

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

**MUNICIPIO DE CAROLINA**  
**AUDITORIA 2005-2006**  
**30 DE JUNIO DE 2006**

OFICINA DEL COMISIONADO  
DE ASUNTOS MUNICIPALES

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

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

**FISCAL YEAR ENDED  
JUNE 30, 2006**

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**PKF, LLP**Accountants &  
business advisers**INDEPENDENT AUDITOR'S REPORT**

Hon. José E. Aponte de la Torre and  
Members of the Municipal Legislature of the  
Commonwealth of Puerto Rico  
Municipality of Carolina  
Carolina, Puerto Rico

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in the Government Auditing Standards, issued by the Comptroller General of the United States of America, and OMB Circular A-133, Audits of States, Local Governments and Nonprofit Organization. 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregated remaining governmental fund information of the Commonwealth of Puerto Rico, Municipality of Carolina, as of June 30, 2006, and the respective changes in financial position thereof and for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

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Accountants &  
business advisers

Hon. José E. Aponte de la Torre and  
Members of the Municipal Legislature of the  
Commonwealth of Puerto Rico  
Municipality of Carolina

In accordance with Government Auditing Standards, we have also issued our report dated December 29, 2006 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants 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 the budgetary comparison information for the general fund are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily 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.



December 29, 2006  
San Juan, Puerto Rico

PKF, LLP

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Expire on December 1, 2007

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a Management Discussion and Analysis of The Municipality of Carolina (herein after "the Municipality") financial performance, providing an overview and comparison of the financial activities for the fiscal years ended on June 30, 2006 and 2005. This narrative overview and analysis is a new format prescribed by the provisions of Government Accounting Standards Board Statement 34 (GASB 34). We encourage readers to consider the information presented here in conjunction with the Municipality's basic financial statements, which follow this narrative.

Because fiscal year ended June 30, 2006 represents the fifth year in which the Municipality implemented the provisions of the GASB Statement No. 34, this discussion and analysis provides comparisons with the previous fiscal year. However, in future years, comparisons will be more significant and will go further in explaining the Municipality's financial position.

### FINANCIAL HIGHLIGHTS

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

- The Municipality's assets exceeded its liabilities (net assets) by \$1,670 millions as of June 30, 2006. That represents an increase of \$31.8 millions (2%) as compared with last fiscal year. Of this amount \$35.2 millions are unrestricted. Net assets may be used to meet the Municipality's current operations.
- The results of activities (excess of revenues over expenses) increased by \$31.8 millions during fiscal year ended June 30, 2006. This amount represents an increase of \$16.2 millions as compared with previous fiscal year.
- The Municipality's assets increased from \$1,948 millions at June 30, 2005 to \$1,979.3 millions at June 30, 2006, for an increase of \$31.3 millions. The liabilities of the Municipality decreased from \$310.1 millions as of June 30 2005 to \$309.6 millions as of June 30, 2006.
- During fiscal year ended June 30 2006, the Municipality was able to record all majors infrastructure assets in compliance with the GASB Statement provisions. The infrastructure assets acquired prior to GASB Statement 34 was deferred to fiscal year 2005-06. Historically, the Municipality's larger portion of infrastructure assets have not been reported nor depreciated in the Government Wide Financial Statements.
- The total revenues of the Municipality decreased from \$171.9 millions for the fiscal year ended June 30, 2005 to \$163.6 millions for the fiscal year ended June 30, 2006. The costs of all Municipality's functions decreased by \$22.5 millions as compared with previous fiscal year.

**Governmental Funds Highlights:**

- The Municipality's total fund balance of governmental funds was \$187.9 millions, an increase of \$7.3 millions (4%) as compared with last fiscal year. Of this amount \$16.1 millions are available for spending in financial activities and providing services to citizens (unreserved fund balances).
- The Municipality's General Fund (the primary operating fund) reflected a fund balance of \$49.5 millions, a decrease of \$15.7 millions as compared with previous fiscal year.
- The total assets of governmental funds increased from \$272.9 millions to \$280.9 millions, as of June 30, 2005 and 2006, respectively. The governmental fund's total liabilities increased from \$92.3 millions to \$93.1 millions, as of June 30, 2005 and 2006, respectively.
- The total revenues of governmental funds increased from \$161.8 millions for the fiscal year ended June 30, 2005 to \$164 millions for the fiscal year ended June 30, 2006, an increase of \$2.2 millions. The governmental fund's expenditures increased from \$177.7 millions for the fiscal year ended June 30, 2005 to \$194.1 millions for the fiscal year ended June 30, 2006, an increase of \$16.4 millions.
- Other financing sources (uses), net, of governmental funds increased by \$37.4 millions, primarily due to proceeds from new debt issuance for economic development and infrastructure projects.
- The total cash recorded was \$229.9 millions, an increase of \$3.6 millions as compared with last fiscal year.
- Loans principal and interest payments were \$23.9 and \$22.5 millions, for fiscal year ended June 30, 2006 and 2005, respectively.

**New Requirements for the Financial Reporting**

The new approach on the preparation of the Municipality's basic financial statements emphasizes on a government wide focus (consolidated) view of its financial operations. Nevertheless major individual funds are presented and evaluated in all of its details. Simultaneous implementation of both of these perspectives allows users to address relevant questions about municipality's performance, enhance Municipality's accountability and provides a basis for comparisons and evaluation of services quality.

New reporting standards required comparisons with prior years data. This narrative report provides a better understanding of the municipality's financial positions and results of its operations.

### Basic Financial Statements Components

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the Municipality's basic financial statements.

This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2006. Because this MD&A is designated to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

The Municipality's basic financial statements include three components: 1) Government-Wide Financial Statements (GWFS), 2) Governmental Fund Financial Statements (GFFS), and 3) Notes to the Basic Financial Statements (NBFS) that provides more details. This report also contain budgetary comparison schedule that include a reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the general fund as presented in the Municipality's basic financial statements. These components are described below:

#### a) Government-Wide Financial Statements

The GWFS present the financial position of the Municipality from the economic resources measurement focus using the accrual basis of accounting. In addition, the GWFS include all assets of the Municipality (including infrastructure) as well as all liabilities (including long-term debt). Certain eliminations have been made in regards to interfund activity, payables and receivables. These financial statements provide short-term and long-term information about the Municipality's financial position, which assist the municipality's management to determine the economic condition at June 30, 2006.

The GWFS were prepared using methods that are similar to those used by most private business. The GWFS are composed of: 1) statement of net assets (SNA) and 2) statement of activities (SA).

The SNA and SA are two financial statements that report information about the Municipality and its activities that should help answer this question: Is the Municipality better off or worse off as result of this year activities?

## **1. Statement of Net Assets**

The SNA reports information of the municipality as a whole. Those statements include all assets and liabilities owed by the Municipality using the accrual basis of accounting, which is similar to the accounting used by most private sector companies. Accrual of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred.

The SNA (pages 25 and 26) present all of the Municipality's assets and liabilities with the difference between the two reported as "net assets". Over time, increase and decrease in net assets is an indicator of whether the Municipality's financial position is improving or deteriorating. Other factors to consider are changes in the Municipality's property tax base and the condition of the Municipality's roads.

## **2. Statement of Activities**

These financial statements presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2006, by presenting all of the Municipality's revenues and expenses. The SA is focused on both the gross and net cost of various activities, which are supported by the Municipality's property tax, municipal license tax and other revenues. It is intended to summarize and simplify the user's analysis of the costs of governmental services. The governmental activities reflect basic services, including public safety, public works and transportation, solid waste disposal and sanitation, recreation and sports, education, public housing and building, health and general government services. Property tax, municipal license tax, construction and permits tax, state and federal grants, and interest income finance most of these activities. This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

The Statement of Activities (page 28) presents information showing how the Municipality's net assets changed during the most recent fiscal year. All the changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only results in cash flows in future fiscal periods.

The SNA and SA report the Municipality's net assets and changes in them. Net assets are the difference between assets and liabilities, which is one way to measure the Municipality's financial health, or financial position.

### **b) Governmental Fund Financial Statements**

These financial statements report the financial position and results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major individual funds. The GFFS are composed of: 1) balance sheet-governmental funds and 2) statement of revenues, expenditures and changes in fund balances-governmental funds. Some funds are required to be established by State law and by bond covenants. However, management establishes many other funds to help control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain taxes, grants, and other monies.

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 major governmental funds presentation provides detailed information about the most significant funds, not the Municipality as a whole.

The Municipality uses fund accounting to ensure and demonstrate compliance with financial related legal requirements. The Municipality's basic services are reported in governmental funds, which focus on how money flows in and out of these funds and the balances at the end of the year that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental funds statement provides a detailed short-term view of the Municipality's general governmental operations and the basic services it provides.

GFFS are prepared on an accounting basis that is significantly different from that used to prepare GFWS. In general, GFFS focus on near-term inflows and outflows of expendable financial resources, consequently, generally measure and account for cash and other assets that can easily be converted to cash. Governmental fund liabilities generally include amounts that normally are going to be paid within a very short period after the end of the fiscal year. Governmental funds information help you determine whether there are more or fewer financial resources that can be spend in the near future to finance Municipality's programs.

The Municipality has five major governmental funds. Each major fund is presented in a separate column in the governmental funds balance sheet and the governmental funds statements of revenues, expenditures and changes in fund balances. The five major governmental funds are: general fund, debt service fund, capital project fund, economic development fund and workforce investment act fund.

The differences of results between governmental activities and governmental funds are explained in a reconciliation schedule following each governmental fund financial statement.

### **c) Notes to Basic Financial Statements**

The NBFS provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Since the budgetary basis differs from actual amounts for the general fund in the accompanying Statement of Revenues and Expenditures – Budget and Actual is presented on the budgetary basis to enhance comparability. Comparison schedule for general fund include changes and variations between the original and final budget, and explanation of any reasons for significant changes in actual results affects the general fund of the Municipality.

The Municipality's Fund Financial Statements start on page 29 and included all Governmental funds for fiscal years ended June 30, 2006 and 2005.

### **Infrastructure Assets**

As mentioned earlier, the Municipality was able to record all major infrastructure assets in compliance with the GASB Statement provisions. The infrastructure assets acquired prior to GASB Statement 34 was deferred to fiscal year 2005-06. Historically, the Municipality's larger portion of infrastructure assets have not been reported nor depreciated in the Government Wide Financial Statements.

The new statement requires that this asset be valued and reported within the Government Wide Financial Statements. Additionally, the government must elect to either depreciate these assets over their estimated useful life or develop a system of asset management designated to maintain the service delivered potentially to near perpetuity.

The Municipality elected to use the historical cost method to value all capital assets, including infrastructure assets. On this approach, capital assets purchased are carried at historical costs. Donated assets are recorded at fair value as of the date of donation. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenances are expensed as incurred. Depreciation on capital assets is calculated using the straight-line method over the estimated useful life.

Additional information on the Municipality's capital assets can be found in Note 9 of the Basic Financial Statements.

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**Financial Analysis of Government-Wide Financial Statements**

The Municipality's overall financial position and operations for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS. The following reflects the comparative condensed Statement of Net Assets.

Condensed Statement of Net Assets  
June 30, 2006 and 2005

<b>Assets:</b>		
Current assets	\$ 266,607,340	\$ 261,377,786
Noncurrent assets:		
Capital assets, net		
Other noncurrent assets	<u>6,803,773</u>	<u>6,786,658</u>
<b>Total assets</b>	<b>1,979,297,257</b>	<b>1,947,969,685</b>
<b>Liabilities:</b>		
Current liabilities	65,568,175	89,934,053
Long-term obligations due within one year	15,057,820	13,349,355
Long-term obligations due after one year	<u>229,009,764</u>	<u>206,831,298</u>
<b>Total liabilities</b>	<b><u>309,635,759</u></b>	<b><u>310,114,706</u></b>
<b>Net assets:</b>		
Invested in capital assets, net related debt	1,513,447,879	1,495,798,242
Restricted	121,021,627	97,401,308
Unrestricted	<u>35,191,992</u>	<u>44,655,429</u>
<b>Total net assets</b>	<b><u>\$ 1,669,661,498</u></b>	<b><u>\$ 1,637,854,979</u></b>

The Municipality's current assets are mainly composed of unrestricted cash, certificates of deposit and restricted cash (\$229.9 millions), federal grants receivables (\$18.7 millions) governmental agencies (\$9.2 millions) and property rent receivables (\$3.6 millions).

The restricted cash represents legally designated for: payments of debt service, acquisition, construction and improvement of major capital assets.

Noncurrent assets amounting to \$1,712.7 millions as of June 30, 2006, are mainly composed of capital assets, with a cost basis of \$1,773.7 millions, which are reported net of accumulated depreciation and amortization of \$68.7 millions.

At the end of the current fiscal year, the Municipality's current liabilities amounting to \$76.7 millions are substantially composed of deferred volume of business taxes (\$26.5 millions), deferred federal revenues (\$12 millions), accounts payable and accrued liabilities (\$12.7) and the portions due within one year of bonds payable (\$14.5 millions). As noted in the condensed statements of net assets, the Municipality's current assets exceeded current liabilities by \$186.1 millions, for a current ratio of 3.0 to 3.5.

The Municipality's noncurrent liabilities, amounting to \$232 millions as of June 30, 2006, are mainly composed of portions due after one year of bonds and notes payable (\$205 millions), compensated absences (\$11.9 millions), governmental agencies payables (\$4.2 millions), legal claims (\$4.1 millions) and estimated liability for the municipal solid waste landfill closure and post closure care costs (\$3.8).

The net assets increased by \$31.8 millions as compared with last fiscal year. Net assets may serve over time as one useful indicator of a government's financial condition. The Municipality's invested in capital assets, amounting to \$1,513.4 millions, reflects its investment in capital assets such land, buildings, equipment and infrastructure (roads, improvements and other immovable assets), less any related debt used to acquire those assets that still outstanding. The assets used to provide services to residents; Consequentially, these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The largest portion of the Municipality's restricted net assets, \$121 millions, represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$35.2 millions, may be used to meet the Municipality's ongoing obligations to residents and creditors. Internally imposed designations of resources are not presented as restricted net assets.

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

**Statement of Activities  
Governmental Activities  
For the Years Ended June 30, 2006 and 2005**

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
<b><i>Program Revenues:</i></b>		
General Revenues	\$ 142,472,805	\$ 132,595,531
Program Revenues	<u>23,111,854</u>	<u>39,361,449</u>
Total Revenues	<u>165,584,659</u>	<u>171,956,980</u>
<b><i>Expenses:</i></b>		
Governmental activities functions	<u>133,778,140</u>	<u>156,319,981</u>
Total Expenses	<u>133,778,140</u>	<u>156,319,981</u>
Change in Net Assets	<u>\$ 31,806,519</u>	<u>\$ 15,636,999</u>

The Municipality's changes in net assets increased by \$31.8 millions or 51%, as compared with last fiscal year. The Municipality's general revenues increased by \$9.9 millions or 7%. The principal increase was in the interest income revenues by \$6.4 millions. Additional changes include:

- Total program revenues and governmental activities functions expenses decreased by \$16.3 (41%) and \$22.5 (14%) millions, respectively, as compared with prior fiscal year.
- The depreciation expense increased from \$3.9 millions for fiscal year ended June 30, 2005 to \$11.9 millions for fiscal year ended June 30, 2006. This increase of \$11 millions was related with the infrastructure assets portion recorded from prior's fiscal years.

Financial Analysis of Governmental Funds Financial Statements

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of expendable resources. Such information is useful in assessing the Municipality's compliance with finance-related legal requirements. Specifically, unreserved fund balance may serve as a useful measure of the Municipality's net resources available for spending at the end of the fiscal year.

At the end of the current fiscal year, Municipality's governmental funds reported a total fund balance of \$187.9 millions that is over last year for \$7.3 millions or 4%. The primary reason for the government fund's increase in the current year were proceeds from new debts issuance amounting to \$37.4 millions recorded as other financial sources in the capital projects fund. The following reflects the condensed comparative Combined Balance Sheet and Statements of Revenues, Expenditures and Changes in Fund Balances:

**Governmental Fund**

*Condensed Balance Sheet*

**June 30, 2006 and 2005**

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
<b>Assets:</b>		
Total assets – major governmental funds	\$ 253,381,209	\$ 252,696,683
Total assets – other governmental funds	<u>27,538,838</u>	<u>20,243,589</u>
<b>Total assets</b>	<u>280,920,047</u>	<u>272,940,272</u>
<b>Liabilities:</b>		
Total liabilities—major governmental funds	73,261,450	80,235,086
Total liabilities—other governmental funds	<u>19,801,880</u>	<u>12,084,500</u>
<b>Total liabilities</b>	<u>93,063,330</u>	<u>92,319,586</u>
<b>Fund balances:</b>		
Reserved – major governmental funds	171,757,197	168,100,831
Unreserved – major governmental funds	8,362,562	7,916,883
Unreserved – other governmental funds	<u>7,736,948</u>	<u>4,602,972</u>
<b>Total fund balances</b>	<u>\$ 187,856,707</u>	<u>\$ 180,620,686</u>

### *Major Governmental Funds*

The following is a summarized financial analysis of the Municipality's governmental funds:

General Fund (GF) - The GF's assets consist mainly of unrestricted and restricted cash and certificate of deposits (\$69.6 millions), short-term amounts due from other funds (\$12.9 millions) and Volume of business taxes receivables (\$3.1 millions). GF's liabilities are composed mainly of deferred volume of business taxes (\$26.5 millions), accounts payable and accrued liabilities (\$7.7 millions) and due to governments agencies (2.1 millions).

Debt Service Fund (DSF) - The DSF's assets consist mainly of restricted cash with fiscal agent (\$39.4 millions) and restricted property tax receivable (\$3.6 millions). DSF's liabilities are mainly composed of matured bonds and notes payable (\$10 millions), matured interest due and payable (\$4.9 millions) and deferred revenues (\$2.8 millions).

Capital Project Fund (CPF) - The CPF's assets are mainly composed of unrestricted and restricted cash (\$103.1 millions). CPF's liabilities are mainly composed of short-term loans to other funds (\$5.9 millions) and accounts payable (\$2.7 millions).

Economic Development Fund (EDF) - The EDF's assets are mainly composed of unrestricted and restricted cash (\$11.2 millions) and federal grants receivables (\$6.5 millions). EDF's liabilities are mainly composed of deferred federal revenues (\$6.5 millions).

Workforce Investment Act Fund (WIAF) - The WIAF's assets and liabilities consist mainly of federal grants receivables and accounts payables and accrued liabilities (\$ 613,000), respectively.

Other Governmental Fund (OGF) - The OGF's total assets are mainly composed of unrestricted and restricted cash (\$6.2 millions), federal grants receivable (\$11.6 millions) and due from government agencies (\$8.7 millions). The OGF's liabilities are principal composed of short and long term loans to other funds (\$6.1 millions), other deferred revenues (\$6.2 millions) and deferred federal revenues (\$5.5 millions).

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*Condensed Statement of Revenues, Expenditures and Change*

*in Fund Balances - Governmental Funds*

**For the Years Ended June 30, 2006 and 2005**

	2006	2005
<b>Revenues:</b>		
Total revenues-major governmental funds	\$147,268,028	\$ 145,061,266
Total revenues- other governmental funds	<u>16,692,756</u>	<u>16,712,920</u>
<b>Total revenues</b>	<u>163,960,784</u>	<u>161,774,186</u>
<b>Expenditures:</b>		
Total expenditures-major gov. funds	175,521,965	160,151,046
Total expenditures- other gov. funds	<u>18,602,788</u>	<u>17,532,453</u>
<b>Total expenditures</b>	<u>194,124,753</u>	<u>177,683,499</u>
Excess (deficiency) of revenues over Expenditures	(30,163,969)	(15,909,313)
<b>Other financial sources, net:</b>		
Other financing sources, net - major	37,400,000	-
Operating transfer in, net - major	21,317,138	11,658,584
Operating transfer in, net - other	987,120	1,003,440
Operating transfer out, net - major	(22,304,258)	(12,662,024)
Operating transfer out, net - other	<u>-</u>	<u>-</u>
Total other financing sources, net	<u>37,400,000</u>	<u>-</u>
Excess of revenues and other financing sources (uses) over expenditures	<u>\$ 7,236,031</u>	<u>\$ (15,909,313)</u>

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### *Major Governmental Funds*

The following is an analysis of operating results of the Municipality's governmental funds:

General Fund (GF) - The GF's revenues consist mainly of property tax (\$50.5 millions), municipal volume business tax (\$31.9 millions), construction tax and permits (\$13.3 millions), intergovernmental grants (\$9.1 millions) and interest income (\$8.7 millions). The GF's most significant variation as compared with prior year revenues was on interest income with an increased of \$5.6 millions. The GF's expenditures amounting to \$114.9 millions for the fiscal year ended June 30, 2006. The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the General Government expenditures, which increased by \$14.1 millions, due to the fact that municipal special funds spending resources in designated projects as reserved by Municipality's management.

Debt Service Fund (DSF) - The DSF's revenues consist mainly of restricted property taxes (\$21.8 millions) and operating transfer in for debt payment (\$5.6 millions). The DSF's expenditures consist mainly of matured principal and interest payments on loans (\$24.1 millions).

Capital Project Fund (CPF) - The CPF's revenues are mainly composed of program revenues fees and federal grants for Municipal Aqueduct (\$726,000) and proceeds from debt issuance (\$37.4 millions). The CPF's expenditures increased from \$23.6 millions for the fiscal year ended June 30, 2005 to \$29 millions for the fiscal year ended June 30, 2006. Those expenditures were related to capital outlays which capitalized on government wide financial statements.

Economic Development Fund (EDF) - The EDF's revenues and expenditures are mainly composed of federal grants (\$4.1 millions) and economic development projects (\$4.3 millions).

Workforce Investment Act Fund (WIAF) - The WIAF's revenues and expenditures consist mainly of federal grants and direct benefits to citizens (\$3.4 millions).

Other Governmental Fund (OGF) - The OGF's total revenues are mainly composed of federal grants (\$14.8 millions). The OGF's total expenditures (\$18.6 millions) are mainly composed of education and housing projects.

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## Capital Assets

The Municipality's capital assets for its governmental activities as of June 30, 2006 amounted to \$1,705,886,144 (net of accumulated depreciation). These assets include buildings, roads and bridges, infrastructure assets, land, machinery and equipments, park facilities, motor vehicles, construction in progress, landfill facilities, recycle plant and other capital assets. Major capital assets additions during fiscal year include:

- ❖ Purchase new vehicles for public works and municipal public transportation
- ❖ Additions of buildings and improvements, construction and infrastructure assets in progress
- ❖ Purchase of equipment, furniture and fixtures

Major additions to construction and infrastructure in progress (disbursements of more than \$800,000) as of June 30, 2006 are as follows:

<u>Project</u>	<u>Amount</u>
Campo de Golf	\$ 8,170,525
Complejo de seguridad y Torre Municipal Isla Verde	4,125,784
Acera y encintado centro urbano	3,154,317
Ave. Pedro Arzuaga	2,535,178
Ave. Roberto Clemente	2,366,854
Parques y facilidades recreativas	1,176,339
Proyectos de viviendas San Ciprian y Paseo San Fernando	888,113
Centro de Servicios Municipales Barrazas	830,464
Almacén de Materiales y Suministros	809,448
	<u>\$ 24,057,022</u>

Additional information on the Municipality's capital assets can be found in Note 9 of the Basic Financial Statements.

## Debt Administration

As of June 30, 2006, the Municipality had a total long-term debt outstanding of \$205,029,870 all of which is debt backed by the full faith and credit of the Municipality. The following is a summary of the long term debt balances:

General obligations bonds	\$ 195,019,870	\$ 172,562,121
Federal loans and notes	<u>\$ 10,010,000</u>	<u>\$ 10,725,000</u>
Totals	<u>\$ 205,029,870</u>	<u>\$ 183,287,121</u>

The Municipality's total debt increased by \$37.4 millions during fiscal year 2005-06, due to the fact of proceeds from debt issuance for infrastructure developments and projects.

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 \$220,201,945.

Additional information on the Municipality's long-term debts can be found in Note 7 of the Basic Financial Statements.

### Budgetary Highlights for the Fiscal Year ended June 30, 2006:

- The original budget of the general fund (operating fund) for the fiscal year ended June 30, 2006 amounted to \$90 millions. Over the course of the fiscal year, the Municipality revised the general fund budget in order to include increase in revenues that were identified during course of the fiscal year based on current developments that positively affected the Municipality's finances. Generally, the Municipal Legislature authorized budget amendments for the following activities: 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 Grants and State Grants; and 3) increases in appropriations that became necessary to maintain services.
- During the current fiscal year, the original budget was revised to recognize an increase of \$32,998,169 in total budgeted revenues, to reach the total revised budget amount of \$123,024,009. Of this amount \$15,925,505 was from unreserved resources (readjustments) from prior years. Increases in budgeted expenditures were also made since the laws and regulations of the Commonwealth mandate a balanced budget.

- Due to the continues increase of financial resources, the Municipality's Legislature revised the Municipality's budget several times increasing the total original budget. The total revised budget for fiscal year ended June 30, 2006 and 2005 amounted to \$291.5 and \$282 millions, respectively.
- During fiscal year 2005-06, expenditures from general fund showed a favorable variance of \$8.3 millions, as compared with budgeted amount. The favorable variance in expenditures was principally due to cost reduction initiative implemented by the Municipality, which emphasized in reducing general and administrative costs while increasing direct services to citizens. On the other hand, the total variance in revenues was mainly on readjustments of prior year revenues (\$15.9 millions) less than current year revenues collected over budgeted amounts.

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### **Economic Factors and Next Year Budget**

The Municipality is a political legal entity with full legislative and administrative powers in every area of municipal government, with perpetual existence and legal personality, separate and independent from the central governmental of Puerto Rico. The Municipal Government comprises the executive and legislative branches. The Mayor exercises the executive power and the legislative power by the Municipal Legislature, which has 16 members.

The Municipality provides a full range of services including public works, education, Public safety, public housing, health, community development, culture, recreation and other administrative services.

The Municipality's principal sources of revenue are property taxes, municipal license taxes, contributions by the state government and federal grants. The municipality has a wide industrial base which includes the International Airport, hotels, large pharmaceuticals, wholesalers, retail stores, financial institutions, restaurants, among others. This industrial base has increased substantially during the most recent years.

During fiscal year 2006-07 the Municipal Legislature approved a municipal sales tax of 1.5% over retail and services sales inside municipal jurisdiction. The additional resource of income collected will be used to provide more direct services to citizen.

The Municipality has an unemployment rate of 9%, which is lower than the state average of 12.8% as of June 30, 2006.

The Municipality's Budget for fiscal year 2006-2007 was \$262 millions that are \$3.5 millions over previous fiscal year (2005-2006).

**Contacting the Municipality's Financial Management**

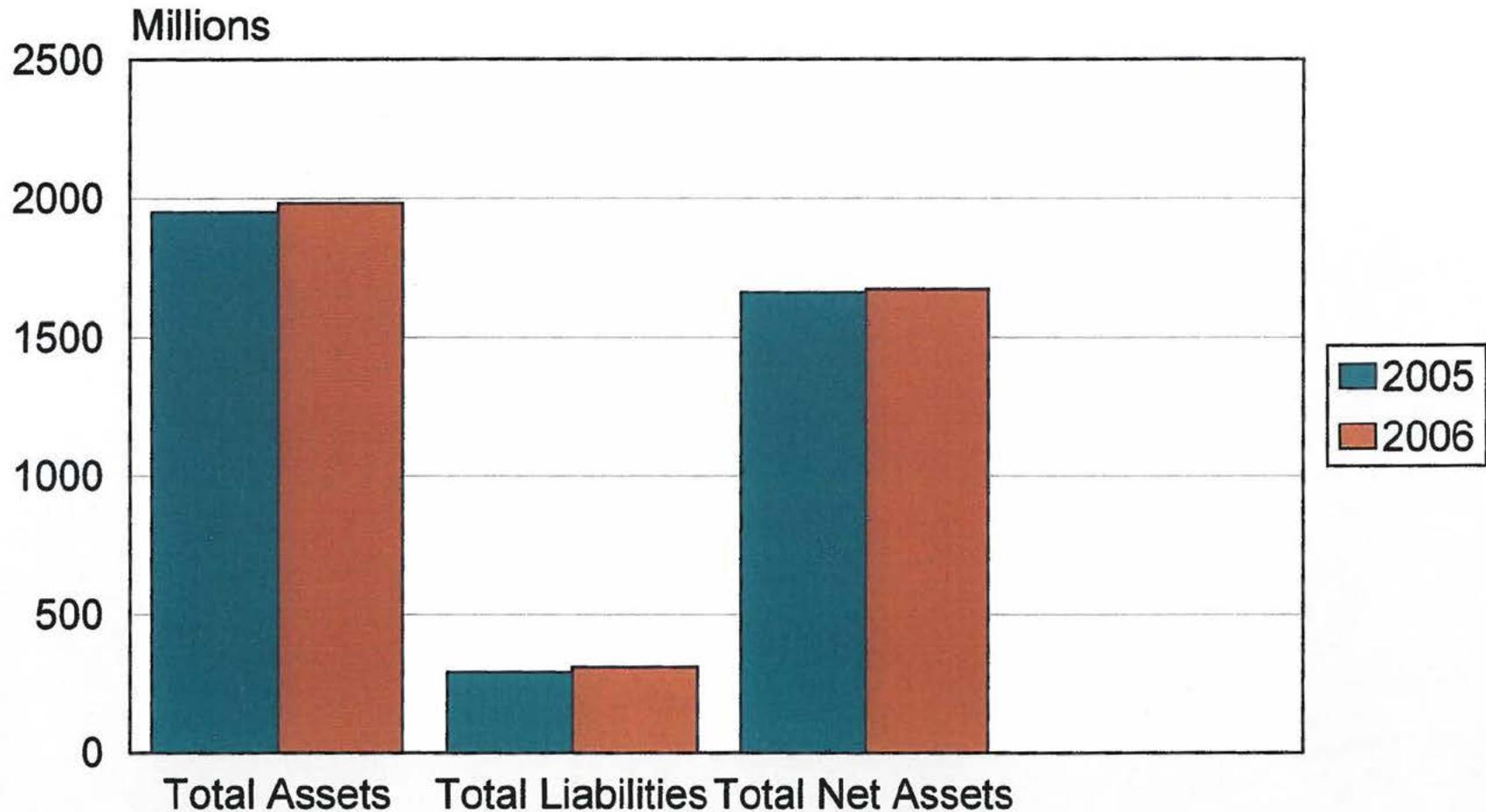
The Municipality's financial statements are designed to provide a general overview of the Municipality's finances for all Carolina residents, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives.

Questions concerning any of the information provided in this report or request for additional information should be addressed to: Municipality of Carolina, Department of Finance, Office of Director, P.O. Box 8, Carolina, Puerto Rico, 00986-0008.



# Municipality of Carolina

## Comparative Condensed Statement of Net Assets June 30, 2005 and 2006



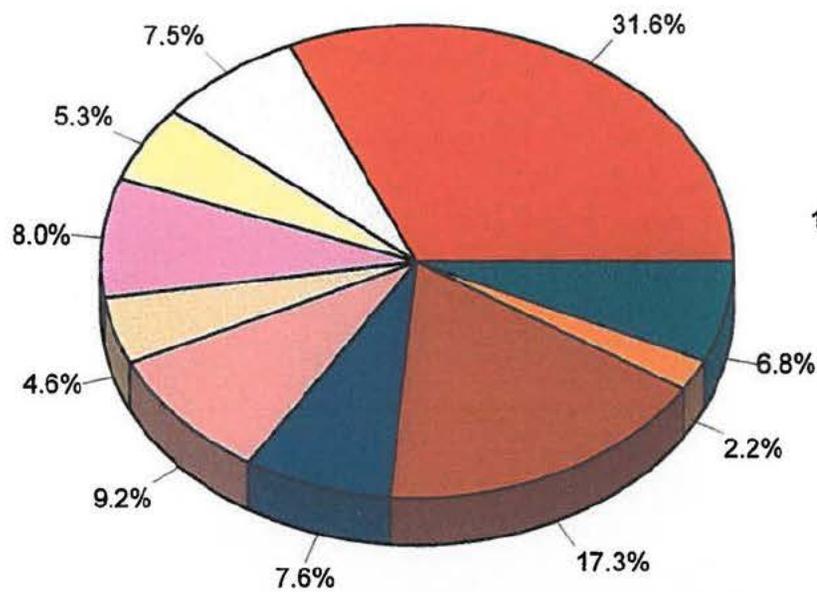


# Municipality of Carolina

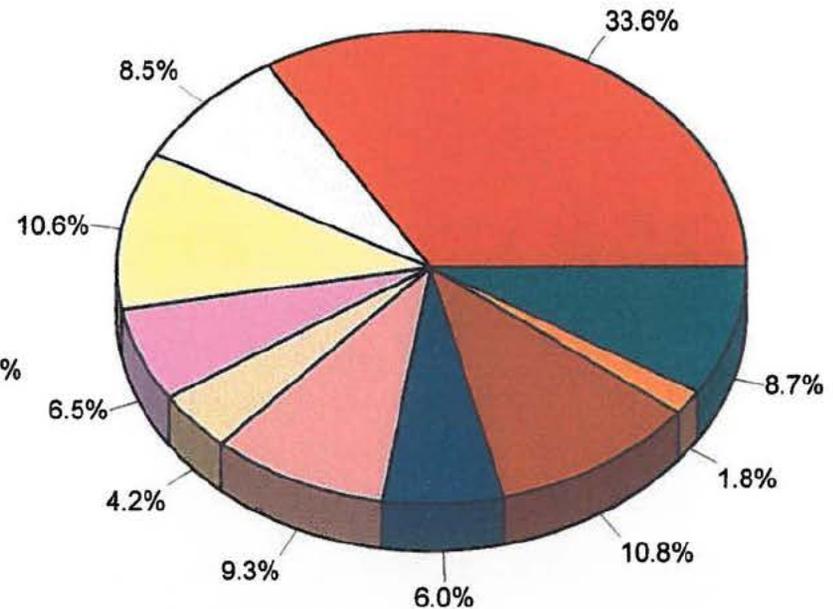
## Statement of Activities

### Expenses by Functions / Programs

For the Year Ended June 30, 2005 and 2006



2005



2006





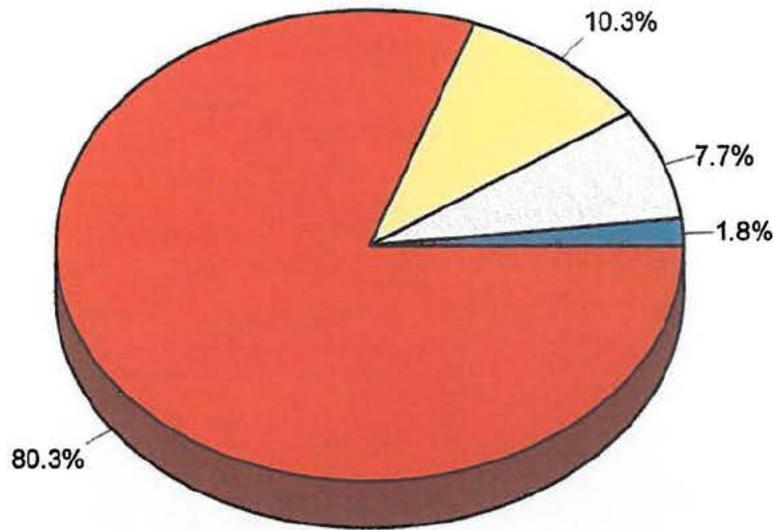
# Municipality of Carolina

## Statement of Activities

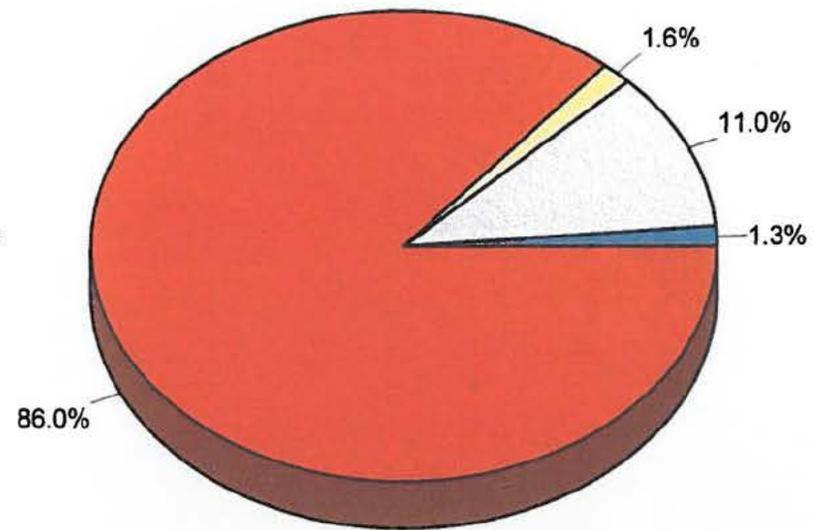
### Revenues



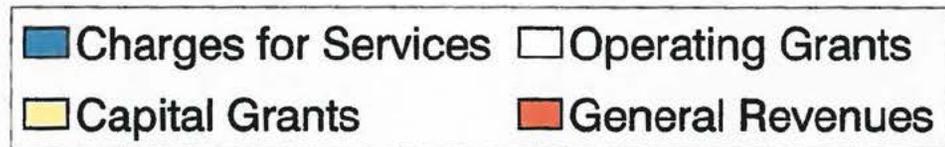
For the Year Ended June 30, 2005 and 2006



2005



2006



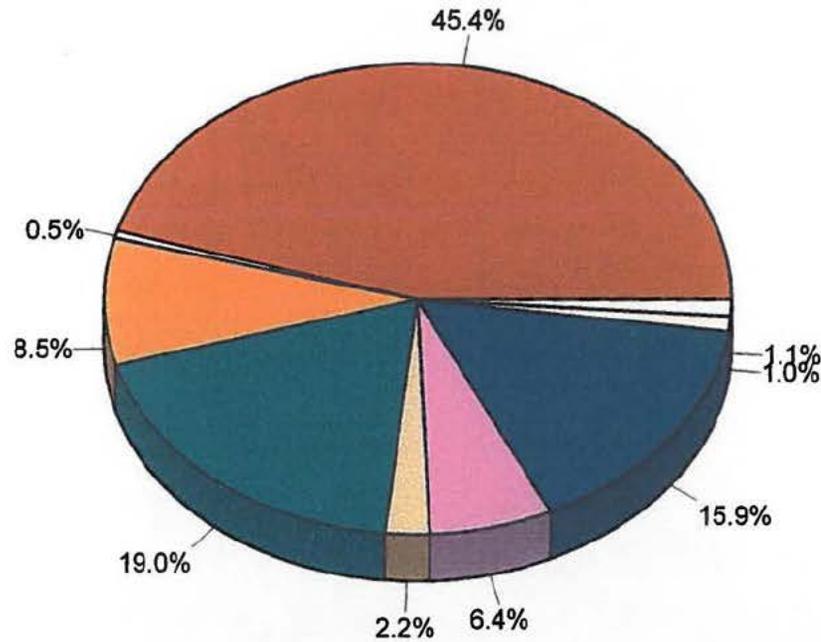


# Municipality of Carolina

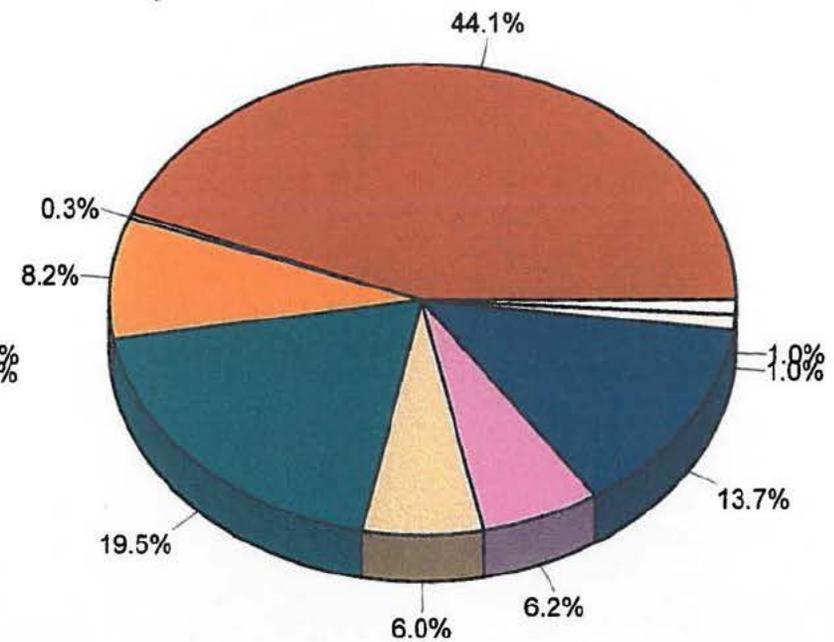
## Governmental Fund

### Combined Statement of Revenues

#### For the Year Ended June 30, 2005 and 2006



2005



2006

Property Taxes	Landfill	Licenses, Permits
Volume of Business	Interest Income	Intergovernmental
Federal Grants	Rent	Other

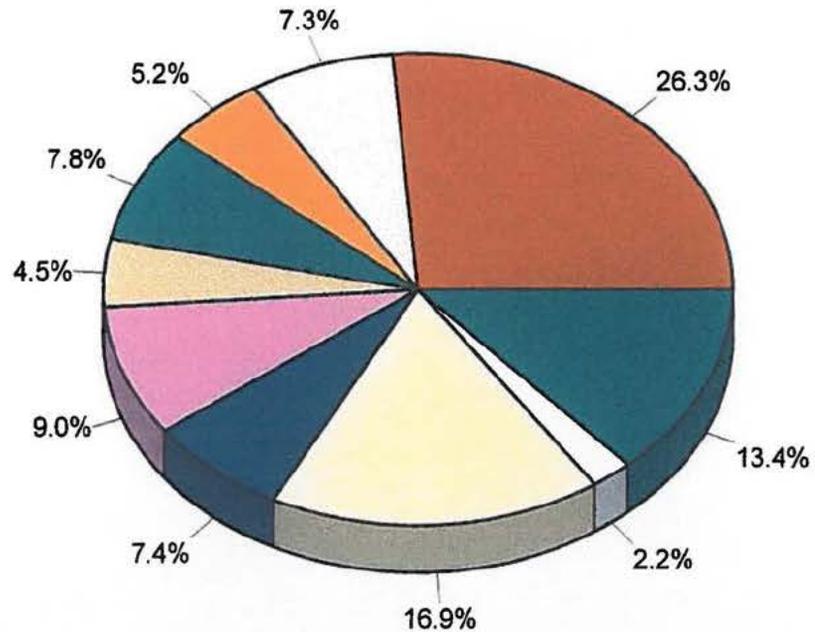


# Municipality of Carolina

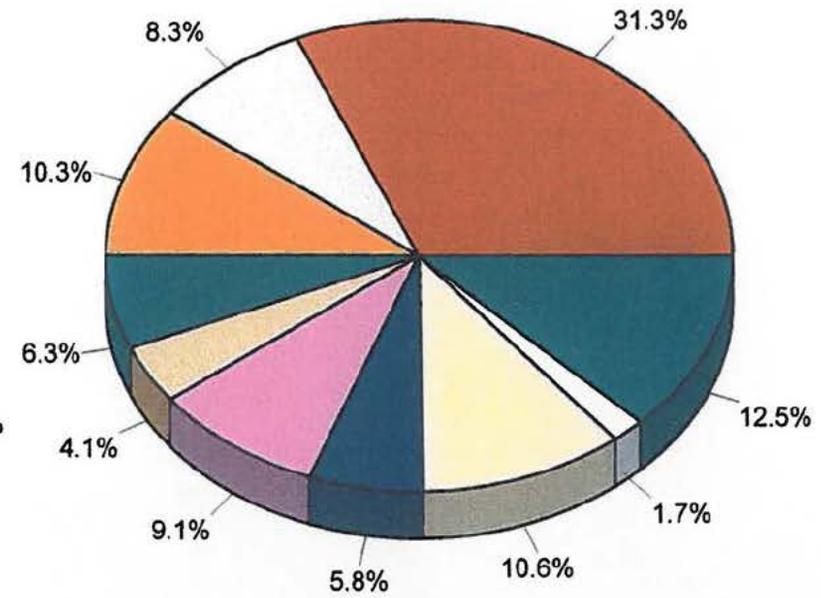
## Governmental Fund

### Combined Statement of Expenditures

#### For the Year Ended June 30, 2005 and 2006



2005



2006

General Government	Public Safety	Public Work & Trans.
Sanitation	Health	Recreation, Education, Welfare
Housing	Economic Development	Employment Opportunities
Debt Payment		

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Statement of Net Assets  
Governmental Activities

	June 30	
	<u>2006</u>	<u>2005</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 91,641,986	\$ 118,253,240
Cash with fiscal agent	138,251,305	108,077,314
Volume of business tax receivable	3,127,807	3,006,155
Due from other governments	9,154,564	9,485,345
Federal grant receivables	18,668,358	14,095,239
Interest receivable	882,876	114,502
Property taxes receivable	3,642,904	5,537,459
Other receivables	<u>1,237,540</u>	<u>2,808,532</u>
Total current assets	<u>266,607,340</u>	<u>261,377,786</u>
Noncurrent assets:		
Capital assets, net	1,705,886,144	1,686,591,899
Bond issue cost	<u>6,803,773</u>	<u>-</u>
Total noncurrent assets	<u>1,712,689,917</u>	<u>1,686,591,899</u>
Total assets	<u>1,979,297,257</u>	<u>1,947,969,685</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Statement of Net Assets (continued)  
Governmental Activities

LIABILITIES	June 30	
	2006	2005
<b>Current liabilities:</b>		
Bonds and notes payable, current	\$ 14,526,147	\$ 11,253,000
Capital lease obligation, current	956,583	810,975
Accounts payable and accrued liabilities	12,682,423	18,646,452
Accrued legal claims, current	6,170	1,672,070
Accrued compensated absences, current	500,000	400,000
Interest payable	4,935,024	4,088,298
Due to other governments, current	2,073,868	-
Due to Federal Agency	727,535	1,325,338
Deferred volume of business taxes	26,534,043	23,323,935
Deferred federal revenue	11,993,836	12,562,770
Other deferred revenues	1,797,804	24,376,928
Total current liabilities	76,733,433	98,459,766
<b>Noncurrent liabilities:</b>		
Bonds and notes payable, noncurrent	205,029,870	183,287,121
Capital lease obligation, non-current	3,915,807	4,872,390
Landfill obligations	3,776,286	3,776,286
Due to other government, non current	4,167,938	5,316,314
Accrued legal claims, non current	4,101,830	3,630,930
Accrued compensated absences, non current	11,910,595	10,771,899
Total noncurrent liabilities	232,902,326	211,654,940
Total liabilities	309,635,759	310,114,706
<b>Net assets:</b>		
Invested in capital assets, net of related debt	1,513,447,879	1,495,798,242
<b>Restricted for:</b>		
Economic development projects	10,124,624	11,787,475
Capital projects	78,065,977	57,116,016
Debt service	25,094,068	23,894,845
Other purposes	7,736,958	4,602,972
Unrestricted	35,191,992	44,655,429
Total net assets	1,669,661,498	1,637,854,979
Total liabilities and net assets	\$ 1,979,297,257	\$ 1,947,969,685

COMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Statement of Activities  
Governmental Activities  
For the Fiscal Year Ended

Functions and Programs	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	June 30	
					2006	2005
<b>Governmental activities:</b>						
General government	\$ 44,221,250				\$ (44,221,250)	\$ (46,482,966)
Public safety	11,422,915		110,784		(11,312,131)	(10,623,607)
Highway, streets and transportation	14,139,766			143,189	(13,996,577)	(6,911,534)
Sanitation	8,650,948	503,022			(8,147,926)	(11,641,677)
Health	5,604,131				(5,604,131)	(7,123,296)
Recreation and sports	2,923,185				(2,923,185)	(3,493,541)
Education and training	9,529,477		7,378,385		(2,151,092)	(4,395,701)
Housing	7,969,052		6,425,469		(1,543,583)	(47,665)
Economic development	14,477,574	1,717,099		2,545,959	(10,214,516)	(15,790,703)
Welfare	753,499		921,472		167,973	(221,741)
Employment opportunities	2,392,423		3,366,475		974,052	375,786
Interest	11,693,920				(11,693,920)	(10,601,887)
<b>Total governmental activities</b>	<b>133,778,140</b>	<b>2,220,121</b>	<b>18,202,585</b>	<b>2,689,148</b>	<b>(110,666,286)</b>	<b>(116,958,532)</b>
<b>General revenues:</b>						
Property taxes					75,567,182	71,160,280
Volume of business taxes					31,931,933	30,746,502
License, and permits					13,366,852	12,910,326
Interest income					9,883,161	3,527,708
Intergovernmental					10,152,873	12,966,879
Other					1,570,804	1,283,836
<b>Total general revenues</b>					<b>142,472,805</b>	<b>132,595,531</b>
<b>Change in net assets</b>					<b>31,806,519</b>	<b>15,636,999</b>
<b>Net assets - beginning (as previously reported)</b>					<b>350,836,314</b>	<b>307,839,945</b>
<b>Prior period adjustments</b>					<b>1,287,018,665</b>	<b>1,314,378,035</b>
<b>Net assets - beginning (as restated)</b>					<b>1,637,854,979</b>	<b>1,622,217,980</b>
<b>Net assets - ending</b>					<b>\$ 1,669,661,498</b>	<b>\$ 1,637,854,979</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Governmental Fund Financial Statements  
Balance Sheet

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other Funds	June 30	
							2006	2005
<b>Assets</b>								
Cash and certificates of deposits	\$ 69,107,892	\$ 820,246	\$ 4,264,429	\$ 11,226,402	\$ 13,736	\$ 6,209,281	\$ 91,641,986	\$ 118,253,240
Cash with fiscal agent	510,671	38,793,872	98,946,762	-	-	-	138,251,305	108,077,314
Volume of business taxes receivable	3,127,807	-	-	-	-	-	3,127,807	3,006,155
Due from other governments	392,806	-	-	36,495	-	8,725,263	9,154,564	9,485,345
Federal grants receivables	-	-	-	6,498,235	582,693	11,587,430	18,668,358	14,095,239
Due from other funds	12,936,610	1,000	811,064	793	-	563,240	14,312,707	11,562,486
Interest receivable	756,976	125,900	-	-	-	-	882,876	114,502
Property taxes receivable	-	3,642,904	-	-	-	-	3,642,904	5,537,459
Other receivables	645,917	-	-	121,399	16,600	453,624	1,237,540	2,808,532
<b>Total assets</b>	<b>\$ 87,478,679</b>	<b>\$ 43,383,922</b>	<b>\$ 104,022,255</b>	<b>\$ 17,883,324</b>	<b>\$ 613,029</b>	<b>\$ 27,538,838</b>	<b>\$ 280,920,047</b>	<b>\$ 272,940,272</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Governmental Fund Financial Statements  
Balance Sheet (continued)

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other Funds	June 30	
							2006	2005
<b>Liabilities and other credits</b>								
Accounts payable and accrued liabilities	\$ 7,723,668	\$ -	\$ 2,663,682	\$ 480,950	\$ 613,029	\$ 1,201,094	\$ 12,682,423	\$ 18,646,452
Bonds and notes payable	-	9,965,000	-	-	-	-	9,965,000	10,675,000
Interest payable	-	4,933,504	-	-	-	1,520	4,935,024	4,088,298
Due to other governments	2,073,868	-	-	-	-	-	2,073,868	1,058,288
Due to other funds	991,449	566,709	5,866,146	775,020	-	6,113,384	14,312,708	11,562,486
Due to federal agency	-	-	-	-	-	727,535	727,535	1,325,338
Deferred volume of business taxes	26,534,043	-	-	-	-	-	26,534,043	29,605,320
Deferred Federal revenue	-	-	-	6,466,235	-	5,527,601	11,993,836	6,281,385
Other deferred revenue	628,081	2,824,641	118,930	36,495	-	6,230,746	9,838,893	9,077,019
<b>Total liabilities and other credits</b>	<b>37,951,109</b>	<b>18,289,654</b>	<b>8,648,758</b>	<b>7,758,700</b>	<b>613,029</b>	<b>19,801,880</b>	<b>93,063,330</b>	<b>92,319,586</b>
<b>Fund Equity</b>								
<b>Fund balances</b>								
Reserved for encumbrances	23,825,455	-	-	-	-	-	23,825,455	25,812,280
Reserved for other purposes	16,828,882	-	-	-	-	-	16,828,882	36,313,802
Reserved for equipment	510,671	-	-	-	-	-	510,671	510,671
Reserved for capital projects	-	-	95,373,497	10,124,624	-	-	105,498,121	75,763,116
Development projects	-	-	-	-	-	-	-	13,415,801
Reserved for debt service	-	25,094,068	-	-	-	-	25,094,068	22,117,008
Unreserved	8,362,562	-	-	-	-	7,736,958	16,099,520	6,688,008
<b>Total fund balances</b>	<b>49,527,570</b>	<b>25,094,068</b>	<b>95,373,497</b>	<b>10,124,624</b>	<b>-</b>	<b>7,736,958</b>	<b>187,856,717</b>	<b>180,620,686</b>
<b>Total liabilities and fund equity</b>	<b>\$ 87,478,679</b>	<b>\$ 43,383,922</b>	<b>\$ 104,022,255</b>	<b>\$ 17,883,324</b>	<b>\$ 613,029</b>	<b>\$ 27,538,838</b>	<b>\$ 280,920,047</b>	<b>\$ 272,940,272</b>

See notes to financial statement

## MUNICIPALITY OF CAROLINA

Reconciliation of Fund Balance of Governmental Funds  
to Net Assets of Governmental Activities

	Years Ended June 30	
	2006	2005
Fund balance per Fund statements	\$ 187,856,717	\$ 180,620,686
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and not reported in the funds	1,705,886,144	1,686,591,899
Bond issue cost of governmental activities are not financial resources and not reported as assets in the funds	6,803,773	-
Other economic resources used in governmental activities are not financial resources and not reported as revenue in the funds	3,217,447	9,837,502
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	(24,462,818)	(55,907,987)
General obligation bonds, special and federal loans are not due and payable in the current period and therefore not reported in the funds	(209,639,765)	(183,287,121)
Net assets of governmental activities	\$ 1,669,661,498	\$ 1,637,854,979

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
Municipality of Carolina

Governmental Fund Financial Statements  
Statement of Revenues, Expenditures and Changes in Fund Balances

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other	Year Ended June 30,	
							2006	2005
<b>Revenues</b>								
Property Taxes	\$ 50,540,709	\$ 21,809,026	\$ -	\$ -	\$ -	\$ -	\$ 72,349,735	\$ 73,464,149
Volume of business taxes	31,931,933	-	-	-	-	-	31,931,933	30,746,502
Licenses, permits, fines and forfeits	13,318,838	-	-	-	-	48,014	13,366,852	13,744,267
Federal grants	-	-	143,189	4,140,860	3,366,475	14,834,781	22,485,305	25,729,996
Interest income	8,746,222	-	57,170	495,233	-	584,536	9,883,161	3,527,708
Intergovernmental	9,134,683	-	389,200	-	-	628,990	10,152,873	10,292,821
Landfill	503,022	-	-	-	-	-	503,022	815,149
Rent	1,717,099	-	-	-	-	-	1,717,099	1,643,190
Other	-	-	974,369	-	-	596,435	1,570,804	1,810,404
<b>Total revenues</b>	<b>115,892,506</b>	<b>21,809,026</b>	<b>1,563,928</b>	<b>4,636,093</b>	<b>3,366,475</b>	<b>16,692,756</b>	<b>163,960,784</b>	<b>161,774,186</b>
<b>Expenditures</b>								
General government	60,474,747	-	-	-	-	7,743	60,482,490	46,391,883
Public safety	15,024,377	-	-	-	-	1,049,272	16,073,649	12,943,856
Highway, streets and transportation	7,064,770	-	12,831,957	-	-	-	19,896,727	9,248,966
Sanitation	12,173,101	-	-	-	-	-	12,173,101	13,791,324
Health	7,885,802	-	-	-	-	-	7,885,802	7,886,243
Recreation and sports	3,433,721	-	-	-	-	679,612	4,113,333	3,867,720
Education and training	5,209,194	-	-	-	-	8,200,121	13,409,315	12,119,487
Housing	3,607,814	-	-	-	-	7,605,762	11,213,576	13,085,473
Economic development	-	-	16,087,721	4,284,262	-	-	20,371,983	29,891,166
Welfare	-	-	-	-	-	1,060,278	1,060,278	972,165
Employment opportunity	-	-	-	-	3,366,475	-	3,366,475	3,884,329
Debt service payments	-	24,078,024	-	-	-	-	24,078,024	23,600,887
<b>Total expenditures</b>	<b>114,873,526</b>	<b>24,078,024</b>	<b>28,919,678</b>	<b>4,284,262</b>	<b>3,366,475</b>	<b>18,602,788</b>	<b>194,124,753</b>	<b>177,683,499</b>
<b>Other financing sources (uses)</b>								
Proceeds from debt issuance	-	-	37,400,000	-	-	-	37,400,000	-
Operating transfer in	2,100,000	5,568,221	13,648,917	-	-	987,120	22,304,258	12,662,024
Operating transfer out	(18,825,988)	(2,100,000)	-	(1,378,270)	-	-	(22,304,258)	(12,662,024)
<b>Other financing sources (uses)</b>	<b>(16,725,988)</b>	<b>3,468,221</b>	<b>51,048,917</b>	<b>(1,378,270)</b>	<b>-</b>	<b>987,120</b>	<b>37,400,000</b>	<b>-</b>
<b>Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses</b>	<b>(15,707,008)</b>	<b>1,199,223</b>	<b>23,693,167</b>	<b>(1,026,439)</b>	<b>-</b>	<b>(922,912)</b>	<b>7,236,031</b>	<b>(15,909,313)</b>
<b>Fund balances at beginning of fiscal year (as previously reported)</b>	<b>65,234,578</b>	<b>23,894,845</b>	<b>71,544,699</b>	<b>11,787,475</b>	<b>-</b>	<b>4,602,972</b>	<b>177,064,569</b>	<b>192,696,261</b>
Prior period adjustment	-	-	135,631	(636,412)	-	4,056,898	3,556,117	3,833,738
<b>Fund balances at beginning of fiscal year (as restated)</b>	<b>65,234,578</b>	<b>23,894,845</b>	<b>71,680,330</b>	<b>11,151,063</b>	<b>-</b>	<b>8,659,870</b>	<b>180,620,686</b>	<b>196,529,999</b>
<b>Fund balances at end of fiscal year</b>	<b>\$ 49,527,570</b>	<b>\$ 25,094,068</b>	<b>\$ 95,373,497</b>	<b>\$ 10,124,624</b>	<b>\$ -</b>	<b>\$ 7,736,958</b>	<b>\$ 187,856,717</b>	<b>\$ 180,620,686</b>

See notes to financial statements

*Official copy*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Reconciliation of the Statement of Revenues, Expenditures and  
Changes in Fund Balances of Governmental Funds  
to the Statement of Activities

	Year Ended June 30	
	<u>2006</u>	<u>2005</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses - total governmental funds	\$ 7,236,031	\$ (15,909,313)
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.	49,201,216	18,957,620
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	1,623,874	11,002,137
Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long term liabilities in the statement of net assets.	12,384,104	12,999,000
Proceeds from debt issuance are other financing sources in the governmental funds but such proceeds increase long term liabilities in the statement of net assets.	(37,400,000)	-
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds.	<u>(1,238,706)</u>	<u>(11,412,445)</u>
Change in net assets of governmental activities	<u>\$ 31,806,519</u>	<u>\$ 15,636,999</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Statement of Revenues and Expenditures  
Budget and Actual- General Fund  
Non GAAP Budgetary Basis  
Year Ended June 30, 2006

	<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	\$ 50,956,806	\$ 50,540,708	\$ 50,540,708	\$ -
Volume of business taxes	25,650,000	29,880,833	30,823,722	942,889
Licenses and permits	4,100,000	9,704,147	11,589,841	1,885,694
Property rent	140,000	227,000	228,520	1,520
Miscellaneous	800,000	3,416,098	2,190,410	(1,225,688)
Intergovernmental services	349,700	349,700	295,359	(54,341)
Intergovernmental grant	6,329,334	6,329,334	6,329,334	-
Interest	1,500,000	6,450,684	8,645,298	2,194,614
Fines and penalties	200,000	200,000	117,949	(82,051)
Readjustments of prior years	-	15,925,505	-	(15,925,505)
	<u>90,025,840</u>	<u>123,024,009</u>	<u>110,761,141</u>	<u>(12,262,868)</u>
Amounts available for appropriation	\$ 90,025,840	\$ 123,024,009	\$ 110,761,141	\$ (12,262,868)
<b>Expenditures charged to appropriations:</b>				
General government	42,540,150	67,174,282	65,017,316	2,156,966
Public safety	15,617,775	14,618,201	14,506,237	111,964
Highways, streets and transportation	5,886,256	7,933,006	6,950,270	982,736
Sanitation	9,243,195	10,867,428	10,130,759	736,669
Health	7,900,000	7,900,000	7,885,802	14,198
Recreation and sports	3,642,920	5,564,322	4,043,183	1,521,139
Education & Training	3,146,601	3,700,633	3,547,824	152,809
Housing and building	2,048,943	5,266,137	2,608,264	2,657,873
	<u>90,025,840</u>	<u>123,024,009</u>	<u>114,689,655</u>	<u>8,334,354</u>
Total charges to appropriations	90,025,840	123,024,009	114,689,655	8,334,354
Excess of appropriations over resources	\$ -	\$ -	\$ (3,928,514)	\$ (3,928,514)

See notes to financial statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements  
June 30, 2006

Note 1 - Summary of significant accounting policies

Reporting Entity

The Municipality of Carolina (the Municipality) is a municipal entity of the Commonwealth of Puerto Rico was founded in 1857. The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of Puerto Rico. The legislative body consists of sixteen assemblymen also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public safety, sanitation, recreation and sports, education, housing, transportation, welfare, construction and/or improvements of highways and streets, and other general and administrative services.

The financial statements of the Municipality of Carolina (the Municipality) have been prepared in conformity with generally accepted accounting principles (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the primary standard-setting body for establishing governmental accounting and financial reporting principles.

In accordance with GASB-34-Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, the basic financial statements of the Municipality include both government-wide and fund financial statements. Both the government-wide and fund financial statements categorize activities as governmental activities.

In the government-wide Statement of Net Assets the governmental activities (a) are presented on a consolidated basis in one column, and (b) are reflected, on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations. The government-wide Statement of Activities reflects both the gross and net cost per functional category. The Statement of Activities reduces gross expenses (including depreciation) by related operating grants and contributions. The operating grants include operating-specific grants. This government-wide focus is more on the substantiality of the Municipality the change in aggregate economic position resulting from the activities of the fiscal period.

The fund financial statements emphasis is on the major funds in the governmental category. Non-major funds are aggregated into a single column. The governmental funds financial statements are presented on a current financial resource measurement focus and modified accrual basis of accounting. This is the manner in which these funds are normally budgeted. This presentation is deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality actual experience conforms to the budget or fiscal plan. Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statement, a reconciliation is presented on the fund statement, which briefly explains the adjustments necessary to transform the fund statements into the governmental wide statements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

The Municipality reports the following major governmental funds:

General Fund - The general fund is the Municipality's primary operating fund. It accounts for all financial resources of the Municipality except those required to be accounted for in another funds.

Economic Development Fund - Accounts for the financial resources required for the economic development of the Municipality. Financing is provided primarily from Federal grants and loans and local special assignments receipts.

Debt Service Fund - Account the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Capital Projects Fund - Accounts for the financial resources required for the acquisition of personal property and/or construction of major improvements which are not financed by other funds.

Workforce Investment Fund - The Workforce Investment Fund accounts for the activities of the Employment Opportunity Municipal Agency (Workforce Investment Area of Municipality of Carolina-Local Area), an entity organized by the Municipality of Carolina as requested by the Governor of Puerto Rico, in accordance with Section 116 of the Workforce Investment Act (WIA) and Section 2.001 of the Autonomous Municipal Law of Puerto Rico. The entity was designated as Service Delivery Area (SDA) according to the provision of the Workforce Investment Act of 1998, set forth in Section 116 and the federal regulation as issued by the U.S. Secretary of Labor for the implementation of WIA. The purpose of the organization is to establish programs to provide remedial education, training and employment assistance to economically disadvantaged youth and adults, and persons facing multiple barriers to employment and dislocated workers.

Basis of Accounting

The accounts of the Municipality are organized on the basis of funds, each of which is considered to be a separate accounting entity. The Municipality has created various types of funds. Each fund is accounted for by a separate set of self-balancing accounts, which include its assets, liabilities, fund balances, and revenues and expenditures/expenses, as applicable. The individual funds accounts for the governmental resources allocated to the Municipality for the purpose of carrying on specific activities in accordance with laws, regulations, or other restrictions.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Measurement Focus

Government-wide Financial Statements. The government wide financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non exchange transactions, in which the Municipality gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants. Revenue from grants is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Funds Financial Statement. Governmental funds are those through which most governmental functions of the Municipality are financed. The acquisition, use, and balances of the Municipality's expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Available means collectible within the current period or 60 days after the end of the period to use them to pay liabilities of the current period. Miscellaneous revenues are recorded when collected. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the year to which they apply. Expenditures are generally recognized when the related fund liability is incurred. General capital asset acquisitions are reported as expenditures in governmental funds.

Licenses and permits, charges for services, fines and forfeits and miscellaneous revenues (except investment earnings) are recorded as revenues when received. Investment earnings (interest) are recorded as earned since they are measurable and available.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Encumbrances

Governmental funds employ encumbrances accounting. Under the encumbrance system, all purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation. Under generally accepted accounting principles, encumbrances outstanding at year-end are reported as balance and they constitute neither expenditures, nor liabilities. Encumbrances constitute the equivalent of expenditures for budgetary purposes only, and, accordingly, are reported with expenditures in all budgetary basis statements.

Budgetary Data

The Municipality follows these procedures, which are in accordance with the municipal law; in establishing the budgetary data reflected in the basic financial statements.

- (1) On or prior to May 15, the Mayor submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1st. The proposed budget includes estimated expenditures and their financing sources.
- (2) The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- (3) Prior to July 1st., the annual budget is legally enacted through passage of the annual appropriation ordinance.
- (4) Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget. Adjustments made during fiscal year June 30, 2006 amounted to \$15,925,505 are reflected in the budget information as adjustments of prior years included in the basic financial statements.

The budget is prepared following the modified accrual basis of accounting except for the encumbrances as described below.

The actual results of operations, presented in the Statement of Revenues, Expenditures and Changes in Fund Balances-Budget and Actual-General Fund, are reflected in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

COMMONWEALTH OF PUERTO RICO  
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Notes to Financial Statements (continued)  
June 30, 2006

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

Since the budgetary basis differs from generally accepted accounting principles (GAAP), actual amounts for the general fund and debt service fund in the accompanying Statement of Revenues and Expenditures-Budget and Actual are presented on the budgetary basis to enhance comparability. The principal differences are as follows:

- (1) Encumbrances are recorded as expenditures under the budgetary basis and as reservations of fund balance under the GAAP basis.
- (2) The property tax advances are presented as revenue in the budgetary basis and as other financing sources in the GAAP basis.
- (3) The Municipality receives certain revenues as contributions from governmental entities, legislative and private parties, which are not included therein nor are the related expenditures.
- (4) Certain debt issuance to acquire personal property is reflected in the general fund and is restricted for that purpose.

The necessary adjustments to convert the result of operations of the general and debt service funds from the modified accrual basis of accounting to the budgetary basis for fiscal year June 30, 2006 are as follows:

Accounting per the statement of revenues, expenditures and changes in fund balance	\$ (15,707,008)
Adjustments:	
Non-budgeted revenues received during the year	(6,639,307)
Non-budgeted expenditures during the year	18,217,801
Current year encumbrances recognized as expenditures on the budgetary basis	(2,300,000)
Prior year encumbrances recognized as expenditures on the accounting basis	<u>2,500,000</u>
Excess of revenues (expenditures) over expenditures (revenues) budgetary basis	<u>\$ (3,928,514)</u>

COMMONWEALTH OF PUERTO RICO  
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Notes to Financial Statements (continued)  
June 30, 2006

Deposits

Substantially all cash balances are commingled in a general checking account 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. Generally, cash is deposited in interest-bearing bank accounts. Investment earnings are credited to the respective fund.

Investments consist of short-term certificates of deposit and are stated at cost, which approximates fair value.

Inventories

The general fund purchases office and printing supplies, gasoline, oil, medicines and other items. The cost of purchases is recorded as expenditure and the inventory is not recorded in the basic financial statements since amount is insignificant.

Capital Assets

All capital assets of the Municipality are general capital assets. They are not reported as assets in the governmental funds but are reported in the government-wide statement of net assets-governmental activities. Capital assets are recorded at historical cost. Donated capital assets are reported at their estimated fair value at the time they are received by the Municipality. Additions, improvements and other capital outlays that significantly extended the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation on capital assets is calculated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Useful Lives</u>	<u>Capitalization Threshold</u>
Vehicles, Heavy Equipment	4-10	\$300
Furniture and Fixture	10	\$300
Computer and Electronic Equipment	5	\$300
Buildings	50	\$1
Infrastructure	60	\$1
Improvements	20-40	\$1

In addition, the Municipality assigned 10% residual value on most capital assets.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Bond costs

Bond issuance costs in the amount of \$6,803,773 are included in noncurrent assets at June 30, 2006 in the Statement of Net Assets. Bond issuance costs consist of legal and accounting fee incurred in the fiscal year 2006 issuance of \$37.4 million bonds debt. Such costs will be amortized over the lives of the related bond issues using the straight-line method.

Vacation and Sick Leave and Other Compensated Absences

Municipal employees are granted 30 days of vacation and 18 days of sick leave annually. Vacation may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years or more of service who are entitled to sick leave pay to the maximum allowed. The Municipality is required to pay excess sick leave over 90 days on or before March 31 of the accumulated excess at December 31 of prior year. The liability for compensated absences was reported in the government-wide financial statements. The balance consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method, in which sick leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Employees' maximum allowed accumulated vacation, with the employer's share of payroll taxes, are accounted in the Statement of Net Asset.

Insurance

The Municipality has insurance coverage for its public facilities and equipment, primarily to provide protection in case of disaster and other losses. Also, principal officials of the Municipality are covered under various surety bonds. The Secretary of the Department of the Treasury of the Commonwealth of Puerto Rico is the designated agency to obtain the necessary insurance coverage for the Municipality.

Cash held with fiscal agent

The cash with fiscal agent consists of property tax collections withheld by the Government Development Bank for Puerto Rico and another financial institution restricted for the payment of Municipality's debt service (See Note 2). The cash held with fiscal agent related with unused proceeds from bonds and notes issued principally for the acquisition or construction of permanent improvements are accounted in the capital project fund.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Reservations of Fund Balance

In the fund financial statements, governmental funds report reservations of fund balances for amounts that are legally segregated for a specific future use. 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 current financial resources available to finance future debt service payments.
- Capital Projects - Represent current financial resources available to finance future capital outlays related with public works.
- For equipment and other purposes - Represents current financial resources legally segregated for acquisition of equipment and other specific future use.
- For economic development projects - Represent current financial resources available to finance and subsidize other projects.

Claims and Judgments

The estimated amount of the liability for claims and judgments, which is due when settled by the court, such as from adjudicated or settled claims, in the Statement of Net Assets.

Use of Estimates

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Note 2 - Property taxes

The "Centro de Recaudación de Ingresos Municipales" (CRIM) is responsible for the assessment of all real and personal property located within the Municipality of Carolina 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 the assessment.

Real property taxes are billed by the CRIM and are due in two equal installments in July and January following the assessment date. Personal property taxes are self-assessed and are due in May 15, when the property tax return is required to be filed.

The tax rate per annum is 8.83% for real property and 6.33% for personal property of which 3.8 % and 1.83%, respectively, belongs to the Commonwealth of Puerto Rico and 4.5% of both percents belong to the Municipality. From the portion belonging to the Municipality, 3% represents the Municipality's basic tax rate, which is appropriated for general purposes and, therefore, accounted for through the general fund. The remaining portion belonging to the Municipality of 1.5% represents the "ad-valorem" tax withheld by the CRIM as fiscal agent, and restricted for debt service which is accounted for through the debt service fund (See Note 11). The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

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. Veterans have additional exemption from taxes of \$5,000 of the assessed value of real property. The Department of Treasury instead of the property taxpayer becomes the source of payment in these cases.

Complete exemption from personal taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000.

COMMONWEALTH OF PUERTO RICO  
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Notes to Financial Statements (continued)  
June 30, 2006

The CRIM reports annually to the Municipality the estimated basic property tax and the tax to be used for the debt service, which will be collected in the fiscal year. The basic tax is advanced to the Municipality during such fiscal year. It is the practice to amortize these advances through the subsequent collection by the CRIM of the basic tax from the taxpayers.

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, the Municipality recognized as an expenditure the operational expenses allocated by the CRIM to the Municipality, which amounted to \$ 1,889,166 and \$1,834,304 during fiscal years ended June 30, 2006 and 2005, respectively.

The following is a summary of the property tax advances, which resulted as an account receivable and payable, at June 30, 2006 and 2005, respectively. In addition, the Municipality reports outstanding debt dated from June 30, 2000 in the Government Wide Financial Statement.

<u>Accounts (Payable) and Receivable</u>	<u>2006</u>	<u>2005</u>
Amortization through collections of property taxes by the CRIM	\$ 51,157,691	\$ 47,776,462
Advanced received,	<u>50,540,709</u>	<u>49,608,083</u>
Due (to) from CRIM	<u>\$ 616,982</u>	<u>\$ (1,831,621)</u>
 Due to CRIM-2000	 <u>\$ 4,167,938</u>	 <u>\$ 4,227,693</u>

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:

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)  
JUNE 30, 2006

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, 2006, the Municipality invested its funds in bank accounts bearing interest.

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

	<u>2006</u>	<u>2005</u>
Insured by the federal deposits insurance corporation	\$ 109,997	\$ 509,997
Collateralized by securities held by the pledging financial institution's trust department in the Municipality's name	<u>137,968,274</u>	<u>148,126,521</u>
Total	<u>\$138,078,271</u>	<u>\$148,636,518</u>

In addition, as of June 30 2006 and 2005, the Municipality's custodial credit risk was approximately \$96 and 71 million, respectively, 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.

Note 4 - 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 1.5% for financial institutions and savings and loans associations, 0.5% for all other non-financial organizations.

COMMONWEALTH OF PUERTO RICO  
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Notes to Financial Statements (continued)  
June 30, 2006

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 5% 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.

The Municipality recognized an account receivable for the estimated municipal license taxes to be collected during the first two months of fiscal year 2006-2007, but corresponding to fiscal year 2006-2007. Municipal license taxes collected prior to June 30, but pertaining to the next fiscal year are recorded as deferred revenues.

Note 5 – Inter-fund transactions

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, 2006:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Debt Service	\$ 566,709
	Capital Project	5,866,146
	Economic Development	390,371
	Other	6,113,384
		<u>12,936,610</u>
Debt Service	Economic Development	<u>1,000</u>
Other	General	297,940
	Economic Development	265,300
		<u>563,240</u>
Economic Development	General	<u>793</u>
Capital Project	General	692,716
	Economic Development	118,348
		<u>811,064</u>
Total		<u>\$ 14,312,708</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

The inter-fund receivables and payables on Fund Financial Statements are eliminated on the Statement of Net Assets (Government Wide Financial Statements).

Note 6 - Intergovernmental revenues

Sources of intergovernmental revenue consist primarily of governmental payments from the Commonwealth of Puerto Rico and "in lieu of tax" payments from certain "quasi-public" corporations, such as the Puerto Rico Electric Power Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements. Almost all these intergovernmental revenues are accounted for in the general fund.

Note 7 - Bonds and notes payable

The following is a summary of the bonds and notes payable transactions for the fiscal years ended June 30:

	<u>2006</u>	<u>2005</u>
Balance at beginning	\$ 194,540,121	\$ 207,539,121
Proceeds from new issuance	37,400,000	-
BAN's notes		-
Less principal payments:		
Bonds           \$11,669,104		
Notes           715,000	<u>(12,384,104)</u>	<u>(12,999,000)</u>
Balance at end of year	<u>\$ 219,556,017</u>	<u>\$ 194,540,121</u>

COMMONWEALTH OF PUERTO RICO  
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Notes to Financial Statements (continued)  
June 30, 2006

General long-term debt as of June 30, 2006 consists of the following:

<u>Bonds</u>	<u>2006</u>	<u>2005</u>
Series of 2005 - \$12,470,000 payable in annual installments of \$400,000 to \$955,000 until July 1, 2025 with interest at 5.00%	\$12,095,000	\$ -
Series of 2005 - \$12,470,000 payable in annual installments of \$400,000 to \$955,000 until July 1, 2025 with interest at 5.00%	12,095,000	-
Series of 2005 - \$12,460,000 payable in annual installments of \$390,000 to \$950,000 until July 1, 2025 with interest at 5.00%	12,080,000	-
Series of 2004 - \$15,550,000 payable in annual installments of \$510,000 to \$1,190,000 until July 1, 2023 with interest at 5.00%	14,065,000	14,585,000
Series of 2003 - \$4,000,000 payable in annual installments of \$102,000 to \$259,000 until July 1, 2027 with interest at 4.50%	3,616,000	3,719,104

COMMONWEALTH OF PUERTO RICO  
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Notes to Financial Statements (continued)  
June 30, 2006

<u>Bonds</u>	<u>2006</u>	<u>2005</u>
Series of 2003 - \$1,310,000 payable in annual installments of \$30,000 to \$105,000 until July 1, 2027; with interest at 6.50%.	1,215,000	1,240,000
Series of 2003 - \$23,000,000 payable in annual installments of \$500,000 to \$1,625,000 until July 1, 2027; with interest at 5.5%.	21,050,000	21,580,000
Series of 2003 --\$1,360,000 payable in annual installments of \$33,000 to \$88,000 until January 1, 2028; with interest at 4.50%.	1,264,000	1,297,000
Series of 2001 - \$20,120,000 payable in annual installments of \$550,000 to \$1,805,000 until July 1, 2020 with interest at 3.21 to 5.29%	16,670,000	17,350,000
Series of 2000 - \$30,285,000 payable in annual installments of \$1,445,000 to \$2,400,000 until July 1, 2017; with interest at 3.21 to 5.01%.	21,785,000	23,230,000
Series of 1998 - \$13,165,000 payable in annual installments of \$400,000 to \$1,175,000 until July 1, 2020; with interest at 5.52% to 6.56%.	10,470,000	10,870,000
Series of 1994 - \$7,320,000 payable in annual installments of \$680,000 to \$790,000 until July 1, 2008; with interest at 7.41% to 7.61%.	1,525,000	2,205,000
Series of 1993 - \$21,260,000 payable in annual installments of \$2,255,000 to \$2,450,000 until July 1, 2007; with interest at 7.41% to 7.51%.	2,450,000	4,705,000
Series 97 - \$1,248,000 payable in annual installments of \$121,000 to \$152,000 until January 1, 2011;with interest at 4.75%.	697,346	818,346

COMMONWEALTH OF PUERTO RICO  
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Notes to Financial Statements (continued)  
June 30, 2006

<u>Bonds</u>	<u>2006</u>	<u>2005</u>
Series of 1994 - \$2,035,000 payable in annual installments of \$175,000 to \$220,000 until July 1, 2009; with interest at 7.41% to 7.71%.	615,000	790,000
Series of 1995 - \$11,885,000 payable in annual installments of \$1,020,000 to \$1,285,000 until July 1, 2009; with interest at 7.41% to 7.71%.	3,575,000	4,595,000
Series of 1992 - \$1,550,000 payable in annual installments of \$162,000 to \$172,000 until January 1, 2007; with interest at 5.62%.	172,020	334,020
Series of 1995 - \$16,630,000 payable in annual installments of \$540,000 to \$1,465,000 until July 1, 2019; with interest at 6.00% to 6.63%.	12,480,000	13,020,000
Series of 1996 - \$10,475,000 payable in annual installments of \$505,000 to \$1,010,000 until July 1, 2015; with interest at 6.00% to 6.58%.	6,805,000	7,310,000
Series of 1997 - \$2,370,000 payable in annual installments of \$60,000 to \$205,000 until July 1, 2022; with interest at 5.52% to 6.56%.	1,965,000	2,025,000
<u>Special long-term debts</u>		
During the fiscal year 2003-2004, the Municipality had issued Bond Anticipation Notes (BAN's) in the amount of \$191,761 (net of amount refinancing by issuing general obligation bond). The Municipality intends to refinance these BAN's on a long-term basis with the Governmental Development Bank of Puerto Rico (GDB), which does not expire within one year from the date of the combined balance sheet. The refinancing will be done by issuing general obligation bonds of \$1,450,000.	1,326,651	1,326,651

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

	<u>2006</u>	<u>2005</u>
Series of 2003 - \$23,500,000 payable in annual installments of \$480,000 to \$1,810,000 until January 1, 2027; with interest at 5.60%.	21,750,000	22,230,000
Series of 2003 - \$5,040,000 payable in annual installments of \$105,000 to \$365,000 until July 1, 2027; with interest at 5.04% .	4,625,000	4,740,000
Series of 2003 - \$4,310,000 payable in annual installments of \$85,000 to \$330,000 until July 1, 2027; with interest at 5.60%	3,980,000	4,070,000
Series of 1999 - \$23,890,000 payable in annual installments of \$600,000 to \$1,860,000 until January 1, 2024; with interest at 4.25% to 6.1%.	<u>20,460,000</u>	<u>21,060,000</u>
Total General and Special Debt-Bonds	<u>\$208,831,017</u>	<u>\$183,100,121</u>
<u>Federal Notes</u>		
Series of 2001- \$14,300,000 Loan guarantee federal program payable in installments of \$715,000 to \$2,145,000 until August 1, 2020 with variable interest rates.	10,725,000	11,440,000
Total federal notes	<u>10,725,000</u>	<u>11,400,000</u>
Total bonds and notes payable	\$219,556,017	194,540,121
Less current portion	<u>(14,526,147)</u>	<u>(11,253,000)</u>
Long-term portion of bonds and notes payable	<u>205,029,870</u>	<u>\$183,287,121</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

The annual requirements to amortize the bonds and notes payable at June 30, 2006, including payment of interest are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interests</u>	<u>Total</u>
2007	\$ 14,526,147	\$ 11,864,531	\$ 26,390,678
2008	11,211,020	11,106,717	22,317,737
2009	11,044,000	10,490,805	21,534,805
2010	10,078,000	9,890,548	19,968,548
2011	10,662,000	9,368,812	20,030,812
2012-2016	61,261,346	37,718,147	98,979,493
2017-2021	58,396,000	20,372,026	78,768,026
2022-2026	37,710,000	6,595,738	44,305,738
2027-2028	4,667,504	257,791	4,925,295
Totals	<u>\$ 219,556,017</u>	<u>\$ 117,665,115</u>	<u>\$ 337,221,132</u>

The original loan guarantee notes payable of \$14,300,000, with an outstanding balance of \$10,725,000, are collateralized with U.S. obligation by a federal financing institution, and real property acquired or to be acquired with these funds

The basic contribution of the Municipality for real property is 7% and for personal property is 9%. Total property assessment, based on information reported by the Municipal Revenues Collection Center amounted to \$ 2,202,019,450 of which \$1,007,777,693 and \$1,193,241,757 are real and personal property, respectively.

In addition, debt issue costs involve legal and accounting fees incurred in the new issuance of \$37,400,000 debt. Such costs are deferred charges and should be amortized over the debt term. Debt issue cost are reported in the statement of net assets, as non current assets amounted to \$6,803,773.

Note 8 - Debt service fund

The revenues of the debt service fund arise from the additional property tax and are recognized when collected and informed by the CRIM (See Note 2). The CRIM retains these collections for the payment of principal and interest of bonds and notes issued by the Municipality. Interest income is for the payment of interest or special obligation notes and property taxes are for the debt service requirements of the general obligations bonds and notes.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Note 9 - Capital assets

A summary of changes in capital assets follows:

Capital Asset	Balance 6/30/2005	Additions	Retirements, Disposition and Transfers	Balance 6/30/2006
Governmental Activities:				
Non-depreciable assets:				
Land	\$ 1,277,093,347	\$ 11,448,781	\$ -	\$ 1,288,542,128
Construction in progress	146,924,884	9,143,587	(21,994,826)	134,073,645
Sub-totals	<u>1,424,018,231</u>	<u>20,592,368</u>	<u>(21,994,826)</u>	<u>1,422,615,773</u>
Infraestructure in progress	23,150,677	8,982,539	(7,912,145)	24,221,071
Total Non-depreciable assets	<u>\$ 1,447,168,908</u>	<u>\$ 29,574,907</u>	<u>\$ (29,906,971)</u>	<u>\$ 1,446,836,844</u>
Capital Asset	Balance 6/30/2005	Additions	Retirements, Disposition and Transfers	Balance 6/30/2006
Governmental Activities:				
Depreciable assets:				
Building, Infraestructure and Improvements:	\$ 274,134,024	\$ 32,283,120	\$ -	\$ 306,417,144
Vehicle and Equipment, furniture & fixtures	19,167,609	2,254,103	(80,647)	21,341,065
Sub-totals	<u>293,301,633</u>	<u>34,537,223</u>	<u>(80,647)</u>	<u>327,758,209</u>
Less accumulated depreciation	<u>(53,878,642)</u>	<u>(14,910,914)</u>	<u>80,647</u>	<u>(68,708,909)</u>
Depreciable assets, net	<u>\$ 239,422,991</u>	<u>\$ 19,626,309</u>	<u>\$ -</u>	<u>\$ 259,049,300</u>
Total Capital Assets	<u>\$ 1,686,591,899</u>			<u>\$ 1,705,886,144</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

	Balance 6/30/2004 as restated	Additions	Retirements, Disposition and Transfers	Balance 6/30/2005
<b>Capital Asset</b>				
<b>Governmental Activities:</b>				
<b>Non-depreciable assets:</b>				
Land	\$ 1,264,677,249	\$ 12,416,098	\$ -	\$ 1,277,093,347
Construction in progress	142,010,668	6,317,477	(1,403,261)	146,924,884
Sub-totales	<u>1,406,687,917</u>	<u>18,733,575</u>	<u>(1,403,261)</u>	<u>1,424,018,231</u>
Infraestructure in progress	19,737,764	3,412,913	-	23,150,677
Total Non-depreciable assets	<u>\$ 1,426,425,681</u>	<u>\$ 22,146,488</u>	<u>\$ (1,403,261)</u>	<u>\$ 1,447,168,908</u>
<b>Governmental Activities:</b>				
<b>Depreciable assets:</b>				
Building, Infraestructure and Improvements:	\$ 273,887,659	\$ 246,365	\$ -	\$ 274,134,024
Vehicle and Equipment, furniture & fixtures	18,732,978	464,916	(30,285)	19,167,609
Sub-totals	<u>292,620,637</u>	<u>711,281</u>	<u>(30,285)</u>	<u>293,301,633</u>
Less accumulated depreciation	(50,008,778)	(3,900,149)	30,285	(53,878,642)
Depreciable assets, net	<u>\$ 242,611,859</u>	<u>\$ (3,188,868)</u>	<u>\$ -</u>	<u>\$ 239,422,991</u>
<b>Total Capital Assets</b>	<u>\$ 1,669,037,540</u>			<u>\$ 1,686,591,899</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Depreciation expense charged to functions in June 30, is as follows:

	<u>2006</u>	<u>2005</u>
General Government	5,303,559	\$ 1,174,274
Economic Development	1,409,458	756,607
Welfare	1,744,633	24,608
Housing	1,067,429	331,200
Highway, streets and transportation	691,486	234,110
Recreation and Sports	360,688	97,900
Education and Training	1,175,830	306,769
Employment Opportunity	983,291	98,341
Sanitation	1,786,369	349,087
Public Safety	92,973	327,636
Health	295,198	199,617
Total	<u>\$ 14,910,914</u>	<u>\$ 3,900,149</u>

Note 10 - Retirement System

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 contribution during the year ended June 30, 2006 and 2005 amounted to approximately \$ 3,059,132 and \$2,828,840, respectively.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

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, 2006 and 2005, total covered payroll was approximately \$32,982,555 and \$30,449,600, respectively. Covered payroll refers to all compensation paid by the Municipality to employees covered by the ERS on which contributions to the pension are based.

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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Actuarial Valuation:

The actuarial determined present value of benefits accrued as of July 1, 2000 (latest date available) for the System as whole, determined through an actuarial valuation performed at such date, amounted to \$9.5 billion. The net assets available for benefits at such date were \$2.1 billion, resulting in an excess of accrued benefits over net assets available (actuarial deficiency) of \$7.4 billion. This information is not available by each participant government agencies nor municipalities. Net assets of the System consist principally of investments in stocks and bonds and loans to participants. The projected unit credit actuarial cost method was used for the actuarial calculation. Significant assumptions were as follows:

- |                                                      |                                                                                                       |
|------------------------------------------------------|-------------------------------------------------------------------------------------------------------|
| a) Interest rate                                     | 8.5% a year                                                                                           |
| b) Salary increases                                  | 5.0% a year                                                                                           |
| c) Mortality                                         | GAM'83 Mortality Table set forward two years.                                                         |
| d) Termination                                       | Medium Turnover Table commensurate with anticipated experience.                                       |
| e) Disability                                        | 65% of Third Railroad Retirement Table Rates.                                                         |
| 1) Retirement age                                    | Graded scale of retirement ages commensurate with anticipated experience.                             |
| g) Proportion of participants with spouses           | 80% of participants assumed to be married, with wives assumed to be four years younger than husbands. |
| h) Number of employees electing higher contributions | 15% of retiring employees assumed to pay retroactive contributions at retirement.                     |
| i) Cost-of-living adjustment                         | 3% every third year                                                                                   |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Note 11 - Other accrued liabilities

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

	<u>Balance at</u> <u>June 30, 2005</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at</u> <u>June 30, 2006</u>	<u>Due within</u> <u>one year</u>
Accrued compensated absences	\$ 11,171,899	\$ 2,415,537	\$ (1,176,831)	\$ 12,410,605	\$ 500,000
Accrued legal claims	5,303,000	477,070	(1,672,070)	4,108,000	6,170
	<u>\$ 16,474,899</u>	<u>\$ 2,892,607</u>	<u>\$ (2,848,901)</u>	<u>\$ 16,518,605</u>	<u>\$ 506,170</u>

	<u>Balance at</u> <u>June 30, 2004</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at</u> <u>June 30, 2005</u>	<u>Due within</u> <u>one year</u>
Accrued compensated absences	\$ 9,241,666	\$ 1,930,233	\$ -	\$ 11,171,899	\$ 400,000
Accrued legal claims	1,547,154	4,200,339	(444,493)	5,303,000	1,672,070
	<u>\$ 10,788,820</u>	<u>\$ 6,130,572</u>	<u>\$ (444,493)</u>	<u>\$ 16,474,899</u>	<u>\$ 2,072,070</u>

Note 12 - Leases

Operating Leases

The Municipality has several short-term operating lease agreements covering some of the Municipality's premises and equipment. All of the agreements are renewed annually. Total rental charges for the year ended June 30, 2006 and 2005, were approximately \$1,198,000 and \$960,000, respectively in all funds.

Capital Leases Obligations

The Employment Opportunity Municipal Agency (Workforce Investment) has four capital leases equipment 4.9% annually expiring in May 2007 with monthly payments between \$347 and \$636. At June 30, capital lease obligation was segregated as follow:

	<u>2006</u>	<u>2005</u>
Portion Due in one year	\$ 48,746 <u>(25,503)</u>	\$ 48,748 <u>(24,285)</u>
Portion Due over one year	<u>\$ 23,245</u>	<u>\$ 48,748</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

The long term debt expires within next two years as follow:

	<u>2006</u>	<u>2005</u>
2006	\$ -	\$ 25,503
2007	<u>23,245</u>	<u>23,245</u>
	<u>\$ 23,245</u>	<u>\$ 48,748</u>

Direct Financial Leases

The Municipality acquired two real properties (See Note 1) on December 16, 1991. One of the properties and a portion of the other have been classified as direct financing leases expiring in eighteen and twenty years, respectively.

These financial leases consist of the following at June 30, 2006:

	<u>2006</u>	<u>2005</u>
Total minimum lease payments to be received	\$ 6,787,675	\$ 8,473,132
Less unearned interest income	<u>(1,964,033)</u>	<u>(2,856,779)</u>
Net investment in direct financing leases	<u>\$ 4,823,642</u>	<u>\$ 5,616,353</u>

The minimum lease payments including interests for each of the two succeeding fiscal years are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interests</u>	<u>Total</u>
2007	\$ 931,080	\$ 748,356	\$ 1,679,436
2008	<u>3,892,562</u>	<u>1,215,677</u>	<u>5,108,239</u>
Total	<u>\$ 4,823,642</u>	<u>\$ 1,964,033</u>	<u>\$ 6,787,675</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Note 13 - Contingencies and Commitments

A. 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 for the year ended June 30, 2006 and 2005 of \$4,108,000 and \$5,303,000, respectively in the government-wide statements for anticipated unfavorable judgments.

The amount presented in the government-wide statements 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.

B. 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

C. Construction projects

The Municipality has construction commitments for which the Municipality is obligated to an amount of approximately \$80 millions (70 millions of municipal funds and 10 millions of federal funds) and \$98 millions (88 millions of municipal funds and 10 millions of federal funds) as of June 30, 2006 and 2005, respectively. These are commitments for the improvements of recreational and cultural facilities and for streets and general developments.

Note 14 - Healthcare costs

During the year ended June 30, 2000 the Governor of the Commonwealth of Puerto Rico imposed 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 \$7,885,802 and \$7,886,243 for the fiscal years ended June 30, 2006 and 2005, respectively.

Note 15 - Prior period adjustments

Governmental fund statements

The beginning fund balances of total governmental funds at July 1, 2005 have been restated by to account due to the corrections in the following non-exchange transactions:

	<u>2006</u>	<u>2005</u>
Overstatement (understatement) in deferred federal revenue	<u>\$ 3,556,117</u>	<u>\$ 3,833,738</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

Government wide statements

The beginning net assets of governmental activities at July 1, 2005 have been restated due to the following:

	<u>2006</u>	<u>2005</u>
Retroactive recognition of major capital assets, net of accumulated depreciation	\$ 1,313,898,717	\$ 1,338,749,168
Understatement in deferred revenues	(26,880,052)	(24,371,133)
Total	<u>\$ 1,287,018,665</u>	<u>\$ 1,314,378,035</u>

Note 16 - Closure and post-closure care cost of landfill

The Municipality owns and operates a solid waste landfill. The state and federal laws and regulations require the Municipality to estimate the total current cost of Municipal Solid Waste Landfill Closure and Post-Closure Care Costs. The Municipality recognized \$3,776,286 for the periods ended June 30, 2006 and 2005, respectively as the estimated obligation for landfill closure and \$324,000 annually for post-closure costs. Actual costs may be higher due to inflation changes in technology or changes in regulations. The amount was reported in the Statement of Net Assets at June 30, 2006. The Municipality expects to finance this obligation with the issuance of general obligation bonds.

Note 17- Subsequent events

Sales Taxes

On June, 2006, our Municipal Legislature approved the Ordinance No. 80 Series 2005-2006-85, as amended by ordinances 03 Series 2006-2007-12, to impose a municipal sales tax of 1% over retail sales inside our municipal jurisdiction.

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 sales and uses tax of 5.5% at a Commonwealth level and authorizes the municipalities to impose 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. Sales tax collections from July 1 to October 31, 2006 amounted to approximately \$6.4 million.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)  
June 30, 2006

General/Obligation Bond

During the fiscal year 2006-2007 the Municipal Legislature, through the Ordinance 02, Serial 2006-07-06 approved the issuance of General Obligation Bond Serial A by \$27.5 million and General Obligation Bond Serial B by \$2.8 million. The proceeds for both issuances are designated for the construction of capital projects.

Contribution to a basketball team

The Municipal Legislature, through the Resolution 2006-2007-24 approved a contribution of \$800,000 for the Carolina's men basketball team for its participation in the 2007 basketball season organized by the Puerto Rico Basketball Superior League. This contribution is scheduled to be paid by the Municipality in the following installments:

<u>Year</u>	<u>Amount</u>
2007	\$225,000
2008	225,000
2009	150,000
2010	100,000
2011	<u>100,000</u>
	<u>\$800,000</u>

DESIGNA DEL COMISIONADO  
MUNICIPALES

777 JPB -2 PW 1:16

USIDIVOL CARREO

**PKF**

Accountants &  
business advisers

**MUNICIPALITY OF CAROLINA**

**SINGLE AUDIT PACKAGE**

Fiscal Year Ended

June 30, 2006

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FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
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PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Hon. José E. Aponte de la Torre  
Mayor  
Commonwealth of Puerto Rico  
Municipality of Carolina

We have audited the basic financial statements of the Municipality of Carolina (the Municipality) as of and for the year ended June 30, 2006 and have issued our report thereon dated December 29, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal control over financial reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Municipality's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and responses as item 2006-1.

Hon. José E. Aponte de la Torre  
Mayor  
Commonwealth of Puerto Rico  
Municipality of Carolina  
Page 2

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition described above to be a material weakness.

Compliance and Other Matters

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

This report is intended solely for the information of the Mayor, the Municipal Assembly, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



*PKF, LLP*

License No. 22  
Expires on December 1, 2007

December 29, 2006

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

Hon. José E. Aponte de la Torre  
Mayor  
Commonwealth of Puerto Rico  
Municipality of Carolina

Compliance

We have audited the compliance of the Municipality of Carolina (the Municipality) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. The Municipality's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

Hon. José E. Aponte de la Torre  
Mayor  
Commonwealth of Puerto Rico  
Municipality of Carolina  
Page 2

As described in item 2006-2 in the accompanying schedule of findings and questioned costs, the Municipality did not comply with requirements regarding reporting that is applicable to its Workforce Investment Act program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with requirements applicable to those programs.

As described in item 2006-3 in the accompanying schedule of findings and questioned costs, the Municipality did not comply with requirements regarding Davis Bacon act that is applicable to its Home Investment Partnership and Loan Guarantees federal programs. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraphs, the Municipality of Carolina complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2006.

Internal control over compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2006-2 and 2006-3.

Hon. José E. Aponte de la Torre  
Mayor  
Commonwealth of Puerto Rico  
Municipality of Carolina  
Page 3

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 2006-3 to be material weaknesses.

Schedule of expenditures of federal awards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Municipality of Carolina (the Municipality) as of and for the fiscal year ended June 30, 2006, and have issued our report thereon dated December 29, 2006. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Mayor, the Municipal Assembly, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



PKF, LLP

License No. 22  
Expires on December 1, 2007

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

**SECTION 1 – SUMMARY OF AUDITOR'S RESULTS**

**Financial Statements:**

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- |                                                                                        |     |
|----------------------------------------------------------------------------------------|-----|
| 1. Material weakness identified?                                                       | Yes |
| 2. Reportable condition(s) identified that are not considered to be material weakness? | No  |
| 3. Noncompliance material to financial statements noted?                               | No  |

**Federal awards:**

Internal control over major programs:

- |                                                                               |     |
|-------------------------------------------------------------------------------|-----|
| 1. Material weakness(es) identified?                                          | Yes |
| 2. Reportable condition(s) that are not considered to be material weaknesses? | Yes |

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

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510 (a)? Yes

Identification of major programs:

<b><u>CFDA Number(s)</u></b>	<b><u>Name of Federal Program or Cluster</u></b>
14.218	Community Development Block Grant Entitlement
14.218	Loan Guarantees (89 & 98)
93.600	Head Start Administration for Youth and Children
14.239	Home Investment Partnerships Program
14.871	Section 8 Housing Choice Voucher
14.850	Public and Indian Housing
93.575	Child Care Grant Pass-through the Puerto Rico Department of the Family
17.258	Workforce Investment Act Adult Program
17.259	Workforce Investment Act Youth Activities
17.260	Workforce Investment Act Dislocated Workers

Dollar threshold used to distinguish between Type A and Type B programs: \$ 712,581

Auditee qualified as a low-risk auditee? No

## SECTION 2 – FINANCIAL STATEMENT

### Finding No. 2006-1 (First Reported as Finding 2004-1)

Program CFDA No. / Grant No.:	N/A
Type of Reportable Condition:	Internal Control Structure Design Material Weakness
Questioned Cost:	None

#### Condition:

At June 30, 2006 the balances of inter-fund loans and beginning fund balances of the non-major governmental funds in the SAP System were not reconciled with their subsidiaries.

#### Criteria:

The Governmental Accounting Standards Board Codification, Section 1300.110 establishes the following:

*“.....because each fund is a fiscal and accounting entity, the amounts due to one fund from other funds, as well as the amounts owed to other funds, should be reflected in the fund accounts and in fund financial statements”.*

Also, Puerto Rico Municipality Law (Law 81), article number 6.005(c), establishes that the Finance Director should supervise the internal controls and tasks related with the fund accounting, transactions and other related financial matters.

#### Cause:

- At June 30, 2006, the Municipality maintained in the SAP System an account denominated *Clearing Account*, which is used basically to account differences found in the recording of journal entries that affect balance sheet accounts, including inter-fund transactions. However, the transactions recorded in the *Clearing Account* are not clearly identified in the SAP System and the Municipality depends on the use of manual accounting records and electronic spreadsheets to obtain more accurate information regarding the funds.
- There are no periodic reconciliation procedures between the information accounted in SAP System regarding inter-fund balances.
- Certain audit adjustments of prior year audit were not posted in the general ledger of non major governmental funds.

#### Effect:

The balances in the SAP System of the balance sheet accounts already mentioned were not updated at June 30, 2006. Because of the *Clearing Account* design limitations, the Municipality has to maintain manual accounting records and electronic spreadsheets for each individual fund to ensure that the specific activities are carried and the objectives are attained in accordance with special regulations, restrictions, or limitations of such transactions. Also, these situations caused the proposal of audit adjustments in order to obtain reasonable assurance about amounts reported in the financial statements.

Recommendation:

We suggest that the Municipality's Finance Department performs monthly monitoring procedures over the status of the inter-fund transactions. A matrix listing the receivable funds on the left and the payable funds across the top can be useful for monitoring the status of the inter-fund transactions.

An example of such a matrix is as follows:

**INTERFUND TRANSACTION MATRIX**

<i>Receivable Funds</i>	<i>Payable Funds</i>				<i>Total</i>
	<i>Major Fund 1</i>	<i>Major Fund 2</i>	<i>Major Fund 3</i>	<i>Major Fund 4</i>	
Major Fund 1	XXX		5,000	5,000	10,000
Major Fund 2	25,000	XXX	15,000		40,000
Major Fund 3		10,000	XXX	10,000	20,000
Major Fund 4			5,000	XXX	5,000
Total	25,000	10,000	25,000	15,000	75,000

Funds reading across are amounts due from each of the Payable Funds listed at the top. Funds reading down owe amounts to the Receivable Funds listed on the left. At the end of the month, all inter-fund accounts should be verified against the matrix to determine whether they are still in agreement.

Also, we recommend the implementation of a formal procedure of processing, reporting and reporting the inter-fund loans, in order to maintain an updated tie-in between inter-fund balances.

Finally, all audit adjustments should be posted on a timely basis in the corresponding accounting records.

### SECTION 3 – FEDERAL AWARDS FINDING

#### Finding 2006-2

Program CFDA No. / Grant No.:	17.258 Workforce Investment Act-Adult 17.259 Program, Youth Activities and 17.260 Dislocated Worker Pass-through the Puerto Rico Department of Labor
Type of Reportable Condition:	Material Non-compliance – Reporting
Questioned Cost:	None

#### Conditions:

The Finance Director of AMOE prepares on a monthly basis all bank reconciliations related to the following accounts:

- 3003571210            WIA cash account
- 013-22-3364        Operating regular cash account
- 013-33-0985        Participants cash account
- 013-22-3356        Payroll employee cash account

Nonetheless, she has not submitted to the Council of Occupational Development and Human Resources (the Council) the bank reconciliations for the period of July 2005 through May 2006.

#### Criteria:

The contract between the Council and AMOE establishes the following:

"QUINTA: Informes y Expedientes....

*B. LA SEGUNDA PARTE someterá al CONSEJO los informes fiscales que se especifican más adelante.....*

*3. Informes Mensuales de Reconciliaciones Bancarias"*

#### Cause:

The Finance Director has not submitted to the Council these bank reconciliations given that the Finance Director has never received any advice of the Council advising of this requirement.

#### Effect:

This situation causes that the Council can not corroborate if the balances presented in the "Informe de Flujo de Efectivo" are accurate.

#### Recommendations:

We recommend to the Finance Director of AMOE to submit monthly to the Council all the bank reconciliations for all bank accounts and those for months for the prior fiscal year.

Views of responsible officials:

The CDORH contract does not require that bank reconciliations are submitted to them on a monthly basis. CDORH requires submitting bank reconciliation corresponding to the end of the fiscal year.

Auditor's Response:

We differ with AMOE's management response because the requirement for submission of monthly bank accounts reconciliations was established in the Delegation of funds contract between AMOE and CODRH. Contract agreement between CODRH and AMOE clearly states in its fifth clause that AMOE should send copy of monthly bank reconciliations to the Council.

### Finding 2006-3

Program CFDA No. / Grant No.:	14.248 Loan Guarantees (89 and 98) 14.239 Home Investment Partnership Program
Type of Reportable Condition:	Material Non-compliance – Davis Bacon Act Material Weakness
Questioned Cost:	None

Conditions:

The Municipality does not provide follow-up to the contractors of construction projects for the timely submission of required certified payrolls.

Criteria:

Compliance requirement establishes the following: "When required by the Davis Bacon Act, the Department of Labor's (DOL) government wide implementation of the Davis-Bacon Act, or by the Federal program legislation, all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (40 USC 267a to 267a-7).

Cause:

The Municipality's Office for Equal Opportunities and Internal Affairs does not maintain an up to date detail of the contractors and as a result of this matter there are various payrolls not reviewed since this Office was unaware of the progress or status of those construction projects.

Effect:

This condition results in a failure to comply with Davis Bacon Act requirements.

Recommendations:

We recommend that the Municipality to implement controls to ensure that contractors submit the required weekly certified payrolls.

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END FINDING NO. 2006-3

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**REPORT ON THE STATUS OF UNCORRECTED MATERIAL  
FINDINGS AND RECOMMENDATIONS  
FROM PRIOR AUDITS THAT AFFECT THE FINANCIAL  
STATEMENT AUDITS AS REQUIRED BY GOVERNMENT  
AUDITING STANDARDS**

**Finding 2004-1**

**Condition:**

At June 30, 2004 the balances of inter-fund receivables, payables, deferred revenues, and fund balances in the SAP System were not reconciled with their subsidiaries.

**Audit Finding Status:**

Condition was partially corrected regarding the deferred revenues, but it prevails in terms of inter-fund loans and beginning fund balances (refer to audit finding 2006-1).

## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS AS REQUIRED BY OMB CIRCULAR A-133

### **Finding 2005-3**

#### Condition:

During our audit of the Head Start Program's participant files, one (1) Head Start participant's file of a sample of twenty-nine (29) did not include allowable evidence of family income as required by federal regulations. File included a certification signed by the parent/guardian stating the family income. According to said certification, participants' family income was below the HHS 2004 and 2005 Poverty Guidelines.

#### Audit Finding Status

Corrective action was taken.

### **Finding 2005-2 (First reported as finding 2004-2)**

#### Condition:

The capital assets subsidiary maintained by Home Investment Partnership and Section 8 Housing Choice Voucher Programs did not include the acquisition date, cost of the units, and who holds title.

#### Audit Finding Status

Corrective action was taken.

### **Finding 2004-2**

#### Condition:

The property subsidiary maintained by the Child Care Programs does not include the acquisition date of the units.

#### Audit Finding Status

Corrective action was taken.

# SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

*Fiscal Year Ended June 30, 2006*

<u>Federal Grantor</u>	<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
US Department of Agriculture	Child Care Food Program Pass-through the Puerto Rico Department of Education	10.588	\$ 630,916
	Nutrition Program for the Elderly	10.570	57,374
US Department of Justice	Edward Byrne Formula Grant Pass-through the Puerto Rico Department of Justice	16.579	304,651
US Department of Health and Human Services	Head Start and Early Head Start	93.600	6,733,745
	Child Care Block Grant Pass-through the Puerto Rico Department of the Family	93.575	925,167
	Elderly Commission-Special Program for Aging (Title III Part B)	93.045	167,457
US Department of Housing and Urban Development	Community Development Block Grant	14.218	2,545,959
	Emergency Shelter Grant	14.231	270,036
	Home Investment Partnership Program	14.239	2,121,242
	Section 8 Housing Choice Vouchers	14.871	3,241,387
	Loan Guarantees (89,92 & 99)	14.248	2,345,091
	Public and Indian Housing Pass-Through the Puerto Rico Public Housing Administration	14.850	601,377
	Housing Opportunities for Person with AIDS (Hopwa)	14.241	51,847
US Department of Transportation	Highway Planning and Construction (Federal Aid Highway Program) Pass-through the Puerto Rico Highway and Transportation Authority	20.205	389,200
US Department of Labor	Workforce Investment Act- Adult Program Pass-through the Puerto Rico Department of Labor	17.258	1,253,618
	Workforce Investment Act- Youth Activities Pass-through the Puerto Rico Department of Labor	17.259	1,352,897
	Workforce Investment Act- Dislocated Worker Pass-through the Puerto Rico Department of Labor	17.260	760,746
<b>Total Expenditures</b>			<b>\$23,752,710</b>

## NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

*Fiscal Year Ended June 30, 2006*

### **NOTE 1 - GENERAL**

The accompanying schedule of expenditures of federal awards presents the expenditures, for the fiscal year ended June 30, 2006, of all the federal assisted programs of the Municipality of Carolina.

### **NOTE 2 - ACCOUNTING BASIS**

The schedule was prepared following the modified accrual basis of accounting, which is further explained in note 1 of the basic financial statements of the Municipality of Carolina for the fiscal year ended June 30, 2006.

## CORRECTIVE ACTION PLAN

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Contact Persons:	Mr. Edwin Lebrón González - Director of Finance Daniel Redón, CPA – Director of Internal Audit
Phone number:	(787) 757-2626 extension 410
Fax:	(787) 276-0735

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The Corrective Action Plan was prepared by the Municipality's management and is included separately of this document.

COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF CAROLINA  
P.O. BOX 8  
CAROLINA, PUERTO RICO 00986-008



**SINGLE AUDIT 2006  
CORRECTIVE ACTION PLAN**



*José E. Aponte Torre De La Torre*  
*Mayor*

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December 29, 2006

Bureau of the Census  
Single Audit Clearinghouse  
1201 E. 10th St.  
Jefferson Ville, IN 47132

**Single Audit Report of the Municipality of Carolina for the year ended  
June 30, 2006**

The following are the Financial Statement under the new format prescribed by the provision of Government Accounting Standard Board Statement 34 (GASB 34) and the Single Audit Package, that represent the Single Audit Report of the Municipality of Carolina for the year ended June 30, 2006 as required by the Single Audit Act of 1984, as amended. The following reports are included:

- a. Data Collection Form
- b. Four (4) copies of the Single Audit Report, including the Schedule of Federal Awards
- c. Current year Corrective Action Plan

If you have any question about the Single Audit Report or need further information, contact the Municipality's Finance Director, Mr. Edwin Lebrón González, or Internal Auditor Director, Mr. Daniel Redón Santiago, at (787) 757-2626 ext. 490 or 361, respectively or addressed to: Municipality of Carolina, Office of the Mayor, P.O. Box 8, Carolina, P.R. 00986-0008.

Cordially,

  
José E. Aponte De La Torre  
Mayor

**COMMONWEALTH OF PUERTO RICO**  
**Municipality of Carolina**  
**Single Audit for the year ended June 30, 2006**  
**Executive Summary**

**About the Single Audit**

The Municipality of Carolina ("Municipality") participates in series of federal financial assistance programs to address the necessities of its growing population of more than 200,000 residents. These programs have been audited according to the Single Audit Act of 1984, as amended, and the US Office of Management and Budget (OMB) Circular A-133. The Municipality has the following major and non-major programs to assist the needs of low-income and moderate-income citizens according to the federal grantors.

**Federal Grantor**

**US Department of Housing and Urban Development**

- Community Development Block Grant Program (CDBG), Entitlement Grant and Loan Guarantee
- Section 8- Housing Assistance Payments Program for Low- Income Families
- Housing Opportunities for Persons with Aids (HOPWA)
- HOME Investment Partnership Program
- Emergency Shelter Grant Program (ESG)
- Public and Indian Housing

**US Department of Health and Human Services**

- Head Start and Early Head Start Program
- Special Program for Elderly
- Child Care Development Block Grant

**US Department of Agriculture**

- Nutrition Program for Elderly
- Child and Adults Care Food Program
- Community Facilities Loans and Grants

**US Department of Justice**

- Byrne Formula Grant Program ( Victims of Crime Act)

**US Department of Labor**

- Workforce Investment Act

**US Department of Transportation**

- Highway Planning and Construction

**COMMONWEALTH OF PUERTO RICO**  
**Municipality of Carolina**  
**Single Audit for the year ended June 30, 2006**  
**Executive Summary**

These programs were audited by Pannell Kerr Forster, LLP, an independent firm of certified public accountants. The audit is a requirement described in the OMB Circular A-133 that are applicable to each of the major federal programs for the year ended June 30, 2006.

The audit was performed for the purpose of forming an opinion on the Municipality's basic financial statement under the provision of GASB Statement 34 taken as a whole.

Auditors, examined on a test basis evidence about the Municipal's compliance with those requirements. According to the Summary of Auditor's Results, the internal controls over the major programs did not identify material weakness.

In their examination, the auditors have detected some findings, which were discussed with the corresponding program officials. The Municipality has made the proper corrective action plan in order to comply with the recommendations of auditors and with federal regulation and procedures.

**Development of the Single Audit**

The audit of the programs followed various steps to obtain proper responses from the Municipality Management.

- ❖ External auditors examined selected programs and cases at random to identify if the Municipality had complied with federal statute and regulations and had made correct use of funds according to norms, regulations and accepted accounting principles.
- ❖ Information and data was requested to Municipality officials to sustain the different accounting transactions, fund balances and allocations.
- ❖ A preliminary draft containing the supposed finding was remitted to the program officials for a management response.
- ❖ After receiving a management response an alleged finding, auditors cleared our upheld the finding. A management draft of finding was remitted to municipal officers.
- ❖ Municipal officer met with auditors to discuss finding and elaborated a management response.
- ❖ The audit report, management response and corrective action plan are submitted to federal authorities.

**COMMONWEALTH OF PUERTO RICO**  
**Municipality of Carolina**  
**Single Audit for the year ended June 30, 2006**  
**Executive Summary**

**Corrective Action Plan**

In order to comply with federal regulations, the Municipality has the challenge to continue improvement the internal controls for the compliance with the regulations and laws.

**Comments to the Single Audit for the year ended in June 30, 2006**

The Municipality has made a corrective action plan for the Single Audit Report of the year ended on June 30, 2006. Enclose find the corrective action plan consisting of finding, management response and corrective action plan.

**Municipality of Carolina  
Financial Statement Findings  
Single Audit for the year June 30, 2006  
Corrective Action Plan**

<b>Finding</b>	<b>Management Response</b>	<b>Corrective Action Plan</b>
<p><b>Section 2- Financial Statement Finding</b></p> <p>Finding 2006-1</p> <p><b><u>Condition:</u></b></p> <p>At June 30, 2006 the balances of inter-funds loans and beginning fund balances of non-major governmental funds in the Accounting System (SAP System) were not reconciled with their subsidiaries.</p> <p><b><u>Criteria:</u></b></p> <p>The Governmental Accounting Standards Board Codification, Section 1300.110 establishes the following:</p> <p>“.....because each fund is a fiscal and accounting entity, the amounts due to one fund from other funds, as well as the amounts owed to other funds, should be reflected in the fund accounts and in fund financial statements”.</p> <p>Also, Puerto Rico Municipality Law (Law 81), article number 6.005 (c), establishes that the Finance Director should supervise the internal controls and tasks related with the fund accounting, transactions and other related financial matters.</p>	<p>Actually the Municipality of Carolina is updating the Accounting System. We are expecting that during the year 2007 all inter-funds loans and non-major governmental fund balance be reconciled with their subsidiaries.</p>	<p>Instructions were given to the Supervisor of the accounting area to verify and reconciled all the financials accounts balances.</p> <p>Also, monthly monitoring procedures reporting inter-funds transactions will be implemented, in order to maintain adequate accounting system.</p>

**Municipality of Carolina  
Federal Award Findings  
Single Audit for the year June 30, 2005  
Corrective Action Plan**

<b>Finding</b>	<b>Management Response</b>	<b>Corrective Action Plan</b>
<p><b>Section 3- Federal Award Findings</b></p> <p>Finding 2006-2</p> <p><b><u>Condition:</u></b></p> <p>The Finance Director of AMOE (Workforce Investment Services Delivery Area) has not submitted to the Council of Occupational Development and Human Resources (Pass-Through Agency) the bank reconciliations for the period of July 2005 through May 2006.</p> <p><b><u>Criteria:</u></b></p> <p>The contract award agreement between the Council of Occupational Development and Human Resources and AMOE established the following:</p> <p>Fifth clause : Financial Reports</p> <p>B. AMOE should send copy of monthly bank Reconciliations to the Council of Occupational Development and Human Resources.</p>	<p>The Finance Director of AMOE prepares on a monthly basis all bank reconciliations related to WIA funds. The Council of Occupational Development and Human Resources Financial Guidance require submitting bank reconciliation corresponding to the end of the fiscal year.</p>	<p>Instructions were given to Program Finance Officials for send copy of monthly bank reconciliations to the Council of Occupational development and Human Resources on a timely basis in accordance with the contract award agreement.</p>

**Municipality of Carolina  
Federal Award Findings  
Single Audit for the year June 30, 2006  
Corrective Action Plan**

Finding	Management Response	Corrective Action Plan
<p><b>Section 3- Federal Award Finding</b></p> <p>Finding 2006-3</p> <p><b><u>Condition:</u></b></p> <p>The Municipality does not provide follow-up to the contractors of construction projects for the timely submission of required certified payrolls.</p> <p><b><u>Criteria:</u></b></p> <p>Compliance requirement establish the following:            "When required by the Davis Bacon Act, the Department of Labor's (DOL) government wide implementation of the David Bacon Act, or by the Federal program legislation, all laborers and mechanism employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by the Federal Assistance funds must be paid wages not less than those established for the locality of the project (prevailing age rates) by the DOL (40 USC 267a to 267a-7).</p>	<p>Instructions were given to the Municipality's CDBG Program Officials and Equal Opportunities workers about the importance to assure that contractors of projects submit the weekly certified payrolls and to verify the wages paid to all laborers in accordance with the DOL federal regulations.</p>	<p>We will take the necessary steps to assure that all construction projects records are fully documented according to federal requirements. A monitoring process of the records will be made, after the submission of weekly certified payrolls, to assure their compliance and to correct the findings.</p>