business tax receivable	16,009,977	-	16,009,977
Sales taxes receivable	2,150,186	-	2,150,186
Intergovernmental receivables	12,896,327	-	12,896,327
Federal grants receivable	5,990,134	-	5,990,134
Rent and other service charges receivable	2,377,278	14,544	2,391,822
Internal balances	<u>614,344</u>	<u>(614,344)</u>	<u>-</u>
Total current assets	<u>134,798,767</u>	<u>3,414,352</u>	<u>138,213,119</u>
<b>Noncurrent assets:</b>			
Loan receivable	-	2,400,575	2,400,575
Capital assets, net of accumulated depreciation	<u>465,859,960</u>	<u>7,754,461</u>	<u>473,614,421</u>
Total noncurrent assets	<u>465,859,960</u>	<u>10,155,036</u>	<u>476,014,996</u>
Total assets	<u>\$ 600,658,727</u>	<u>\$ 13,569,388</u>	<u>\$ 614,228,115</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Net Assets (continued)  
June 30, 2007

	Governmental Activities	Business-Type Activities	Total
<b>LIABILITIES AND NET ASSETS</b>			
<b>Current liabilities:</b>			
Accounts payable	\$ 20,552,746	\$ 73,384	\$ 20,626,130
Deferred volume of business tax revenue	24,131,021		24,131,021
Deferred intergovernmental revenue	1,482,191		1,482,191
Bonds and notes payable, current	9,038,033	84,547	9,122,580
Accrued compensated absences, current	122,292	-	122,292
Accrued legal claims, current	90,468	-	90,468
Due to other governments	418,604	-	418,604
Advance deposits	1,114,221	-	1,114,221
<b>Total current liabilities</b>	<b>56,949,576</b>	<b>157,931</b>	<b>57,107,507</b>
<b>Noncurrent liabilities net of current portions:</b>			
Bonds and notes payable	163,764,438	279,435	164,043,873
Accrued compensated absences	9,674,994	-	9,674,994
Accrued legal claims	7,733,639	-	7,733,639
Other accrued liabilities	1,588,915	-	1,588,915
<b>Total noncurrent liabilities</b>	<b>182,761,986</b>	<b>279,435</b>	<b>183,041,421</b>
<b>Total liabilities</b>	<b>239,711,562</b>	<b>437,366</b>	<b>240,148,928</b>
<b>Net assets:</b>			
Invested in capital assets, net of related debt	293,057,489	7,754,461	300,811,950
Restricted for:			
Housing programs	8,471,456	-	8,471,456
Food and children programs	1,443,709	-	1,443,709
Capital projects	41,129,619	-	41,129,619
Debt service	6,318,128	-	6,318,128
Other special purposes	1,653,571	5,377,561	7,031,132
Unrestricted	8,873,193	-	8,873,193
<b>Total net assets</b>	<b>\$ 360,947,165</b>	<b>\$ 13,132,022</b>	<b>\$ 374,079,187</b>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Activities  
For the Fiscal Year Ended June 30, 2007

Functions Programs	Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Governmental activities	Business-type activities	Total
<b>Governmental activities:</b>							
General government	\$ 53,886,597	\$ 3,518,766	\$ -	\$ -	\$ (50,367,831)	\$ -	\$ (50,367,831)
Public safety	9,272,095	407,103	2,167,050	-	(6,697,942)	-	(6,697,942)
Public works	41,441,711	-	-	17,467,339	(23,974,372)	-	(23,974,372)
Culture and recreation	7,804,848	-	-	-	(7,804,848)	-	(7,804,848)
Health and wealthfare	7,836,447	12,201	2,508,067	-	(5,316,179)	-	(5,316,179)
Economic and social development	6,327,654	688,264	-	-	(5,639,390)	-	(5,639,390)
Housing	10,959,641	-	13,867,478	-	2,907,837	-	2,907,837
Sanitation and environmental	13,263,809	-	-	-	(13,263,809)	-	(13,263,809)
Education	14,076,737	-	12,617,761	-	(1,458,976)	-	(1,458,976)
Debt service payments	10,472,894	-	-	-	(10,472,894)	-	(10,472,894)
<b>Total governmental activities</b>	<b>175,342,433</b>	<b>4,626,334</b>	<b>31,160,356</b>	<b>17,467,339</b>	<b>(122,088,404)</b>	<b>-</b>	<b>(122,088,404)</b>
<b>Business-type activities:</b>							
Community Development Bank	249,921	112,577	-	-	-	(137,344)	(137,344)
Multitenant	165,216	397,831	-	1,710,000	-	1,942,615	1,942,615
<b>Total Business-type activities</b>	<b>415,137</b>	<b>510,408</b>	<b>-</b>	<b>1,710,000</b>	<b>-</b>	<b>1,805,271</b>	<b>1,805,271</b>
<b>General revenues:</b>							
Property taxes					53,882,740	-	53,882,740
Volume of business taxes					29,428,186	-	29,428,186
Sales taxes					19,510,957	-	19,510,957
Licenses and permits					8,902,337	-	8,902,337
Interest and investment income					3,135,304	105,112	3,240,416
<b>Total general revenues</b>					<b>114,859,524</b>	<b>105,112</b>	<b>114,964,636</b>
Transfers-in (out)					(547,075)	547,075	-
<b>Change in net assets</b>					<b>(7,775,955)</b>	<b>2,457,458</b>	<b>(5,318,497)</b>
Net assets - beginning (as previously reported)					243,966,970	12,303,143	256,270,113
Prior period adjustments					124,756,150	(1,628,579)	123,127,571
Net assets - beginning (as restated)					368,723,120	10,674,564	379,397,684
<b>Net assets - ending</b>					<b>\$ 360,947,165</b>	<b>\$ 13,132,022</b>	<b>\$ 374,079,187</b>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Governmental Funds Balance Sheet  
June 30, 2007

	General	Housing and Rental Program	Public Residential Administration	Head Start Food and Children Programs	Capital Projects	Debt Service	Legislative	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>									
Cash and investments	\$ 4,100,503	\$ 3,348,777	\$ 4,850	\$ 2,309,342	\$ 64,803,610	\$ 185,046	\$ 229,090	\$ 2,589,297	\$ 77,570,515
Cash with fiscal agent	-	-	-	-	-	17,190,006	-	-	17,190,006
Volume of business tax receivable	16,009,977	-	-	-	-	-	-	-	16,009,977
Sales taxes receivable	2,150,186	-	-	-	-	-	-	-	2,150,186
Intergovernmental receivables	10,762,536	-	-	-	458,218	-	651,600	1,023,973	12,896,327
Federal grants receivable	-	3,321,243	344,259	299,854	560,346	-	-	1,464,432	5,990,134
Due from other funds	6,947,287	2,000,000	-	-	-	2,292,305	-	-	11,239,592
Rent and other service charges receivable	2,078,241	151,043	-	3,446	127,958	-	-	16,690	2,377,378
<b>Total assets</b>	<b>42,048,730</b>	<b>8,821,063</b>	<b>349,109</b>	<b>2,612,642</b>	<b>65,950,132</b>	<b>19,667,357</b>	<b>880,690</b>	<b>5,094,392</b>	<b>145,424,115</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Governmental Funds Balance Sheet (continued)  
June 30, 2007

	General	Housing Rental Program	Public Residential Administration	Head Start Food and Children Programs	Capital Projects	Debt Service	Legislative	Other Governmental Funds	Total Governmental Funds
<b>LIABILITIES AND FUND BALANCES</b>									
<b>Liabilities:</b>									
Accounts payable and accrued liabilities	3,637,990	-	42,288	73,408	2,385,442	13,349,229	193,607	870,782	20,552,746
Due to other governments	-	-	-	-	-	-	-	-	-
Due to other funds	4,292,305	495,630	80,798	1,089,075	3,458,583	-	-	1,208,857	10,625,248
Deferred volume of business tax	24,131,021	-	-	-	-	-	-	-	24,131,021
Deferred federal grant revenues	-	80,000	-	6,450	560,363	-	-	337,109	983,922
Deferred intergovernmental	-	-	-	-	-	-	-	1,023,973	1,023,973
Advanced deposits	1,114,221	-	-	-	458,218	-	-	-	1,572,439
<b>Total liabilities</b>	<b>33,175,537</b>	<b>575,630</b>	<b>123,086</b>	<b>1,168,933</b>	<b>6,862,606</b>	<b>13,349,229</b>	<b>193,607</b>	<b>3,440,721</b>	<b>58,889,349</b>
<b>Fund Balances:</b>									
Reserved for encumbrances	6,917,308	-	-	-	-	-	-	-	6,917,308
Reserved for housing programs	-	8,245,433	226,023	-	-	-	-	-	8,471,456
Reserved for youth and children programs	-	-	-	1,443,609	-	-	-	-	1,443,609
Reserved for debt service	-	-	-	-	-	6,318,128	-	-	6,318,128
Reserved for capital projects	-	-	-	-	59,087,526	-	687,083	-	59,774,609
Reserved for special projects	-	-	-	-	-	-	-	1,653,671	1,653,671
Unreserved	1,955,885	-	-	-	-	-	-	-	1,955,885
<b>Total fund balances</b>	<b>8,873,193</b>	<b>8,245,433</b>	<b>226,023</b>	<b>1,443,609</b>	<b>59,087,526</b>	<b>6,318,128</b>	<b>687,083</b>	<b>1,653,671</b>	<b>86,534,666</b>
<b>Total liabilities and fund balances</b>	<b>\$ 42,048,730</b>	<b>\$ 8,821,063</b>	<b>\$ 349,109</b>	<b>\$ 2,612,542</b>	<b>\$ 65,950,132</b>	<b>\$ 19,667,357</b>	<b>\$ 880,690</b>	<b>\$ 5,094,392</b>	<b>\$ 145,424,015</b>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Reconciliation of Fund Balance of Governmental Funds  
to Net Assets of Governmental Activities  
June 30, 2007

Fund balance per Fund statements	\$ 86,534,666
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resource and not reported in the funds	465,859,960
Other long-term liabilities, such as accrued compensated absences, litigations and other contingencies are not available to pay for current year expenditures and therefore not reported in the funds	(19,628,912)
Other economic resources not available to pay current year expenditures, but collectible after the period of availability, are not reported in the funds	983,922
General obligation bonds, special and federal loans are not due and payable in the current period and therefore not reported in the funds	<u>(172,802,471)</u>
Net assets of governmental activities	<u>\$ 360,947,165</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Revenues, Expenditures and Changes in Fund Balances  
Governmental Funds  
For the Fiscal Year Ended June 30, 2007

	General	Housing and Rental Programs	Public Residential Administration	Head Start Food and Children Programs	Capital Projects	Debt Service	Legislative	Other Governmental Funds	Totals
<b>Revenues :</b>									
Property taxes	\$ 36,116,371	\$ -	\$ -	\$ -	\$ -	\$ 17,766,369	\$ -	\$ -	\$ 53,882,740
Volume of business taxes	29,428,186	-	-	-	-	-	-	-	29,428,186
Sales tax	17,033,245	-	-	-	-	2,477,352	-	-	19,510,597
Licenses and permits	8,889,737	-	-	-	12,600	-	-	-	8,902,337
Federal grants	-	12,825,073	962,405	12,611,311	3,893,524	-	-	2,756,484	33,048,797
Fines and penalties	251,811	-	-	-	-	-	-	-	251,811
Interest and investment income	2,805,117	80,795	19,016	77,341	89,661	-	16,482	46,892	3,135,304
Intergovernmental	8,323,878	-	-	224,047	496,110	-	4,091,600	1,817,340	14,952,975
Parking lot fees	190,544	-	-	-	14,000	-	-	155,292	359,836
Rent	675,921	-	-	-	-	-	-	-	675,921
Other	2,044,157	-	-	12,201	264,840	-	-	-	2,321,198
<b>Total revenues</b>	<b>105,758,967</b>	<b>12,905,868</b>	<b>981,421</b>	<b>12,924,900</b>	<b>4,770,735</b>	<b>20,243,721</b>	<b>4,108,082</b>	<b>4,776,008</b>	<b>166,469,702</b>
<b>Expenditures</b>									
General government	44,374,128	-	-	-	-	-	-	-	44,374,128
Public safety	8,273,334	-	-	-	-	-	3,352	810,260	9,086,946
Public works	12,770,521	-	-	-	10,567,030	-	1,358,560	1,300,447	25,996,558
Culture and recreation	5,993,505	-	-	-	1,021,332	-	635	683,125	7,698,597
Health and welfare	3,837,330	-	-	1,513,817	101,854	-	253,687	1,872,067	7,578,755
Economic and social development	4,416,608	-	-	-	1,176,013	-	109,760	504,228	6,206,609
Housing	773,470	8,909,826	1,076,621	-	199,724	-	-	-	10,959,641
Sanitation and environmental	12,720,186	-	-	-	63,600	-	-	386,608	13,170,394
Education	1,795,130	-	-	10,365,349	234,245	-	210,192	1,241,033	13,845,949
Capital outlays	6,066,654	114,791	109,207	607,094	21,260,030	-	2,002,896	4,206,412	34,367,084
Debt service payments	-	-	-	-	-	-	-	-	-
Principal	-	-	-	-	-	9,176,033	-	-	9,176,033
Interest	-	-	-	-	-	10,472,894	-	-	10,472,894
<b>Total expenditures</b>	<b>101,020,866</b>	<b>9,024,617</b>	<b>1,185,828</b>	<b>12,486,260</b>	<b>34,623,828</b>	<b>19,648,927</b>	<b>3,939,082</b>	<b>11,004,180</b>	<b>192,933,588</b>
<b>Excess (deficiency) of revenues over expenditures</b>	<b>4,738,101</b>	<b>3,881,251</b>	<b>(204,407)</b>	<b>438,640</b>	<b>(29,853,093)</b>	<b>594,794</b>	<b>169,000</b>	<b>(6,228,172)</b>	<b>(26,463,886)</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Revenues, Expenditures and Changes in Fund Balances-(continued)  
Governmental Funds  
For the Fiscal Year Ended June 30, 2007

	General	Housing and Rental Programs	Public Residential Administration	Head Start Food and Children Programs	Capital Projects	Debt Service	Legislative	Other Governmental Funds	Totals
Excess (deficiency) of revenues over expenditures	\$ 4,738,101	\$ 3,881,251	\$ (204,407)	\$ 438,640	\$ (29,853,093)	\$ 594,794	\$ 169,000	\$ (6,228,171)	\$ (26,463,885)
Other financing sources (uses)									
Proceeds from debt issuance	-	-	-	-	24,210,000	-	-	-	24,210,000
Property taxes transferred from debt service fund	8,500,000	-	-	-	-	(8,500,000)	-	-	-
Interest transferred from debt service fund	672,646	-	-	-	-	(672,646)	-	-	-
Operating transfer in	-	170,000	-	-	7,874,473	6,715,769	30,928	4,734,398	19,525,568
Operating transfer out	(18,484,022)	-	-	-	(1,588,622)	-	-	-	(20,072,644)
Other financing sources, net	(9,311,376)	170,000	-	-	30,495,851	(2,456,877)	30,928	4,734,398	23,662,924
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	(4,573,275)	4,051,251	(204,407)	438,640	642,758	(1,862,083)	199,928	(1,493,773)	(2,800,961)
Fund balances at beginning of year (as previously reported)	31,207,829	3,555,881	86,175	1,004,969	29,141,881	16,846,301	487,155	2,501,819	84,832,010
Prior period adjustments	(17,761,361)	638,301	344,255	-	29,302,887	(8,666,090)	-	645,625	4,503,617
Fund balances at beginning of year (as restated)	13,446,468	4,194,182	430,430	1,004,969	58,444,768	8,180,211	487,155	3,147,444	89,335,627
Fund balances at end of year	\$ 8,873,193	\$ 8,245,433	\$ 226,023	\$ 1,443,609	\$ 59,087,526	\$ 6,318,128	\$ 687,083	\$ 1,653,671	\$ 86,534,666

*D. Lopez*  
*02/09/08*  
*✓*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Reconciliation of the Statement of Revenues, Expenditures and  
Changes in Fund Balances of Governmental Funds  
to the Statement of Activities  
for the Fiscal Year Ended June 30, 2007

Net change in fund balance - total governmental funds	\$ (2,800,961)
Amounts reported in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the statement of activities , the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	14,672,677
General long-term debt proceeds provide current financial resources to governmental funds, but issuing debt increases long term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long term liabilities in the statement of net assets. This is the amount by which proceeds exceed or are below the repayments	(11,291,000)
Some revenues and expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as revenues and expenditures in the governmental funds.	<u>(8,356,671)</u>
Change in net assets of governmental activities	<u>\$ (7,775,955)</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Revenues and Expenditures  
Budget and Actual- General Fund  
Non GAAP Budgetary Basis  
for the Fiscal Year Ended June 30, 2007

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual amounts in the budgetary basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>Resources:</b>				
Property taxes	\$ 33,321,742	\$ 33,321,742	\$ 36,116,370	\$ 2,794,628
Property taxes transferred from debt service	-	-	8,500,000	8,500,000
Volume of business taxes	26,200,000	26,200,000	29,428,186	3,228,186
Sales taxes	11,400,000	12,258,000	17,033,245	4,775,245
Fines and penalties	250,000	250,000	251,810	1,810
Interest and investment income	750,000	750,000	2,805,117	2,055,117
Interest transferred from debt service	-	-	672,646	672,646
Intergovernmental	9,106,899	9,106,899	8,320,129	(786,770)
Licenses and permits	6,028,000	6,028,000	8,889,737	2,861,737
Parking lot fees	177,600	177,600	190,544	12,944
Rent and other resources	10,948,359	25,662,722	2,652,353	(23,010,369)
Amounts available for appropriation	<u>\$ 98,182,600</u>	<u>\$ 113,754,963</u>	<u>\$ 114,860,137</u>	<u>\$ 1,105,174</u>
<b>Expenditures charged to appropriations:</b>				
Culture and recreation	6,877,244	6,675,008	6,674,971	37
Economic and social development	4,574,428	7,384,681	7,382,331	2,350
Education	2,238,293	2,495,097	2,495,097	-
General government	41,540,539	49,543,919	49,512,179	31,740
Health and welfare	4,086,879	3,981,927	3,981,927	-
Housing	829,958	890,450	890,350	100
Sanitation and environmental	14,367,332	13,558,277	13,558,277	-
Public safety	9,258,147	8,494,873	8,494,873	-
Public works	14,409,780	20,730,731	20,711,142	19,589
Total charges to appropriations	<u>98,182,600</u>	<u>113,754,963</u>	<u>113,701,147</u>	<u>53,816</u>
Excess of resources over appropriations	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,158,990</u>	<u>\$ 1,158,990</u>

See notes to the financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Net Assets  
Proprietary Funds  
June 30, 2007

	Community Development Bank	Multitenant Funds	Totals
<b>ASSETS</b>			
<b>Current Assets:</b>			
Cash and cash equivalents	\$ 2,331,317	\$ 1,682,835	\$ 4,014,152
Rent receivable	-	14,544	14,544
Due from federal agency	-	-	-
<b>Total current assets</b>	<u>2,331,317</u>	<u>1,697,379</u>	<u>4,028,696</u>
<b>Noncurrent Assets:</b>			
Loans receivable, net	<u>2,400,575</u>	-	<u>2,400,575</u>
<b>Capital assets:</b>			
Land	-	2,982,254	2,982,254
Building and improvements	-	3,020,270	3,020,270
Equipment	33,603	2,145	35,748
Less: Accumulated depreciation	(33,603)	(406,291)	(439,894)
Construction in progress	-	2,156,083	2,156,083
<b>Capital assets net</b>	<u>-</u>	<u>7,754,461</u>	<u>7,754,461</u>
<b>Total non-current assets</b>	<u>2,400,575</u>	<u>7,754,461</u>	<u>10,155,036</u>
<b>Total assets</b>	<u>\$ 4,731,892</u>	<u>\$ 9,451,840</u>	<u>\$ 14,183,732</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Net Assets (continued)  
Proprietary Funds  
June 30, 2007

	Community Development Bank	Multitenant Funds	Totals
<b>LIABILITIES AND NET ASSETS</b>			
<b>Liabilities:</b>			
<b>Current liabilities</b>			
Notes payable (current portion)	\$ 84,547	\$ -	\$ 84,547
Due to other fund	384,102	230,242	614,344
Accounts payable and accrued liabilities	780	72,604	73,384
Total current liabilities	469,429	302,846	772,275
<b>Noncurrent liabilities:</b>			
Notes payable (net of current portion)	279,435	-	279,435
Total liabilities	748,864	302,846	1,051,710
<b>Net assets:</b>			
Investment in capital assets (net of related debt)	-	7,754,461	7,754,461
Unrestricted	3,983,028	1,394,533	5,377,561
Total net assets	3,983,028	9,148,994	13,132,022
Commitments and contingencies	-	-	-
Total liabilities and net assets	\$ 4,731,892	\$ 9,451,840	\$ 14,183,732

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Revenues, Expenses and Changes in Net Assets  
Proprietary Funds  
For the Fiscal Year Ended June 30, 2007

	Community Development Bank	Multitenant Funds	Totals
Operating revenues:			
Rent, interest on loans and origination fees	\$ 112,577	\$ 397,831	\$ 510,408
Operating expenses:			
Payroll	131,413	-	131,413
Depreciation	2,634	61,164	63,798
Professional fees	78,000	-	78,000
Bank service charges	2,312	-	2,312
Repairs and maintenance	-	97,437	97,437
Office supplies	-	-	-
Rent	19,200	6,080	25,280
Utilities	6,000	-	6,000
Other	1,950	535	2,485
Total operating expenses	<u>241,509</u>	<u>165,216</u>	<u>406,725</u>
Income (loss) before contributions and transfers	<u>(128,932)</u>	<u>232,615</u>	<u>103,683</u>
Non-operating revenues (expenses)			
Interest income	58,639	46,473	105,112
Interest expense	<u>(8,412)</u>	<u>-</u>	<u>(8,412)</u>
Total non-operating revenues (expenses)	<u>50,227</u>	<u>46,473</u>	<u>96,700</u>
Income (loss) before contributions and transfers	<u>(78,705)</u>	<u>279,088</u>	<u>200,383</u>
Contributions:			
Federal grants	-	1,710,000	1,710,000
Transfers from governmental funds	<u>547,075</u>	<u>-</u>	<u>547,075</u>
	<u>547,075</u>	<u>1,710,000</u>	<u>2,257,075</u>
Changes in net assets	<u>468,370</u>	<u>1,989,088</u>	<u>2,457,458</u>
Net assets at beginning of fiscal year			
(as previously reported)	3,685,225	8,617,918	12,303,143
Prior period adjustmentS	<u>(170,567)</u>	<u>(1,458,012)</u>	<u>(1,628,579)</u>
Net assets at beginning of fiscal year (restated)	<u>3,514,658</u>	<u>7,159,906</u>	<u>10,674,564</u>
Net assets at end of fiscal year	<u>\$ 3,983,028</u>	<u>\$ 9,148,994</u>	<u>\$ 13,132,022</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Statement of Cash-Flows  
Proprietary Funds  
June 30, 2007

	Community Development Bank	Multitenant Funds	Totals
Cash flows from operating activities:			
Receipts from customers	\$ 112,577	\$ 397,831	\$ 510,408
(Increase) in loans receivable	(837,856)	-	(837,856)
Payments to suppliers	(107,762)	(104,052)	(211,814)
Payments to employees	(131,413)	-	(131,413)
Net cash provided by (used in) operating activities	<u>(964,454)</u>	<u>293,779</u>	<u>(670,675)</u>
Cash flows from capital and related financing activities:			
Capital assets investments	-	(1,025,468)	(1,025,468)
Capital contributions from Federal Government	-	1,710,000	1,710,000
Increase in amount due from Federal Government	-	-	-
Principal paid on capital debt	(83,393)	-	(83,393)
Interest paid on capital debt	(8,412)	-	(8,412)
Net cash provided by (used in) capital and financing activities	<u>(91,805)</u>	<u>684,532</u>	<u>592,727</u>
Cash flows from non-capital financing activities:			
Transfer from governmental funds	547,075	-	547,075
Increase (decrease) in loan due to general fund	413,136	(679,164)	(266,028)
	<u>960,211</u>	<u>(679,164)</u>	<u>281,047</u>
Cash flows from investing activities:			
Interest income	58,639	46,473	105,112
Net cash provided by investing activities	<u>58,639</u>	<u>46,473</u>	<u>105,112</u>
Net increase (decrease) in cash and cash equivalents	(584,484)	345,620	(238,864)
Cash and cash equivalent at beginning fiscal year	2,915,801	1,337,215	4,253,016
Cash equivalente at end fiscal year	<u>\$ 2,331,317</u>	<u>\$ 1,682,835</u>	<u>\$ 4,014,152</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:			
Adjustments to reconcile operating income (loss) to net cash provided in (used) in operating activities:			
Operating income (loss)	\$ (128,932)	\$ 232,615	\$ 103,683
Depreciation	2,634	61,164	63,798
(Increase) in loan receivable	(838,156)	-	(838,156)
Net cash provided by (used in) operating activities	<u>\$ (964,454)</u>	<u>\$ 293,779</u>	<u>\$ (670,675)</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements  
June 30, 2007

Note 1 - Summary of significant accounting policies

The Municipality of Caguas (the Municipality), founded in 1894, is a municipality of the Commonwealth of Puerto Rico. It is governed by a Major and a 16 member Municipal Assembly elected for a four-year term. The Municipality provides services to its residents in the areas of health, public works, education, public safety, urban development, economic development, culture and recreation, and other services.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America.

Financial reporting entity

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 of the Governmental Accounting Standards Board (GASB). 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 government 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. Based on the above criteria the Municipality does not have component units to include within its reporting entity.

In June 1999, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 34 Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments. GASB-34 significantly changed the way in which the Municipality reported its finances.

GASB-34 established two bases for reporting financial information: government-wide financial statements and fund presentation. The government-wide financial statements method adopts the flow of economic resources measurement focus and accrual basis of accounting for both governmental activities and business-type activities. The basis for preparing fund financial statements is similar to conventional governmental financial statements except the focus for presentation is on major funds rather than fund types. Capital assets, including infrastructure assets, and depreciation charges are reported on the entity-wide perspective financial statements. The management's discussion and analysis information precedes the basis financial statements but is considered required supplementary information. Budgetary information is no longer presented in the financial statements but rather is presented as required supplementary information.

The Municipality implemented this statement in fiscal year ended June 30, 2003.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Basic Financial Statements GASB Statement No. 34

Government Wide Financial Statements:

The focus of the government wide financial statements is on the overall financial position and activities of the Municipality as a whole. The government wide financial statements will provide with the following:

- Present financial information about the overall government without presenting information about the individual funds or fund types.
- Differentiate between the Municipality's governmental activities and business type activities.
- Measure and present all financial balances and activities based on the economic resources measurement focus and the accrual basis of accounting.

The flow of economic resources measurement and accrual accounting are the basis upon which government wide financial statements are prepared. Under the flow of economic resources measurement focus and accrual basis of accounting, revenues are recognized when earned and expenses are incurred when incurred when these activities are related to exchange and exchange like activities. In addition, long-lived assets are capitalized and depreciated over their estimated economic lives.

The government wide statements include the Statement of Net Assets and the Statement of Activities:

Statement of net assets:

Presentation of assets and liabilities – Assets and liabilities should be presented in the statement of net assets based on their relative liquidity. The liquidity of the assets is determined based their ability to be converted in cash and the absence of any restriction that might limit their conversion to cash. The liquidity of liabilities is based on maturity dates or expected payment dates.

Presentation of capital assets – The governmental entity should report all of its capital assets in the statement of net assets, based on their original historical cost. Capital assets that have been donated should be capitalized at their estimated fair value at the date of the receipt.

Presentation of long-term liabilities - Long-term liabilities include debts such as bonds, notes, and federal loans. In addition, operating liabilities such as compensated absences and claims must be reported in the statement of net assets.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Presentation of component of net assets - Net assets represent the difference between the Municipality's total assets and its total liabilities. The statement of net assets must identify the components of the net assets, namely (a) invested in capital assets, net of related debt; (b) restricted net assets; and (c) unrestricted net assets.

Invested in capital assets, net of related debt is the difference between capital assets (net of accumulated depreciation) and liabilities attributable to the acquisition, construction or improvement of those assets.

Restricted net assets arise if either of the following conditions exists: (a) externally imposed by creditor, grantors, contributors or laws and regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation.

Assets that are not classified as invested in capital assets (net of related debt) or restricted are included in the category of unrestricted net assets.

Revenues and other financing inflows - A fundamental concept in the presentation of the statement of activities is the identification of resources inflows to the Municipality that are related to specific programs and those that are general in nature. Revenues are divided in program revenues and general revenues.

Program revenues - Program revenues are those that are identified with an specific function, otherwise the revenues would not flow to the Municipality. As established before, program revenues are presented in the statement of activities as a subtraction of related program expenses in order to identify the net cost or benefit of a particular program. Program revenues are divided in charges for services, operating grants and contributions and capital grants.

General revenues - General revenues included resources that are not specifically related with a specific function, but that are used in the operation of the Municipality.

Expenses - The Municipality reports expenses, including depreciation expense by function. Direct expenses are those that are specifically associated with a service, program or department and are clearly identifiable to a particular function.

Generally, the cost (net of estimated salvage value) of capital assets should be depreciated over their estimated useful lives. Depreciation expense is reported as direct expense of the specific functional category with which the related capital asset has relationship.

Fund Financial Statements:

Fund based financial statements are included in order to demonstrate that restrictions imposed by statutes, regulations, or contracts have been followed. The Municipality has the following major funds:

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Governmental funds - These financial statements have a short term emphasis and generally measure and account for cash and other assets that can easily be converted to cash and are used to account for the Municipality's expendable financial resources and the related liabilities. The measurement focus is upon determination of any changes in financial position. The Municipality's major funds are the following:

General fund

The general fund is used to account for all financial transactions, except those required to be accounted for in another fund.

Housing and Rental Programs

Accounts for current financial resources restricted mainly for housing rental programs to low and very low income family units. Resources are funded by the United States Department of Housing and Urban Development, mainly through the Section 8 Housing Voucher and Home Investment Partnership Programs.

Head Start Food and Children Program

It was previously reported as Head Start Youth and Children funds. Accounts for current financial resources restricted for the education of pre-school aged children that are mainly funded by the United States Department of Health and Human Services and the United States Department of Agriculture.

Capital Projects

Capital projects fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds.

Debt service funds

The debt service fund is 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 CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Legislative funds

The legislative funds account the accumulation of resources approved by the Legislature of the Commonwealth of Puerto Rico designated for the investment of such in special projects related mainly with health and welfare, public works, economic development and others as requested by the Municipality's citizenship.

Public Residential Administration

On March 26, 2003, the Municipality entered into an Intergovernmental Management Agreement with the Puerto Rico Public Housing Administration (PRPHA). The purpose of the Agreement was to designate the Municipality to act as independent contractor for the PRPHA to manage, administer and operate the low income housing project denominated as José Gautier Benítez, under the United States Housing Act of 1937, as amended. The Project is located at State Road No. 1, behind Villa del Carmen Shopping Center, Caguas, Puerto Rico.

As part of the Agreement, the Municipality submits, on the 1<sup>st</sup> day of February of each year, an Annual Management Plan in which it delineates its proposed budgets for the year and any work to be performed in the Project.

The terms of the Agreement commenced on May 1<sup>st</sup>, 2003 (effective date) and shall expire at midnight on April 30<sup>th</sup>, 2005 (original term). The Agreement may be renewed by the PRPHA for additional periods of one year each, but not beyond April 30<sup>th</sup>, 2007

The Municipality operates the Program using fiscal periods beginning on July 1<sup>st</sup> and ending June 30<sup>th</sup>.

Other Special Revenue funds

It were previously reported as Other Special Revenue funds. Current financial resources used to account for the proceeds of specific revenue sources (other than debt service or capital projects) such as federal grants, that are legally restricted to expenditures for various specified purposes.

The financial statements of the governmental funds are the following:

Balance sheet – Reports information at June 30 about the current financial resources (assets, liabilities and fund balances) of each major governmental fund.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Statement of revenues, expenditures and changes in fund balance - Reports information about the inflows, outflows and balances of current financial resources of each major governmental fund for the fiscal year ended June 30.

Proprietary funds – Financial statements for proprietary funds are based on the flow of economic resources (measurement focus) and the accrual basis of accounting. They are used to account for activities, which are similar to operations in the private sector. The proprietary fund type consists of enterprise funds.

Enterprise funds

The enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the cost of providing goods and services (including depreciation) be financed or recovered primarily through user charges, or where the Municipality has decided that periodic determination of revenues earned and expenses incurred is appropriate. The Municipality's enterprise funds follows:

Community Development Bank - Accounts for the economic resources designated mainly for the approval of loans for economic development, education and emergency in the benefit of the Caguas citizenship.

Multi-tenant Funds - Accounts the deposit of rental resources designated for the Municipality's normal operation other than those functions accounted in the general fund.

The financial statements of the proprietary funds are the following:

Statement of net assets or balance sheet - Assets and liabilities are presented in a classified format to distinguish between current and long term assets and liabilities.

Statement of revenues, expenditures and changes in fund net assets - Revenues and expenses are reported by distinguishing between operating and non-operating revenues and expenses.

Statement of cash flows - The primary purpose of the statement of cash flows is to provide relevant information about the cash receipts and disbursements of the Municipality during the fiscal year. The information of the statement of cash flows should help financial report users assess (a) Municipality's ability to generate future cash flows; (b) ability to meet its obligation as they come due; (c) its needs for external financing; (d) the reasons for differences between operating income and associated cash receipts and disbursements and the effects on the entity's financial position of operating, capital and related financing activities, non-capital related financing activities and investment activities during the period.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Basis of accounting

The basis of accounting determines when the Municipality recognizes revenues and expenditures/expenses and related assets and liabilities.

Governmental fund types follow the modified accrual basis of accounting. Under this basis of accounting, revenues are recorded in the accounting period in which they become susceptible to accrual, that is, when they become both measurable and available. Available is defined as expected to be collected within the current period or soon enough thereafter to be used to pay liabilities of the current period.

In applying the susceptible to accrual concept to governmental revenues, there are essentially two types of revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the Municipality; therefore, revenues are recognized based upon the expenditures incurred. In the other, monies are virtually unrestricted and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the susceptible to accrual criteria are met.

The Municipality reports deferred revenue on its combined balance sheet. Deferred revenue arises when potential revenue does not meet both the measurable and available criteria for recognition in the current period. Deferred revenue also arises when the Municipality receives resources before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures.

In subsequent periods, when both revenue recognition criteria are met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and revenue is recognized.

Licenses, permits, service charges, fines and forfeits and miscellaneous revenues are recorded as revenues on the cash basis, which includes amounts collected shortly after June 30. Investment income is recorded as revenue when received. The enterprise fund follows the accrual basis of accounting. Under the accrual basis, revenue is recognized when earned and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Expenditures and related liabilities are generally recorded, except as described below, in the accounting period in which the liability is incurred. Expenditures and related liabilities for interest on long-term obligations, are recorded when due, except for interest due July 1st of the following year which is accounted for as paid on June 30. Vacation, sick leave, disallowances and litigation are recorded in the statement of net assets.

Budgetary accounting

The Municipality's annual budget is prepared on the budgetary basis of accounting and represents departmental appropriations recommended by the Mayor and approved by the Municipality's City Council prior to the beginning of the fiscal year. Budgetary control is maintained at the department level for each individual appropriation.

Amendments to the budget, and budgetary transfers related to personal expenditures, require the approval of the City Council. Non-capital encumbrances lapse at the end of the next fiscal year.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the general fund in the accompanying Statement of Revenues and Expenditures - Budget and Actual - General Fund is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are considered as expenditures for budgetary purposes.
2. Prior year encumbrances settled during the year and recorded as expenditures for GAAP Basis.
3. Effect of GAAP basis accruals.

The following is reconciliation, of the differences between GAAP and the budgetary basis for the general fund excess of expenditures and other financing uses over revenues and other financing sources:

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Change in fund balance as per Statement of Revenues, Expenditures and Change in Fund Balance (GAAP Basis)	(\$4,573,275)
Prior year's encumbrances settled during the current fiscal year	11,059,223
Current fiscal year encumbrances treated as current year expenditures for budgetary purposes	-
Non-budgeted revenues	(5,255,484)
	(71,474)
Excess of resources over appropriations - Non GAAP Budgetary Basis	\$ 1,158,990

Cash and investments

Substantially all cash balances are commingled in a deposit and checking accounts, certificates of deposits and several special purpose bank accounts, except for cash and investments restricted by law. Each fund records its equity interest in the pooled cash balance. The available cash balance in the general checking account beyond immediate needs is invested in interest-bearing deposits. Investment earnings are all credited to the general fund.

Investments are carried at fair market value. Investments are composed of highly liquid U.S. Treasury Securities which are covered by the provisions of GASB Statement No. 31 "Accounting and Financial Reporting for Certain Investments and for External Investment Pools" therefore, the Municipality accounts for changes in the market value of its investments at the closing of the period.

Cash with fiscal agent reports property tax collections retained by the "Centro de Recaudaciones de Ingresos Municipales" (CRIM) and restricted for the payment of the Municipality's general obligations through the debt service fund.

Inter-fund transactions

The Municipality has the following types of transactions among funds:

Operating transfers - Transfers that are reported when incurred as "Operating transfers in" by the recipient fund and as "Operating transfers out" by the disbursing fund.

Receivables and payable - Transactions between funds outstanding at the end of the fiscal year are referred as due to/from other funds. The general fund provides services, at cost, to other funds. The amounts charged to other funds are treated as reductions in expenditures of the general fund.

Eliminations are made in the government wide statements of the amounts reported as inter-fund receivables as well as operating transfers, except for the net residual amounts due between governmental and business-type activities, which are reported as internal balances.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Capital assets

Capital assets acquired or constructed, whether owned by governmental activities or business-type activities are recorded and depreciated in the government-wide financial statements. No long-term capital assets or depreciation are shown in the governmental funds financial statements.

Capital assets, include public domain infrastructure (e.g., roads, bridges, sidewalks and other assets that are immovable and of value only to the Municipality). Capital assets are recorded at cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at the 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 capital asset or extend capital assets lives are not capitalized. Major improvements are capitalized and depreciated over the remaining useful lives of the related capital assets. Finally, major outlays for capital assets and improvements are capitalized as the projects are constructed.

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

Facilities and recreational parks	120 to 720 months
Building and building improvements	60 to 360 months
Streets and roads	nil to 600 months
Personal property	36 to 180 months
Software	60 to 72 months

Compensated absences

Employees accrue 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. 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 unpaid sick leave at their then current rate of pay, if the employee has at least 10 years of service with the Municipality. Total vested pay benefits accrued for compensated absences at June 30, 2007 amounts to approximately \$9,797,200.

Long-term debt

The liabilities reported in the government-wide statements include the Municipality's general obligation bonds and notes for the realization of capital projects, and other long-term liabilities including vacation, sick leave, and litigation.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAGUAS

Notes to Financial Statements (continued)  
June 30, 2007

Reserves of fund balance

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

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.

Debt service - Represents fund balance available to finance future debt service payments.

Capital projects - Represent fund balance available to finance future capital outlays and other public works projects. Also includes fund balances available to finance projects approved by the Legislature of the Commonwealth of Puerto Rico for housing, culture an recreation, public works, economic development and other activities requested by the Municipality's citizenship.

Head Start Food and Children programs - Represents fund balances available to finance activities of education and care of the eligible elderly population, mainly through the Head Start, Child Care and Child Care Food federal programs.

Housing projects - Represents fund balances available to finance activities oriented to the housing rent, acquisition, construction and rehabilitation for the Municipality's eligible citizenship.

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. The government wide financial statements include an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

Note 2 - Annual revenues

Property taxes

The CRIM is responsible for the assessment of all real and personal property located within the Municipality of Caguas and for the levy, administration and collection of the corresponding taxes. The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are established at the estimated current value existing in the year 1957 and of personal property at the current value at the date of assessment.

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Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first \$15,000 of the assessed valuation of owner occupied residential units. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000. The Department of the Treasury instead of the property taxpayer becomes the source of payment in these cases.

The annual tax rate for fiscal year 2007 is 8.78% for real property and 6.58% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 6.00% and 4.00% respectively, represent the Municipality's basic property tax rate which is appropriated for general purposes and accounted in the general fund. Such amount is deposited by the CRIM in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.75% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

The Commonwealth also contributes an annual tax rate of .20% of each of the tax rates due to a discount granted by the state to the taxpayers.

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, the Municipality records the revenues related to property taxes, net of the operational expenses allocated by the CRIM to the Municipality, when such revenues are reported by the CRIM. During the fiscal year ended June 30, 2007 the allocated expenses amounted to \$1,306,337.

At the end of fiscal year, the amount receivable or payable arising from the fiscal year end settlement of actual property tax collections versus property tax advances made by the CRIM to the Municipality are reported as an increase or deduction of property tax revenue in the general fund, as applicable. Advances of property tax on (a) and (b) above, are recorded as revenues on the General Fund and Debt Service Fund, respectively.

Municipal license taxes

The Municipality imposes a volume of business tax pursuant to Act No. 82 of August 30, 1991, on all business entities, which operate within the Municipality, which are not exempt from the tax pursuant to the Industrial Incentives Act. The tax is based on gross revenues, as defined by law, computed at the rate of 1.50% for financial institutions and savings and loans associations, and .50% for all other business entities.

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The minimum gross revenue to file the Volume of Business Tax Declaration is \$5,000 and the minimum tax payable is \$25. The date to file the Volume of Business Tax Declaration is April 15. The Municipality grants a five percent discount, if the taxes are paid on or before April 15. Otherwise, 50% of taxes payable must be paid within the first 15 days of each semester beginning with the first semester ending December 31.

Collections of volume of business tax revenues received mainly in April 15, are accounted as deferred revenues, since such collections have a time requirement and should be used starting July 1<sup>st</sup> of next fiscal year. In the next fiscal year, the deferred volume of business tax revenues are recognized as revenue, net of any credit or refunds payable to taxpayers.

Sales taxes

On February, 2005, the Municipal Legislature approved the Ordinance No. 05A-46, which defined the public policy of establishing a Municipal Citizen's Contribution (a sales tax) of 1% over retail sales inside the municipal jurisdiction. Said Ordinance was then amended on June 30, and October 31, 2005, to include the scope, limitations and administrative provisions for the management of the Contribution and some other tax-free items, respectively. A Ruling was also approved by the Mayor on September 1, 2005 to provide a better understanding of the Ordinances.

On July 4, 2006, the Governor of Puerto Rico signed Act No. 117, known as the "Tax Fairness Act of 2006" (hereinafter the "Act"). Among its provisions, the Act provides for a sales and use tax of 5.5% at a Commonwealth level and authorizes the municipalities to impose a sales and use tax of 1.5% at the municipal level. On July 12, 2006, our Mayor signed Ordinance No. 06A-6, Series 2006-2007, which imposes the 1.5% sales and use tax authorized by the Act, effective on September 1, 2006. Consequently, the Ordinance 05A-46, as amended, was rescinded effective on August 31, 2006.

The Municipality's sales tax revenues for the year ended June 30, 2007 amounted to \$19,510,597, of which \$17,033,245 are allocated to the general fund for the Municipality's regular operation and \$2,477,352 to be used for debt service.

Note 3 - Cash, cash equivalents, and investments

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws. During the year, the Municipality invested its funds in interest bearing bank accounts, and certificates of deposit. The Municipality is subject to the following credit risks:

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Notes to Financial Statements (continued)  
June 30, 2007

Custodial credit risk:

The Municipality is authorized to deposit only in institutions approved by the Department of the Treasury of the Commonwealth of Puerto Rico. Such deposits should be kept in separate accounts in the name of the Municipality. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. During the year ended June 30, 2007, the Municipality invested its funds in bank accounts bearing interest.

At June 30, 2007 the Municipality had bank balances as follows:

Insured by the federal deposits insurance corporation	\$ 800,000
Collateralized by securities held by the pledging financial institution's trust department in the Corporation's name	<u>44,820,297</u>
Total	<u>\$45,620,297</u>

In addition, as of June 30 2007, the Municipality's custodial credit risk was approximately \$45 million, which is the bank balance of cash deposited at the Government Development Bank for Puerto Rico. These deposits are exempt from the collateral requirement established by the Commonwealth.

Interest rate credit risk:

At June 30, 2007, the Municipality maintains investments in debt securities with a fair market value of approximately \$4.5 millions, which are secured by the Federal Government. Market values of such investments are very sensitive to the changes in the interest rates. At June 30, 2007, the Municipality had a risk of not recovering the market value of such investments if such investments are sold.

Note 4 - Intergovernmental revenues

Sources of intergovernmental revenues are primarily of governmental payments from the Commonwealth of Puerto Rico and "in lieu of tax" payments from certain quasi public corporations, such as Puerto Rico Electric Power Authority. The amount of contribution in lieu of tax for the year 2006-2007 was \$ 6,521,200.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, subsidies through legislative appropriations mainly for capital improvements.

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Notes to Financial Statements (continued)  
June 30, 2007

Note 5 – Inter-fund loans

Due from/to other funds

Inter-fund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures. Following is a summary of inter-fund assets and liabilities as of June 30, 2007:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Debt service	General	2,292,305
Housing	General	2,000,000
	Housin and Rental	495,630
	Public Residential Administration	80,798
	Head Start Food and Children	1,089,075
	Capital Project	3,458,583
	Community Development Bank	384,102
	Multi-tenants	230,242
	Other governmental	<u>1,208,857</u>
General		<u>\$ 6,947,287</u>

The purpose of each inter-fund balances are the following:

Payables to the general funds:

Housing and rental - includes expenditures mainly of the Section 8 Housing Choice Voucher, HOME Investment Partnership Program and other housing projects sponsored by the Municipality, which are initially disbursed through the general fund.

Public Residential Administration – includes maintenance expenditures allowable under the intergovernmental agreement between the Municipality and the Puerto Rico Public Housing Administration regarding the José Gautier Benítez public residential residential project, by which the Municipality is a Management Agent for the maintenance of the dwelling units and the facilities of the project, as well as other certain administration tasks. These expenditures are initially disbursed through the general fund.

Head Start Food and Children - includes expenditures mainly of the Head Start, Child Care and USDA Food and Children programs and other related projects sponsored by the Municipality, which are initially disbursed through the general fund.

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Capital project fund - includes expenditures mainly of the Community Development Block grants and Community Facilities Loans Programs and other related projects sponsored by the Municipality, which are initially disbursed through the general fund.

Community Development Bank (CDB) - includes professional fees, rent and other operating expenses of the CDB, but disbursed initially through the general fund.

Multi-tenant Funds - includes expenditures to finance mainly the construction of the "Escuela de Ciencia y Tecnología", of the "Multifabril" Building., which were disbursed initially through the general fund.

Other governmental funds - includes expenditures mainly to finance certain public safety and health and welfare projects that involve both the use of federal and municipal funds and which were initially disbursed through the general fund.

Payable to the debt service fund:

General fund - includes sales taxes approved for debt service payments, which are deposited in the depository bank account of the general fund.

Payable to the Housing funds:

General fund - represents investment account maintained for the housing project Caguas Millenium, which was temporarily withdrew for the operations of the general fund. This investment was re-deposited in the housing project special account after June 30, 2007.

Transfers in/out

Inter-fund transfers in/out reflect the transfers of resources between from one fund to another without the attempt of recovering. Following is a summary of inter-fund transfers for the year ended June 30, 2007:

<u>Transferred In</u>	<u>Transferred Out</u>	<u>Amount</u>
Debt Service	Capital Project	\$ 1,538,622
Community Development Bank	Capital Project	\$ 50,000
Capital Project		7,874,473
Debt Service		5,177,149
Community Development Bank		497,075
Housing and Rental		170,000
Legislative Fund		30,928
Other Governmental		4,734,397
	General Fund	<u>\$ 18,484,022</u>

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The purpose of each inter-fund balances are the following:

Transfers-out from the general fund – current financial resources transferred for the performing of capital projects, housing, operational loans debt service payments, public safety, public works and health and welfare projects and CDB's debt service and payroll expenses.

Transfer-outs from capital project fund – current financial resources transferred to the debt service fund for the debt service payment of federal loans and notes and to the CDB for economic development programs.

Note 6 - Capital assets

A summary of the activity of capital assets for governmental activities group follows:

	Balance June 30, 2006	Additions	Retirements	Transfers	Balance June 30, 2007
<u>Capital assets not being depreciated</u>					
Land and improvements	\$ 36,449,098	\$ 2,075,093	\$ -	\$ 71,258	\$ 38,595,449
Construction in progress	83,360,600	27,317,538	-	(30,772,553)	79,905,585
Works of art and historical treasures	2,685,541	304,000	-	-	2,989,541
Total not being depreciated	<u>122,495,239</u>	<u>29,696,631</u>	<u>-</u>	<u>(30,701,295)</u>	<u>121,490,575</u>
<u>Other capital assets</u>					
Facilities and improvements	87,363,593	-	-	15,263,850	102,627,443
Buildings and improvements	13,564,237	-	-	3,134,257	16,698,494
Computer software	1,112,084	-	-	-	1,112,084
Roads and streets	382,561,828	-	-	12,303,188	394,865,016
Equipment and vehicles	31,243,741	4,670,455	(668,427)	-	35,245,769
Total Other capital assets	<u>515,845,483</u>	<u>4,670,455</u>	<u>(668,427)</u>	<u>30,701,295</u>	<u>550,548,806</u>
<u>Accumulated depreciation</u>					
	Balance June 30, 2006	Depreciation Expense	Retirements	Transfers	Balance June 30, 2007
Facilities and improvements	65,870,008	5,424,867	-	-	71,294,875
Building and improvements	5,225,684	1,738,975	-	-	6,964,659
Equipment and vehicles	17,938,094	2,404,630	(615,522)	-	19,727,202
Computer software	314,667	1,500	-	-	316,167
Roads and streets	97,482,081	10,394,437	-	-	107,876,518
	<u>186,830,534</u>	<u>19,964,409</u>	<u>(615,522)</u>	<u>-</u>	<u>206,179,421</u>
Capital assets, net	<u>\$ 451,510,188</u>	<u>\$ 14,402,677</u>	<u>\$ (52,905)</u>	<u>\$ -</u>	<u>\$ 465,859,960</u>

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Notes to Financial Statements (continued)  
June 30, 2007

A summary of the activity of capital assets for business-type activities group follows:

	Balance at June 30, 2006	Additions	Retirements	Balance at June 30, 2007
<b>Capital assets not being depreciated</b>				
Land and improvements	\$ 2,982,254	\$ -	\$ -	\$ 2,982,254
Construction in progress	790,000	1,366,083	-	2,156,083
<b>Total not being depreciated</b>	<u>3,772,254</u>	<u>1,366,083</u>	<u>-</u>	<u>5,138,337</u>
<b>Other capital assets</b>				
Building and improvements	3,020,270	-	-	3,020,270
Equipment	33,603	2,145	-	35,748
<b>Total other capital assets</b>	<u>3,053,873</u>	<u>2,145</u>	<u>-</u>	<u>3,056,018</u>
<b>Accumulated depreciation</b>				
Building and improvement	345,117	60,745	-	405,862
Equipment	30,979	3,053	-	34,032
	<u>376,096</u>	<u>63,798</u>	<u>-</u>	<u>439,894</u>
<b>Capital assets, net</b>	<u>\$ 6,450,031</u>	<u>\$ 1,304,430</u>	<u>\$ -</u>	<u>\$ 7,754,461</u>

Depreciation expense for capital assets of governmental activities was charged to the following functions as follows:

General government	\$ 4,414,946
Public safety	185,149
Public works	14,785,126
Culture and recreation	106,251
Health and welfare	257,792
Economic and social development	121,045
Housing	-
Sanitation and environmental	93,415
Education	685
	<u>\$ 19,964,409</u>

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Note 7 - General long - term debt

The legal debt margin of the Municipality is equal to 10% of the total assessment of property located within the Municipality. At June 30, 2007, total property assessments, based on information reported by the Municipal Revenue Collection Center amounted to \$1,218,101,461 of which \$637,333,592 and \$580,767,869 are real and personal property, respectively. All of the Municipality's long-term debt has been issued for the construction of capital projects in benefit of the citizenship.

Changes in general long - term debt of governmental activities for the fiscal year ended June 30, 2007 are summarized as follows:

	Bonds	Federal Loan and Notes	Special Loans	Totals
Balance at June 30, 2006	\$ 101,853,030	\$ 9,560,000	\$ 43,684,824	\$ 155,097,854
Payments	(6,005,000)	(955,000)	(2,216,033)	(9,176,033)
New debt issued	18,305,650	-	8,575,000	26,880,650
Balance at June 30, 2007	<u>\$ 114,153,680</u>	<u>\$ 8,605,000</u>	<u>\$ 50,043,791</u>	<u>\$ 172,802,471</u>

As of June 30, 2007, debt service requirements for the above long-term debt, are as follows:

Fiscal year	Principal	Interest	Total
2008	\$ 9,038,033	\$ 10,019,638	\$ 19,057,671
2009	9,527,758	9,227,828	18,755,586
2010	9,703,003	8,897,524	18,600,527
2011	9,397,000	8,358,249	17,755,249
2012	9,130,000	7,449,176	16,579,176
2013-2017	42,088,090	29,261,816	71,349,906
2018-2022	39,469,027	17,994,514	57,463,541
2023-2027	41,773,000	6,335,488	48,108,488
2028-2032	2,676,560	503,380	3,179,940
	<u>\$ 172,802,471</u>	<u>\$ 98,047,613</u>	<u>\$ 270,850,084</u>

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Notes to Financial Statements (continued)  
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Bonds

General obligation bonds payable as of June 30, 2007 are as follows:

<u>Series</u>	<u>Interest Rate</u>	<u>Payable Through</u>	<u>Original Issue</u>	<u>Balance July 2, 2007</u>
1984	5.00	2008	\$ 663,000	\$ 46,000
1986	5.00	2010	1,118,000	244,003
1987	6.13	2011	1,870,000	542,000
1987	5.00	2011	283,000	74,000
1989	5.00	2014	85,000	37,000
1991	5.00	2015	580,000	278,000
1992	3.26-6.41	2007	4,745,000	-
1994	5.00-7.71	2013	18,890,000	8,900,000
1996	4.70-6.58	2015	15,955,000	9,345,000
1994	5.63	2018	2,200,000	1,498,000
1996	4.50	2019	776,000	544,027

<u>Series</u>	<u>Interest Rate</u>	<u>Payable Through</u>	<u>Original Issue</u>	<u>Balance July 2, 2006</u>
1999	4.86-6.34	2106	\$ 13,300,000	\$ 8,865,000
2000	2.70-7.29	2024	3,150,000	2,690,000
2000	2.70-7.29	2026	10,350,000	8,555,000
2002	2.70-5.60	2026	9,845,000	8,795,000
2002	2.70-5.60	2026	125,000	95,000
2002	5.00-5.60	2026	1,360,000	1,200,000
2003	1.65-5.00	2028	9,900,000	9,005,000
2004	2.36-6.00	2029	1,575,000	1,450,000
2005	4.37-5.00	2024	1,610,000	1,455,000
2004	2.52-5.00	2029	370,000	350,000
2004	2.52-5.00	2029	460,000	430,000
2006	5.32-6.25	2021	9,910,000	9,085,000
2000	4.75	2030	500,000	478,000
2006	4.74-5.00	2025	11,015,000	10,370,000
2006	4.74-5.00	2025	11,020,000	10,370,000
1999	4.50	2030	1,640,000	1,565,000
2007	5.54%	2026	7,575,000	7,360,000
2007	4.75%	2031	2,695,000	2,637,650
2007	6%	2031	8,060,000	7,865,000
				<u>\$ 114,178,680</u>

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Notes to Financial Statements (continued)  
June 30, 2007

Federal loans and notes

Sec. 108 loan of \$8,000,000 payable in annual installments fluctuating from \$200,000 to \$600,000 at 7.50% interest rate until 2019, secured by building and adjacent parking facility owned by the Municipality and appraised at an aggregate fair market value of approximately \$11,750,000

\$ 6,200,000

Sec. 108 loan \$2,545,000, interest from 1.21% to 4.44% payable in annual installments from \$350,000 to \$500,000 until year 2009, secured by public facilities of the Municipality.

1,415,000

Sec. 108 loan \$1,400,000, interest at 6.57% payable in annual installments from \$125,000 to \$270,000, until year 2011, secured by public facilities of the Municipality.

990,000

Total federal loans and notes

\$ 8,605,000

Loans

Operational loan of \$2,065,000 payable in annual installments from \$35,000 to \$165,000 with interest fluctuating from 3.65 to 6.67% until 2027, secured by the Municipality.

\$ 1,870,000

Operational loan of \$2,350,000 payable in annual installments from \$270,000 to \$400,000 with interest of 5.5% until 2009, secured by the Municipality.

780,000

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Operational loan of \$540,662 payable in annual installments from \$6,758 to \$27,033 at 8% interest until 2008, secured by the Municipality.	33,791
Operational loan of \$5,185,000 payable in annual installments from \$90,000 to \$400,000 with interest fluctuating from 3.65 to 6.67 until 2027, secured by the Municipality.	4,680,000
Operational loan of \$640,000 payable in annual installments from \$80,000 to \$110,000 with interest fluctuating of 5.00 until 2011, secured by the Municipality.	390,000
Operational loan of \$15,385,000 payable in annual installments from \$260,000 to \$1,185,000 with interest fluctuating from 3.65 to 6.40 until 2027, secured by the Municipality.	13,900,000
Operational loan of \$1,385,000 payable in annual installments from \$245,000 to \$305,000 with interest fluctuating from 3.59 to 4.50 until 2010, secured by the Municipality.	875,000
Operational loan of \$10,015,000 payable in annual installments from \$300,000 to \$765,000 with interest fluctuating from 5.00 to 5.581 until 2025, secured by the Municipality.	9,395,000
Operational loan of \$10,075,000 payable in annual installments from \$255,000 to \$855,000 with interest fluctuating from 5.841 to 6.071 until 2026, secured by the Municipality.	<u>9,820,000</u>
Total loans	<u>\$ 50,043,791</u>
Total long-term debt governmental activities	<u>\$172,827,471</u>

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June 30, 2007

Long-term debt for business-type activities at June 30, 2006 is summarized as follows:

Special bond obligation for \$500,000 to provide financing for the construction and rehabilitation of housing project for citizens of low and moderate income; annual interest rate at 2% with maturity on January 1, 2010, secured by the Municipality.	<u>\$204,000</u>
Special bond obligation for \$300,000 to provide for financing the reconstruction and rehabilitation of housing project for citizens of low and moderate income; annual interest rate at 2% with maturity on July 30, 2012, secured by the Municipality.	<u>159,982</u>
Total long-term debt for business-type activities	<u>\$363,982</u>

The debt service requirement for the long-term debt of Enterprise funds is scheduled as follow:

Fiscal year	Principal	Interest	Total
2008	84,547	7,316	91,863
2009	104,010	5,636	109,646
2010	130,199	2,015	132,214
2011	35,269	1,320	36,589
2012-2013	9,957	647	10,604
	\$ 363,982	\$ 16,934	\$ 380,916

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Notes to Financial Statements (continued)  
June 30, 2007

Note 8 - Retirement plans

Retirement System of the Commonwealth of Puerto Rico

The Municipality participates in the Employee's Retirement System of the Government of Puerto Rico and its instrumentalities (ERS), a multiple-employer contributory retirement plan, which covers only eligible full-time employees. The system provides retirement, death, and disability benefits and annuities to Commonwealth employees not covered by their own systems.

Commonwealth legislation required 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 participants' gross salary. Total employer contributions during the year ended June 30, 2007 amounted to approximately \$ 2,480,000.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1991, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating 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 on or after January 1, 2000 will only be allowed to become members of the System 2000. System 2000 will reduce the retirement age from 65 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 the System 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% of the employees' salary up to a maximum of 10%) will be invested in account which 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 System 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.

For the year ended June 30, 2007, total covered payroll was approximately \$27 million. Covered payroll refers to all compensation paid by the Municipality to employees covered by the ERS on which contributions to the pension are based.

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June 30, 2007

The amount of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation multiplied by the number of years of creditable service in excess of twenty years, for those employees covered after March 31, 1990, the annuity shall be equal to one and one-half percent of the average compensation multiplied by the number of years of creditable service, in no case shall the annuity be less than \$2,400.

Retirement plan of Head Start Program

Effective January 1, 2002, the Municipality created a retirement plan (the Plan) for all employees of the whose salaries were funded with the Head Start federal financial award and which have at least one year of service and are age twenty-one or older. The Plan is part of the Popular Master Defined Contribution Retirement. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The Municipality was required to contribute three percent (3%) of the employees' annual compensation. Participants may contribute based on after tax contributions amounts representing up to ten percent (10%) of the aggregate compensation paid to the employee, excluding the Christmas Bonus.

Participants are immediately vested in their contributions plus actual earnings thereon. Vesting is based on years of continuous service. The participant vesting schedule on such portion of their accounts is described below:

<u>Completed years of service</u>	<u>Vested percentage</u>
Less than 3 years	0%
At least 3 years	20%
At least 4 years	40%
At least 5 years	60%
At least 6 years	80%
At least 7 years	100%

The vesting provisions consider years of service before the employer established this Plan.

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On termination of service due to death, disability or retirement, a participant or beneficiary may elect to receive a lump-sum amount equal to the value of the participants' vested interest in his/her account, or maintain the funds in the Plan. Also, ten years annuities are allowed under the plan. The normal retirement age is the latter of the date a participant attains his 65<sup>th</sup> birthday or the fifth anniversary of the first day of the plan year in which he/she commenced participation in the Plan. Early retirement distributions are not permitted. Under the provisions of the Plan, participants are not permitted to withdraw any amount contributed by the employer from the plan, unless separated from employment.

During the year ended June 30, 2007, the Municipality contributions to this plan amounted to approximately \$963,682. At June 30, 2007, the Municipality had a restricted amount of \$1,211,707, which is also reported as part of the accrued liabilities in the Statement of Net Assets for the vested benefits to Plan's participants.

Note 9 - Commitments

Operating leases

The Municipality leases various properties and equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed if sufficient funds are available. Lease agreements covering periods in excess of one-year are cancelable at the Municipality's option upon 30 days written notice to the lessor. Rental expenditures for the year ended June 30, 2006 amounted to approximately \$1,546,000. Future operating lease commitments are scheduled as follows:

2008	\$ 2,062,027
2009	466,323
2010	140,496
2011	78,996
2012	40,007
	<u>\$ 2,787,849</u>

General construction of capital project commitments

The Municipality has commitments to invest approximately \$78,995,000 to complete construction and rehabilitation projects at several locations within the Municipality, which is allocated between Federal and Municipal funds for \$14,176,000 and \$64,819,000, respectively to satisfy these projects.

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June 30, 2007

Solid waste disposal contract

In January 1984, the Municipality contracted E.C. Waste Inc. to provide the service of for the recollection, management and disposal of solid waste. This contract was amended in March 1994, September 2001, April and December 2003 to incorporate additional services related with those previously mentioned. In the contract it was established that the Municipality is committed to pay E.C. Waste Inc. \$10.50 per unit recollected applied to a starting minimum of 40,000 units with annual increases of two and a half percent (2.5%) up to fiscal year to be ended at June 30, 2010. Expenditure for the year ended June 30, 2007 for this service amounts to \$5,846,400. The scheduled payments for this commitment are disclosed as follows:

2008	\$	5,688,000
2009		5,990,400
2010		3,069,600
		<u>\$ 14,748,000</u>

In addition, the Municipality is committed to pay an additional \$34 per tons that the Municipality transports and deposits in the E.C. Waste, Inc.'s center of recollection of such solid wastes for their processing. The price of the rate is also subject to an annual increase of two and a half (2 ½ %). During the fiscal year ended June 30, 2007 the cost for the Municipality for this additional service amounted to approximately \$343,000.

Contributions to the operations of the Fine Arts Center

On August 9, 2002, the Autonomous Municipalities' Law was amended to allow the creation of non-profit private entities by municipal governments, universities, and the private sectors to carry out public purposes.

Under this authorization it was created "Corporación de Bellas Artes de Caguas" (COBAC) to carry out the activities that, until June 30, 2004, were being executed as an enterprise fund of the Municipality. On October 8, 2004, representatives of the Municipality and COBAC signed a 15-year lease contract, transferring to COBAC the operations of the Fine Arts Center (FAC) effective on July 1, 2004. As established in such lease contract, the Municipality will bill COBAC an annual rental fee of \$1,000.

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June 30, 2007

The Municipality is scheduled to make a 5-year annual contribution as part of the commitments that each representation of the Board (government, universities and the private sector) has to do, as established by Law. The contribution made by the Municipality to COBAC for the year ended June 30, 2007 was \$524,425. The remaining contributions are as follows:

2008	\$ 349,617
2009	<u>174,800</u>
	<u>\$ 524,417</u>

On the other hand, the Municipality's representation in the COBAC's Board of Directors is four of a total of seventeen members, which constitutes twenty two percent of the voting power in the Board.

Due to the Administration of the Retirement Systems

As a result of an audit performed in the Administration of the Retirement System of the Commonwealth of Puerto Rico (the System), it was determined that the System had not billed to the Municipality the costs of benefits due to inflation and salary increases during the fiscal periods covering from 2002-2003 to 2006-2007. Amount due to the System for this concept amounted to \$795,813.

Through the Ordinance 07B-22, the Municipality ratified a payment plan agreement with the System for the amount above mentioned and it is schedule to mature on May 2010, as follows:

2008	\$ 418,604
2009	188,604
2010	<u>188,604</u>
	<u>\$ 795,812</u>

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Notes to Financial Statements (continued)  
June 30, 2007

Maintenance and repair of municipal vehicles

At June 30, 2007, the Municipality maintained a contract with a private company for the maintenance and repairs of its official vehicles. This contract is extensive up to June 30, 2008. During the year ended June 30, 2007, the Municipality disbursed approximately \$1,815,000 in this service. In addition, the amount contracted up to June 30, 2008 amounts to approximately \$1,239,000. This contract is renewable three months after June 30, 2008, for an amount pending to be determined, based on the availability of funds.

Note 10 - Contingencies

Litigation

The Municipality is a defendant in 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 \$7,824,107 in the government-wide statements for anticipated unfavorable judgments or future disbursements.

The amount presented in the total liabilities of the governmental activities in the statement of net assets represents the amount estimated as probable liability, which will require future available financial resources for its payment. The Municipality's administration and legal counsel believes that the ultimate liability in excess of amounts provided would not be significant. In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in the discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available cannot determine the final outcome of these claims. As a result, the accompanying general-purpose financial statements do not include adjustments, if any, that could result from the resolution of these legal proceedings.

Federal financial assistance

The Municipality receives financial assistance from the federal government in the form of grants or entitlements. The Municipality recognizes federal grant revenues when the related grant agreements are approved and notified by the federal agencies by written communication. All grants are subject to financial and compliance audits by the grantor agencies, which could result in requests for reimbursement by the grantor agencies for expenditures, if disallowed under the terms of the grants. These amounts, if any, of expenditures, which may be disallowed by the granting agencies, cannot be determined at this time. The Municipality's administration believes that such disallowances, if any, will not have a material adverse effect on the financial position of the Municipality.

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Notes to Financial Statements (continued)  
June 30, 2007

Note 11 - Healthcare costs

During the year ended June 30, 2000 the Governor of the Commonwealth of Puerto Rico required to the municipalities of Puerto Rico an annual contribution to subsidy the cost of the implementation and administration of the Healthcare Reform. Such contributions are required to be disbursed from general fund operating budget. Total contributions made by the Municipality amounted to approximately \$7,794,000 for the fiscal year ended June 30, 2007.

Note 12 - Accrued liabilities

At June 30, the Municipality had the following accrued liabilities:

	<u>Balance at June 30, 2006</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at June 30, 2007</u>	<u>Due within one year</u>
Accrued compensated absences	\$ 8,672,108	\$ 3,916,545	\$ (2,791,367)	\$ 9,797,286	\$ 122,292
Accrued legal claims	4,081,762	3,810,145	(67,800)	7,824,107	90,468
	<u>\$ 12,753,870</u>	<u>\$ 7,726,690</u>	<u>\$ (2,859,167)</u>	<u>\$ 17,621,393</u>	<u>\$ 212,760</u>

Note 13 -Prior period adjustments

Governmental fund statements:

The Municipality restated the beginning fund balances at July 1, 2006 in the following governmental funds:

	General	Housing	Public Residential	Capital Project	Debt service	Other governmental	Total
Overstatement in volume of business tax receivable	\$ (1,316,321)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (1,316,321)
Understatement in deferred volume of business taxes	(139,732)	-	-	-	-	-	(139,732)
Understatement in amount due from proprietary fund	170,567	-	-	-	-	-	170,567
(Over) understatement in cash held for capital project	(16,475,875)	-	-	29,302,887	-	-	12,827,012
Understatement in due from federal agencies	-	638,301	344,255	-	-	-	982,556
Understatement in debt service liability	-	-	-	-	(8,666,090)	-	(8,666,090)
Understatement in intergovernmental receivables	-	-	-	-	-	645,625	645,625
	<u>\$ (17,761,361)</u>	<u>\$ 638,301</u>	<u>\$ 344,255</u>	<u>\$ 29,302,887</u>	<u>\$ (8,666,090)</u>	<u>\$ 645,625</u>	<u>\$ 4,503,617</u>

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Notes to Financial Statements (continued)  
June 30, 2007

Government wide statements (governmental activities):

The Municipality restated the beginning net assets of governmental activities at July 1, 2006 due to the following:

Net overstatement in activities related with general fund	\$ (17,761,361)
Net understatement in activites related with housing	96,127
Net understatement in activities related with public residential	344,255
Net understatement of activities related to capital project	29,302,887
Understatement in activities related with other governmental funds	645,625
Understatement in activities related with debt service	(8,666,090)
Retroactive inclusion of major capital assets	<u>120,794,707</u>
	<u>\$ 124,756,150</u>

Proprietary fund statements and business type activities:

The Municipality restated the beginning fund balances at July 1, 2006 in the following proprietary funds and business type activities:

	Community Development		Total
	Bank	Multitenants	
Understatement in amount due to general fund	\$ (170,567)	-	\$ (170,567)
Overstatement in capital assets	-	(1,458,012)	(1,458,012)
	<u>\$ (170,567)</u>	<u>\$ (1,458,012)</u>	<u>\$ (1,628,579)</u>