

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE CAROLINA

AUDITORIA 2006-2007

30 DE JUNIO DE 2007

OFICINA DEL COMISIONADO
DE ASUNTOS MUNICIPALES

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA**

FINANCIAL STATEMENTS
(with Independent Auditor's Report Thereon)

**FISCAL YEAR ENDED
JUNE 30, 2007**

3/31/08

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Commonwealth of Puerto Rico, Municipality of Carolina as of and for the fiscal years ended June 30, 2007 and 2006, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining governmental fund information of the Commonwealth of Puerto Rico, Municipality of Carolina, as of June 30, 2007 and 2006, and the respective changes in financial position, where applicable, thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.



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To the Honorable Mayor and
Members of the Municipal Legislature
Commonwealth of Puerto Rico
Municipality of Carolina
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In accordance with Government Auditing Standards, we have also issued our report dated December 1, 2007 on our consideration of the Municipality's internal control over financial reporting and on 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, as listed in the table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted 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.



PKF,LLP

License No. 22
Expires December 1, 2007

December 1, 2007
San Juan, Puerto Rico

Oficina del Alcalde

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal Year Ended June 30, 2007

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, 2007 and 2006. 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 additional information that is furnished in the Municipality's basic financial statements, which follow this narrative.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's assets exceeded its liabilities (net assets) by \$1,704 million at June 30, 2007, for an increase of \$47 million (3%) as compared with last fiscal year. Of this amount \$18.3 million are unrestricted. Net assets may be used to meet the Municipality's current operations.
- The Municipality's assets increased from \$1,979 million at June 30, 2006 to \$2,060 million at June 30, 2007, for an increase of \$81 million (4%). The liabilities of the Municipality increased from \$321.3 million at June 30, 2006 to \$355.6 million at June 30, 2007, for an increase of \$34.3 million (10%).
- The Municipality's net assets increased by \$45.8 million (excess of revenues over expenses) during the fiscal year ended June 30, 2007. This amount represents an increase of \$14 million (32%) as compared with previous fiscal year.
- The total revenues of the Municipality increased from \$165.6 million for the fiscal year ended June 30, 2006 to \$207.9 million for the fiscal year ended June 30, 2007, for an increase of \$42.3 million (20%). The Municipality's expenses increased from \$133.8 million for the fiscal year ended June 30, 2006 to \$162 million for the fiscal year ended June 30, 2007, for an increase of \$28.2 million (17%).

Governmental Funds Highlights:

- The Municipality's total fund balance of governmental funds amounted to \$202.9 million at June 30, 2007, for an increase of \$15 million (7%). Of this amount \$10.8 million are available for spending in financial activities and providing services to citizens (unreserved fund balances).
- The total assets of governmental funds increased from \$280.9 million at June 30, 2006 to \$307.2 million at June 30, 2007, for an increase of \$26.3 million (9%). The governmental fund's total liabilities increased from \$93.1 million at June 30, 2006 to \$104.3 million at June 30, 2007, for an increase of \$11.2 million (11%).
- The governmental funds revenues of the Municipality increased from \$163.9 million for the fiscal year ended June 30, 2006 to \$212.1 million for the fiscal year ended June 30, 2007, for an increase of \$48.2 million (23%). The governmental fund's expenditures increased from \$194.1 million for the fiscal year ended June 30, 2006 to \$234.1 million for the fiscal year ended June 30, 2007, for an increase of \$40 million (17%).
- Other financing sources (uses), net of governmental funds, decreased from \$37.4 million for the fiscal year ended June 30, 2006 to \$36.2 million for the fiscal year ended June 30, 2007, for a decrease of \$1.2 million (3%).
- The Municipality's General Fund (the primary operating fund) reflected a fund balance of \$50.1 million at June 30, 2007, an increase of \$533,607 as compared with previous fiscal year.
- The total governmental fund cash recorded was \$254.8 million, an increase of \$24.9 million (10%) as compared with last fiscal year.
- The Municipality's loans principal and interest expenditures were \$28.3 and \$24.1 million, for fiscal year ended June 30, 2007 and 2006, respectively.

Overview of the Basic Financial Statements

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, 2007. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

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. These components are described below.

The basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental funds. Both perspectives allow the users to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements 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, 2007. The GWFS are composed of: 1) statement of net assets (SNA) and 2) statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to those used by most private business.

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 purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. 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. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality.

1. Statement of Net Assets (Continuation)

On the other hand, the Municipality reports liabilities, such as claims and judgments or municipal solid waste landfill closure and post-closure care costs, even though these liabilities might not be paid until several fiscal years into the future.

The difference between the Municipality's total assets and total liabilities reported in SNA is presented as *net assets*, which is similar to the total owners' equity reported by a commercial enterprise in its financial statements. Although the purpose of the Municipality is not to accumulate net assets, as this amount increases or decreases over time, such amount represents a useful indicator of whether the financial position of the Municipality is either improving or deteriorating, respectively.

2. Statement of Activities

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2007, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

Although SA looks different from a commercial enterprise's income statement, the difference is only in format, not substance. Whereas the bottom line in a commercial enterprise represents its net income, the Municipality reports an amount described as *net change in net assets*, which is essentially the same concept.

The focus of SA is on the *net cost* of various activities provided by the Municipality. The statement begins with a column that identifies the cost of each of the Municipality's major functions. Another column identifies the revenues that are specifically related to the classified governmental functions. The difference between the expenses and revenues related to specific functions/programs identifies the extent to which each function of the Municipality draws from general revenues or is self-financing through fees, intergovernmental aid and other sources of resources. This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

GWFS and GFFS present all of the Municipality's governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions).

2. Statement of Activities (Continuation)

The SA 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, streets and transportation, solid waste disposal and sanitation, recreation and sports, education, public housing and building, welfare, health, economic development activities, employment opportunities and general government services. This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

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. 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 governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The major governmental funds presentation provides detailed information about the most significant funds, not the Municipality as a whole. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with financial related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions. 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.

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.

b) Governmental Fund Financial Statements (Continuation)

Governmental funds are used to account for all of the services provided by the Municipality. These funds are used to account for essentially the same functions reported as governmental activities in the GWFS.

Unlike GWFS, the focus of GFFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, GFFS report the Municipality's operations in more detail than the GWFS.

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.

For financial reporting purposes, the Municipality classifies its governmental funds as: general fund, debt service fund, capital project fund, economic development fund and workforce investment act fund.

GFFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. 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. For example, amounts reported on the balance sheet include capital assets within a very short period, but do not include capital assets such as land and buildings. 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. The difference between a fund's total assets and total liabilities is reported as the fund balance and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for governmental funds reports only those revenues and expenditures that were collected in cash or paid with cash, respectively, during the current fiscal year or very shortly after the end of the fiscal year.

Because the focus of GFFS is narrower than that of the GWFS, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the GWFS. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and the governmental activities reported in the government-wide financial statements.

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 Government Wide Financial Statements begin on page 27. The Municipality's Fund Financial Statements begin on page 30.

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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.

Comparative Condensed Statement of Net Assets Government Activities

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Assets:		
Current assets	\$ 290,834,334	266,607,340
Noncurrent assets:		
Capital assets, net	1,768,379,801	1,711,734,295
Other noncurrent assets	<u>367,391</u>	<u>167,868</u>
Total assets	<u>\$ 2,059,581,526</u>	<u>1,978,509,503</u>
Liabilities:		
Current liabilities	\$ 73,091,745	60,744,533
Long-term obligations due within one year	19,112,631	16,857,580
Long-term obligations due after one year	<u>263,424,199</u>	<u>243,734,573</u>
Total liabilities	<u>\$ 355,628,575</u>	<u>321,336,686</u>
Net assets:		
Invested in capital assets, net related debt	\$ 1,590,987,704	1,512,660,125
Restricted	94,695,533	121,021,627
Unrestricted	<u>18,269,714</u>	<u>23,491,065</u>
Total net assets	<u>\$ 1,703,952,951</u>	<u>1,657,172,817</u>

At June 30, 2007, the Municipality's current assets amounting to \$290,834,334 are mainly composed of unrestricted cash and certificates of deposits (\$123.5 million) and restricted cash (\$131.4 million), federal grants receivables (\$13 million) and governmental agencies receivables (\$8.4 million).

The restricted cash represents legally designated for: (1) payments of debt service, (2) the acquisition, construction and improvement of major capital assets and (3) the operations of federally and state funded programs.

Restricted cash also consists of unspent proceeds of bonds issued to pay accounts payable and certain specific commitments. The short-term investments in certificates of deposit are unrestricted and available to meet operational needs and obligations with citizens and creditors. Restricted property taxes receivable represent resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's noncurrent assets, amounting to \$1,768.4 million as of June 30, 2007 are mainly composed of capital assets, with a cost basis of \$1,837.4 million, which are reported net of accumulated depreciation and amortization of \$69.0 million.

At the end of the current fiscal year, the Municipality's current liabilities amounting to \$92.2 million are substantially composed of deferred volume of business taxes (\$27.8 million), deferred federal revenues (\$16.5 million), the portions due within one year of bonds payable (\$12.8 million) and accounts payables and accrued liabilities (\$16.9). As noted in the condensed statements of net assets, the Municipality's current assets exceeded current liabilities by \$198.6 million, for a current ratio of 3.0 to 3.5.

The Municipality's noncurrent liabilities, amounting to \$263.4 million at June 30, 2007, are mainly composed of portions due after one year of bonds and notes payable (\$228.6 million), compensated absences (\$12.2 million), interest due for account sold (\$7.6 million), governmental agencies payables (\$4.1 million) and estimated liability for the municipal solid waste landfill closure and post closure care costs (\$4.9 million).

The Municipality's change in net assets increased by \$45.8 million 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 \$1,591 million, 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, \$94.7 million, represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$18.2 million, 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**

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
<i>Program Revenues:</i>		
General revenues	\$174,018,263	142,472,805
Program revenues	31,869,792	20,891,733
Charges for services	<u>1,974,068</u>	<u>2,220,121</u>
Total Revenues	<u>207,862,123</u>	<u>165,584,659</u>
<i>Expenses:</i>		
Governmental activities functions	<u>162,027,115</u>	<u>133,778,140</u>
Total Expenses	<u>162,027,115</u>	<u>133,778,140</u>
Change in Net Assets	<u>\$ 45,835,008</u>	<u>31,806,519</u>

As mentioned earlier, the Municipality's net assets increased by \$45.8 million (3%) during current fiscal year. The revenues of the Municipality increase from by \$165.6 million for the fiscal year ended June 30, 2006 to \$207.9 million for the fiscal year ended June 30, 2007, for an increase of \$42.3 million or 20%. Of this amount, \$144.2 million (70%) came from property taxes, volume of business taxes, sales taxes and licenses and construction excise taxes, while \$45.7 million (23%) came from capital and operating grants and contributions and \$12 million (6%) came from of interests. Charges for services amounting to \$1.97 million or 1% of the total revenues for the current fiscal year. The most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

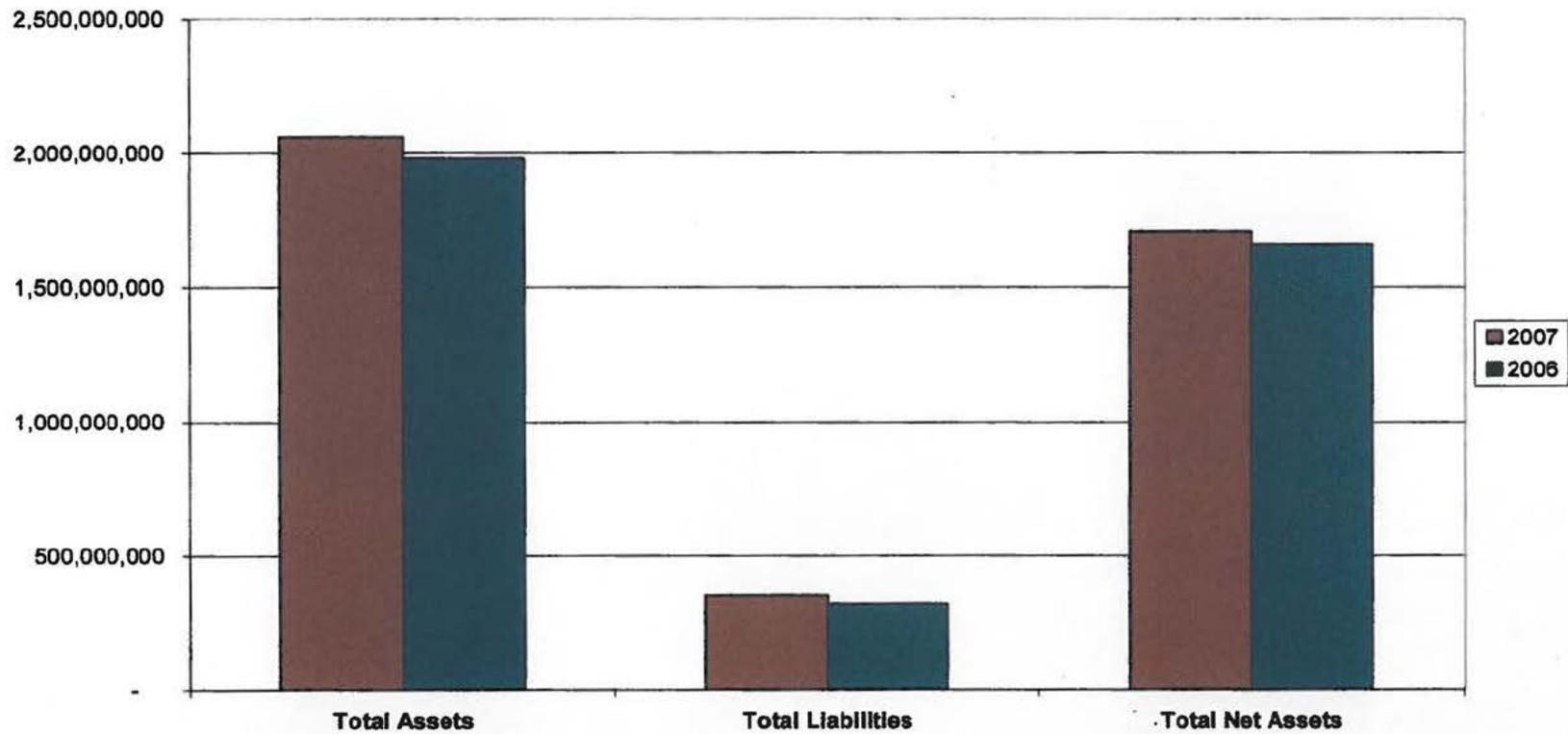
- Sales tax revenues increase by \$24.1 million during the current fiscal year. This new income sources was provided through a new state tax provision approved in accordance with the Tax Fairness Act of 2006. Among its provisions, the Act provides for sales and uses tax of 1% to 1.5% at the municipal level.
- The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2007 were related to general administrating, operating costs and direct services to citizens (\$54.3 million), which were classified as "general government".

- During fiscal year 2006-07, general government expenses increased by \$10 million due to increase in operational costs and direct services to citizens. In addition, sanitation expenses increased by \$7.5 million due to increase in waste disposal services, recycling services and landfill operational costs and other sanitation services.

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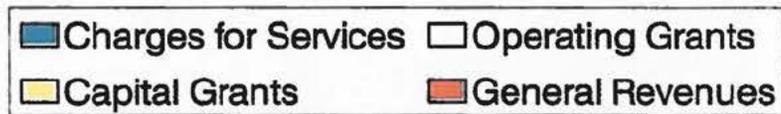
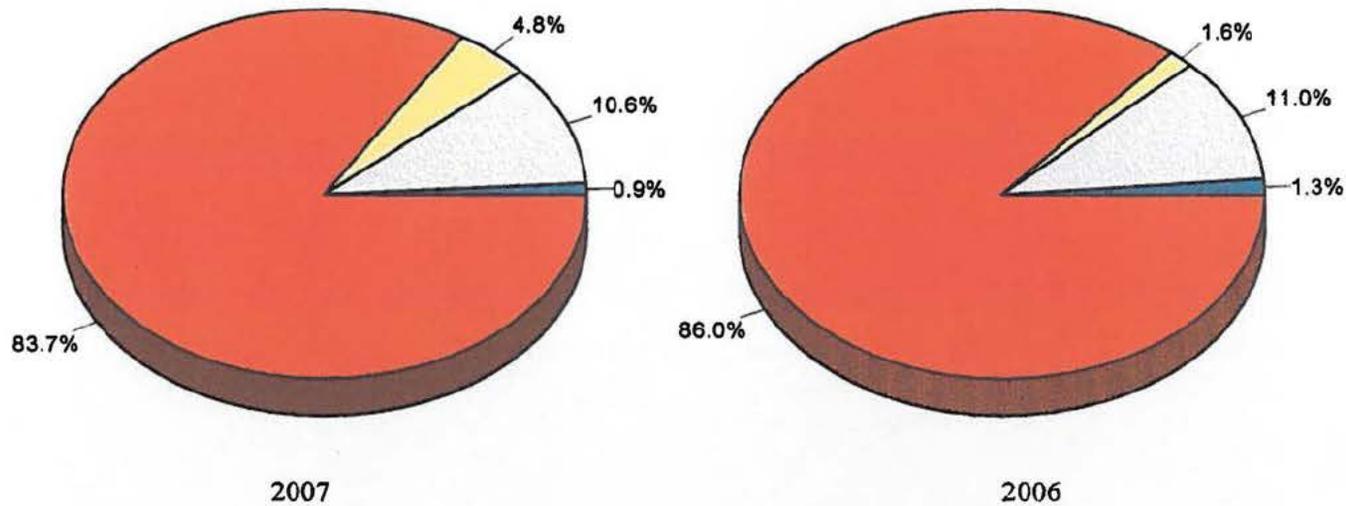


Municipality of Carolina
Comparative Condensed
Statement of Net Assets
June 30, 2007 and 2006



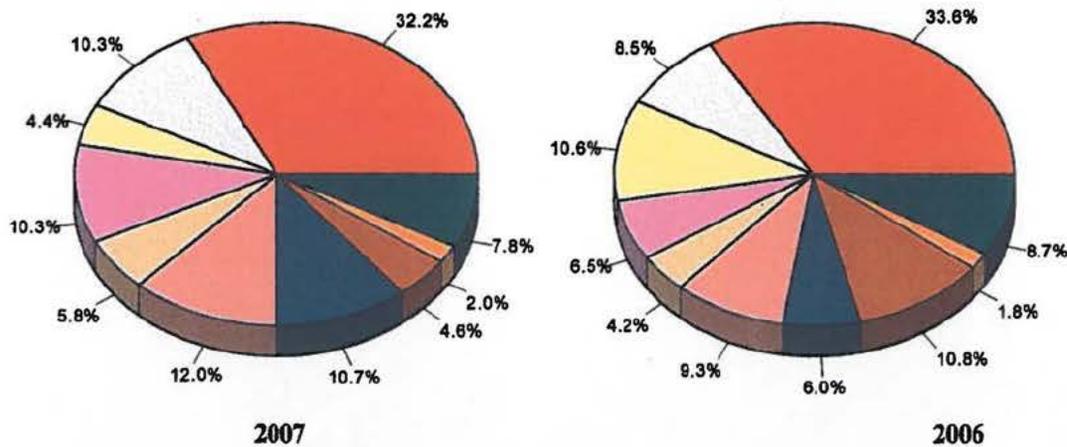


Municipality of Carolina
Statement of Activities
Revenues
June 30, 2007 and 2006





Municipality of Carolina
Statement of Activities
Expenses by Functions / Programs
For the Year Ended June 30, 2007 and 2006



General Government	Public Safety	Public Works and Trans.
Sanitation	Health	Recreation, Education and Welfare
Housing	Economic	Employment Opportunities
Interest		

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 \$202.9 million that is over last year for \$15 million or 7%. The primary reason for the government fund's increase in the current year were sales taxes revenues collected amounting to \$24.1 million and proceeds from new debts issuance amounting to \$36.2 million recorded as other financial sources in the capital projects fund and economic development fund. The following reflects the condensed comparative Combined Balance Sheet:

Comparative Condensed Balance Sheet Governmental Funds

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Assets:		
Total assets – major governmental funds	\$281,762,210	253,381,209
Total assets – other governmental funds	<u>25,483,851</u>	<u>27,538,838</u>
Total assets	<u>307,246,061</u>	<u>280,920,047</u>
Liabilities:		
Total liabilities–major governmental funds	83,867,804	73,261,450
Total liabilities–other governmental funds	<u>20,480,378</u>	<u>19,801,880</u>
Total liabilities	<u>104,348,182</u>	<u>93,063,330</u>
Fund balances:		
Reserved – major governmental funds	187,095,022	171,757,197
Reserved – other governmental funds	5,003,473	8,362,562
Unreserved – major governmental funds	<u>10,799,384</u>	<u>7,736,958</u>
Total fund balances	<u>\$ 202,897,879</u>	<u>187,856,717</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 million), short-term amounts due from other funds (\$14.7 million), volume of business taxes receivables (\$2.9 million) and sales taxes receivables (\$2.1 million). GF's liabilities are composed mainly of deferred volume of business taxes (\$27.8 million), accounts payable and accrued liabilities (\$8.2 million) and due to government's agencies (3.5 million).

Debt Service Fund (DSF) – The DSF's assets consist mainly of restricted cash with fiscal agent (\$42.1 million) and restricted property tax receivable (\$3.2 million). DSF's liabilities are mainly composed of matured bonds and notes payable (\$11.8 million), matured interest due and payable (\$5.7 million) and deferred revenues (\$2.9 million).

Capital Project Fund (CPF) – The CPF's assets are mainly composed of unrestricted and restricted cash (\$119.9 million). CPF's liabilities are mainly composed of short-term loans to other funds (\$7.1 million) and accounts payable (\$6.2 million).

Economic Development Fund (EDF) – The EDF's assets are mainly composed of unrestricted and restricted cash (\$16.5 million) and federal grants receivables (\$5.7 million). EDF's liabilities are mainly composed of deferred federal revenues (\$5.5 million) and short-term loans to other funds (\$1.1 million).

Workforce Investment Act Fund (WIAF) – The WIAF's assets and liabilities consist mainly of federal grants receivables and accounts payables and accrued liabilities (\$405,911), respectively.

Other Governmental Fund (OGF) – The OGF's total assets are mainly composed of unrestricted and restricted cash (\$6.7 million), federal grants receivable (\$7 million) and due from government agencies (\$7.4 million). The OGF's liabilities are principal composed of short and long term loans to other funds (\$6.7 million), deferred federal revenues (\$11.1 million) and accounts payables (\$1.8 million).

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

**Condensed Statement of Revenues, Expenditures and Change
in Fund Balances – Governmental Funds**

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Revenues:		
Total revenues-major governmental funds	\$194,146,737	147,268,028
Total revenues- other governmental funds	<u>17,924,011</u>	<u>16,692,756</u>
Total revenues	<u>212,070,748</u>	<u>163,960,784</u>
Expenditures:		
Total expenditures-major gov. funds	209,751,408	175,521,965
Total expenditures- other gov. funds	<u>24,394,694</u>	<u>18,602,788</u>
Total expenditures	<u>234,146,102</u>	<u>194,124,753</u>
<i>Other financial sources, net:</i>		
Other financing sources, net - major	36,171,390	37,400,000
Operating transfer in, net - major	31,473,883	21,317,138
Operating transfer in, net - other	3,619,129	987,120
Operating transfer out, net - major	(34,938,074)	(22,304,258)
Operating transfer out, net - other	<u>(154,938)</u>	<u>-</u>
Total other financing sources, net	<u>36,171,390</u>	<u>37,400,000</u>
Excess of revenues and other financing sources (uses) over expenditures	\$ <u>14,096,036</u>	<u>7,236,031</u>

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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 (\$52 million), municipal volume business tax (\$32.2 million), sales taxes (\$24.1 million), construction tax and permits (\$11.2 million), intergovernmental grants (\$16.4 million) and interest income (\$10.6 million). The GF's most significant variation as compared with prior year revenues was the inclusion of sales taxes revenues amounting \$24.1 million. The GF's expenditures amounting to \$123 million for the fiscal year ended June 30, 2007. The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the sanitation expenditures, which increased by \$3.6 million due to increase in operational costs of landfill and waste disposal services and housing and buildings expenditures increased by \$5.7 million due to increase in housing projects and acquisitions or improvements to municipal facilities.

Debt Service Fund (DSF) – The DSF's revenues consist mainly of restricted property taxes (\$24.7 million) and operating transfer in for debt payment (\$5.6 million). The DSF's expenditures consist mainly of matured principal and interest payments on loans (\$28.3 million).

Capital Project Fund (CPF) – The CPF's revenues are mainly composed of intergovernmental grants (\$9 million) and proceeds from debt issuance (\$31.2 million). The CPF's expenditures increased from \$29 million for the fiscal year ended June 30, 2006 to \$50.8 million for the fiscal year ended June 30, 2007. 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 (\$4.8 million), proceeds from federal loan guarantee (\$5 million) and economic development project's expenditures (\$4.2 million).

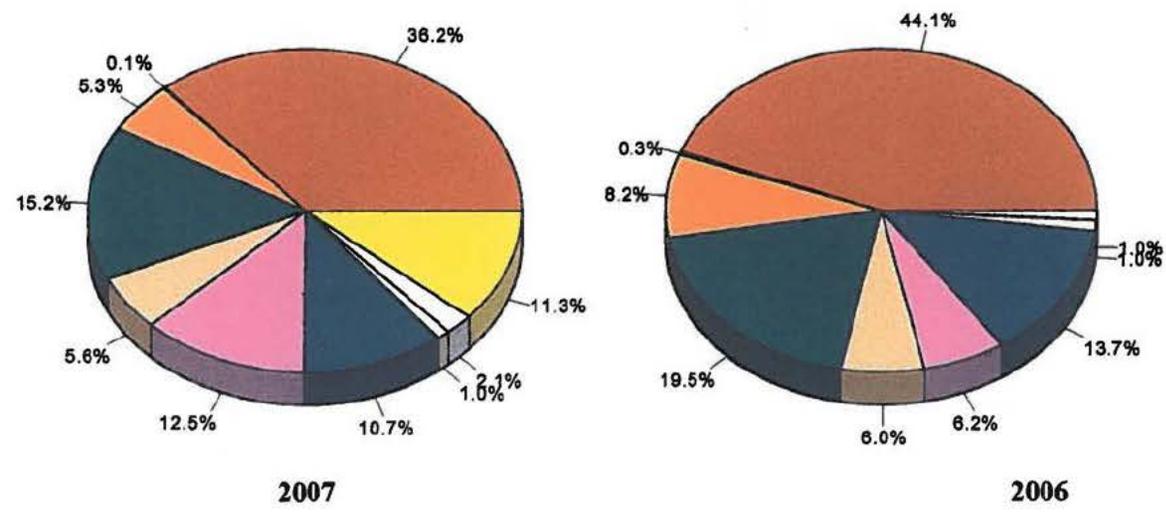
Workforce Investment Act Fund (WIAF) – The WIAF's revenues and expenditures consist mainly of federal grants and direct benefits to citizens (\$3.2 million) in employment opportunities.

Other Governmental Fund (OGF) – The OGF's total revenues are mainly composed of federal grants (\$14.7 million). The OGF's total expenditures are mainly composed of education (\$7.6 million), housing projects (\$8.4 million) and recreation and sports (\$2.6 million).

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Municipality of Carolina
 Governmental Fund
 Combined Statement of Revenues
 For the Year Ended June 30, 2007 and 2006



Property Tax	Landfill	Licenses, Permits
Volume of Business	Interest Income	Intergovernmental
Federal Grants	Rent	Other
Sales tax		

Debt Administration

As of June 30, 2007, the Municipality had a total long-term debt outstanding of \$228,644,536 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:

	<u>2007</u>	<u>2006</u>
General obligations bonds	\$214,599,536	195,019,870
Federal loans and notes	<u>14,045,000</u>	<u>10,010,000</u>
Totals	<u>\$228,644,536</u>	<u>205,029,870</u>

The Municipality's total debt increased by \$36.2 million during fiscal year 2006-07, due to the fact of proceeds from debt issuance and federal loan guarantee 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 general obligation bonds is approximately \$225,327,721.

Additional information on the Municipality's long-term debts can be found in Note 8 of the Basic Financial Statements.

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BUDGETARY HIGHLIGHTS:

- The original budget of the general fund (operating fund) for the fiscal year ended June 30, 2007 amounted to \$93.9 million. 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 \$28,727,069 in total budgeted revenues, to reach the total revised budget amount of \$122,615,801 in the General Fund. Of this amount \$11,367,265 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 increase of financial resources, the Municipality's Legislature revised continuously the Municipality's budget several times increasing the total original budget. The total Municipality's revised budget for fiscal year ended June 30, 2007 and 2006 amounted to \$290.7 and \$291.5 million, respectively.
- During fiscal year 2006-07, expenditures from general fund showed a favorable variance of \$11.9 million, 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 (\$11.4 million) less than current year revenues collected over budgeted amounts.

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 in streets and transportation infrastructure, solid waste disposal and sanitation, education and training, public safety, public housing, health, welfare, community and economic development, employment opportunities, recreation and sports, culture and other administrative services.

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The Municipality's principal sources of revenue are property taxes, municipal license taxes, sales 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.

The Municipality has an unemployment rate of 10%, which lower than the state average of 12.8% as of June 30, 2007.

The Municipality's Original Budget for fiscal year 2007-2008 was \$275.8 million that are \$13.8 million over previous fiscal year (2006-07).

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Statements of Net Assets

	June 30	
	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 123,447,007	\$ 91,641,986
Cash with fiscal agent	131,388,038	138,251,305
Volume of business tax receivable	2,855,204	3,127,807
Sales taxes receivable	2,194,829	-
Due from other governments	8,429,505	9,154,564
Federal grants receivable	12,994,218	18,668,358
Interest receivable	757,800	882,876
Property taxes receivable	4,029,490	3,642,904
Other receivables	4,738,243	1,237,540
Total current assets	290,834,334	266,607,340
Noncurrent assets:		
Capital assets, net	1,768,379,801	1,711,734,295
Bond issue costs	367,391	167,868
Total noncurrent assets	1,768,747,192	1,711,902,163
Total assets	2,059,581,526	1,978,509,503
LIABILITIES		
Current liabilities:		
Bonds and notes payable	12,813,200	14,526,147
Capital lease obligations	4,842,288	956,583
Accounts payable and accrued liabilities	16,917,761	12,682,423
Accrued legal claims	20,560	6,170
Accrued compensated absences	534,620	500,000
Interest payable	5,676,810	4,935,024
Due to other governments	4,206,687	2,073,868
LIMS refinancing debt	584,483	551,200
Interest due for accounts sold	317,480	317,480
Due to Federal Agency	-	727,535
Deferred volume of business taxes	27,757,142	26,534,043
Deferred federal revenue	16,527,434	11,993,836
Other deferred revenues	2,005,911	1,797,804
Total current liabilities	92,204,376	77,602,113

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Statements of Net Assets (continued)

	June 30	
	2007	2006
Noncurrent liabilities, net of current portions:		
Bonds and notes payable	228,644,536	205,029,870
Capital lease obligations	-	3,915,807
Landfill obligations	4,910,456	3,776,286
Due to other governments	4,096,683	4,167,938
LIMS refinancing debt	2,337,937	2,922,419
Interest due for accounts sold	7,619,577	7,909,828
Accrued legal claims	3,626,750	4,101,830
Accrued compensated absences	12,188,260	11,910,595
Total noncurrent liabilities	263,424,199	243,734,573
Total liabilities	355,628,575	321,336,686
NET ASSETS		
Invested in capital assets, net of related debt	1,590,987,704	1,512,660,125
Restricted for:		
Economic development projects	15,569,191	10,124,624
Capital projects	51,677,501	78,065,977
Debt service	27,261,864	25,094,068
Other purposes	186,977	7,736,958
Unrestricted	18,269,714	23,491,065
Total net assets	\$ 1,703,952,951	\$ 1,657,172,817

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Governmental Fund Financial Statements
Balance Sheets

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other Funds	June 30	
							2007	2006
ASSETS								
Cash and certificates of deposit	\$ 69,628,488	\$ 853,869	\$ 29,730,647	\$ 16,517,895	\$ 56,774	\$ 6,659,334	\$ 123,447,007	\$ 91,641,986
Cash with fiscal agent	192	41,188,396	90,199,450	-	-	-	131,388,038	138,251,305
Volume of business taxes receivable	2,855,204	-	-	-	-	-	2,855,204	3,127,807
Sales taxes receivable	2,194,829	-	-	-	-	-	2,194,829	-
Due from other governments	-	-	1,050,000	-	-	7,379,505	8,429,505	9,154,564
Federal grants receivable	-	-	-	5,683,727	343,709	6,966,782	12,994,218	18,668,358
Due from other funds	14,721,317	1,000	932,936	139,953	-	616,521	16,411,727	14,312,707
Interest receivable	599,940	157,860	-	-	-	-	757,800	882,876
Property taxes receivable	803,005	3,226,485	-	-	-	-	4,029,490	3,642,904
Other receivables	801,947	-	-	69,159	5,428	3,861,709	4,738,243	1,237,540
Total assets	91,604,922	45,427,610	121,913,033	22,410,734	405,911	25,483,851	307,246,061	280,920,047

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Governmental Fund Financial Statements
Balance Sheets (continued)

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other Funds	June 30	
							2007	2006
LIABILITIES, OTHER CREDITS, AND FUND BALANCES								
Liabilities and other credits:								
Accounts payable and accrued liabilities	8,213,061	-	6,213,966	281,907	405,911	1,802,916	16,917,761	12,682,423
Bonds and notes payable	-	11,800,000	-	-	-	-	11,800,000	9,965,000
Interest payable	-	5,676,810	-	-	-	-	5,676,810	4,935,024
Due to other governments	3,492,459	-	-	-	-	714,228	4,206,687	2,073,868
Due to other funds	771,222	688,936	7,143,110	1,092,053	-	6,716,406	16,411,727	14,312,708
Due to federal agency	-	-	-	-	-	-	-	727,535
Deferred volume of business taxes	27,757,142	-	-	-	-	-	27,757,142	26,534,043
Deferred federal revenue	-	-	-	5,467,583	-	11,059,851	16,527,434	11,993,836
Other deferred revenue	1,309,861	2,857,733	696,050	-	-	186,977	5,050,621	9,838,893
Total liabilities and credits	41,543,745	21,023,479	14,053,126	6,841,543	405,911	20,480,378	104,348,182	93,063,330
Fund balances:								
Reserved for encumbrances	13,587,497	-	34,291,409	2,697,368	-	252,159	50,828,433	23,825,455
Reserved for equipment	192	-	-	-	-	-	192	510,671
Reserved for capital projects	-	-	73,568,498	-	-	-	73,568,498	95,373,497
Reserved for development projects	-	-	-	12,871,823	-	-	12,871,823	10,124,624
Reserved for debt service	-	24,404,131	-	-	-	-	24,404,131	25,094,068
Reserved for other purposes	25,674,104	-	-	-	-	4,751,314	30,425,418	16,828,882
Unreserved	10,799,384	-	-	-	-	-	10,799,384	16,099,520
Total fund balances	50,061,177	24,404,131	107,859,907	15,569,191	-	5,003,473	202,897,879	187,856,717
Total liabilities, other credits and fund balances	\$ 91,604,922	\$ 45,427,610	\$ 121,913,033	\$ 22,410,734	\$ 405,911	\$ 25,483,851	\$ 307,246,061	\$ 280,920,047

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

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

	For the Fiscal Year Ended June 30	
	2007	2006
Fund balance per Fund statements	\$ 202,897,879	\$ 187,856,717
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	1,768,529,201	1,712,522,049
Bond issue cost of governmental activities are not financial resources and not reported as assets in the funds	217,991	167,868
Other economic resources used in governmental activities are not financial resources and not reported as revenue in the funds	3,044,710	3,217,447
Other long-term liabilities, such as accrued compensated absences, litigations, LIMS debt, interest of accounts sold current year and other contingencies are not available to pay for expenditures and therefore not reported in the funds	(37,602,284)	(36,951,499)
General obligation bonds, special and federal loans are not due and payable in the current period and therefore not reported in the funds	<u>(233,134,546)</u>	<u>(209,639,765)</u>
Net assets of governmental activities	<u>\$ 1,703,952,951</u>	<u>\$ 1,657,172,817</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
Municipality of Carolina

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

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other	For the Fiscal Year Ended June 30	
							2007	2006
Revenues :								
Property Taxes	\$ 51,994,217	\$ 24,699,775	\$ -	\$ -	\$ -	\$ -	\$ 76,693,992	\$ 72,349,735
Volume of business taxes	32,182,902	-	-	-	-	-	32,182,902	31,931,933
Sales taxes	24,051,643	-	-	-	-	-	24,051,643	-
Licenses, permits, fines and forfeits	11,199,630	-	-	-	-	-	11,199,630	13,366,852
Federal grants	-	-	-	4,784,769	3,167,281	14,694,706	22,646,756	22,485,305
Interest income	10,639,969	-	141,248	688,764	-	484,456	11,954,437	9,883,161
Intergovernmental	16,447,682	-	8,985,720	-	-	1,000,262	26,433,664	10,152,873
Landfill	287,340	-	-	-	-	-	287,340	503,022
Rent	2,104,906	-	-	-	-	-	2,104,906	1,717,099
Other	1,143,982	-	889,884	737,025	-	1,744,587	4,515,478	1,570,804
Total revenues	150,052,271	24,699,775	10,016,852	6,210,558	3,167,281	17,924,011	212,070,748	163,960,784
Expenditures:								
General government	56,367,610	-	-	-	-	798,081	57,165,691	60,482,490
Public safety	16,410,284	-	-	-	-	606,141	17,016,425	16,073,649
Highway, streets and transportation	7,732,940	-	47,499,628	234,794	-	1,792,076	57,259,438	19,896,727
Sanitation	15,729,641	-	-	-	-	-	15,729,641	12,173,101
Health	7,885,800	-	-	-	-	1,738,047	9,623,847	7,885,802
Recreation and sports	4,209,710	-	-	-	-	2,590,147	6,799,857	4,113,333
Education and training	5,342,550	-	-	-	-	7,559,364	12,901,914	13,409,315
Housing	9,319,315	-	-	-	-	8,378,646	17,697,961	11,213,576
Economic development	-	-	3,301,072	4,206,538	-	-	7,507,610	20,371,983
Welfare	-	-	-	-	-	932,192	932,192	1,060,278
Employment opportunity	-	-	-	-	3,167,281	-	3,167,281	3,366,475
Debt service payments	-	28,344,245	-	-	-	-	28,344,245	24,078,024
Total expenditures	122,997,850	28,344,245	50,800,700	4,441,332	3,167,281	24,394,694	234,146,102	194,124,753
Other financing sources (uses) :								
Proceeds from debt issuance	-	-	31,171,390	5,000,000	-	-	36,171,390	37,400,000
Operating transfer in	2,932,341	5,854,533	21,545,097	1,341,912	-	3,619,129	35,093,012	22,304,258
Operating transfer out	(29,453,155)	(2,700,000)	-	(2,784,919)	-	(154,938)	(35,093,012)	(22,304,258)
Other financing sources (uses)	(26,520,814)	2,954,533	52,716,487	3,556,993	-	3,464,191	36,171,390	37,400,000
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	533,607	(889,937)	11,932,639	5,326,219	-	(3,006,482)	14,096,036	7,236,031
Fund balances at beginning of fiscal year (as previously reported)	49,527,570	25,094,068	95,373,497	10,124,624	-	7,736,958	187,856,717	177,064,569
Prior period adjustments	-	-	553,771	118,348	-	273,007	945,126	3,556,117
Fund balances at beginning of fiscal year (as restated)	49,527,570	25,094,068	95,927,268	10,242,972	-	8,009,965	188,801,843	180,620,686
Fund balances at end of fiscal year	\$ 50,061,177	\$ 24,404,131	\$ 107,859,907	\$ 15,569,191	\$ -	\$ 5,003,473	\$ 202,897,879	\$ 187,856,717

See notes to financial statements

02/04/08

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

	For the Fiscal Year Ended June 30	
	<u>2007</u>	<u>2006</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses - total governmental funds	\$ 14,096,036	\$ 7,236,031
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.	54,291,123	49,201,216
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	3,044,710	1,623,874
Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long term liabilities in the statement of net assets.	16,104,671	12,384,104
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.	(36,171,390)	(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>(5,530,142)</u>	<u>(1,238,706)</u>
Change in net assets of governmental activities	<u>\$ 45,835,008</u>	<u>\$ 31,806,519</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

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

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual amounts in the budgetary basis</u>	<u>Variance Favorable (Unfavorable)</u>
Resources:				
Property taxes	\$ 49,764,470	\$ 51,630,105	\$ 51,994,217	\$ 364,112
Volume of business taxes	27,378,100	31,669,047	31,776,668	107,621
Licenses and permits	4,043,427	8,782,987	9,380,032	597,045
Property rent	115,000	202,000	84,170	(117,830)
Miscellaneous	1,500,000	1,500,000	1,036,487	(463,513)
Intergovernmental services	342,000	342,000	328,138	(13,862)
Intergovernmental grant	7,545,735	7,545,735	8,794,132	1,248,397
Interest	3,000,000	8,544,621	10,289,548	1,744,927
Fines and penalties	200,000	1,032,041	1,143,982	111,941
Readjustments of prior years	-	11,367,265	-	(11,367,265)
Amount available for appropriation	<u>\$ 93,888,732</u>	<u>\$ 122,615,801</u>	<u>\$ 114,827,374</u>	<u>\$ (7,788,427)</u>
Expenditures charged to appropriations:				
General government	46,281,398	71,110,304	61,841,235	9,269,069
Public safety	17,793,966	17,378,838	17,232,718	146,120
Highways, streets and transportation	6,162,253	6,627,124	5,020,535	1,606,589
Sanitation	3,630,343	4,252,134	4,233,722	18,412
Health	7,885,802	7,885,802	7,885,802	-
Recreation and sports	4,344,314	4,336,776	4,018,035	318,741
Education and training	4,956,712	4,841,406	4,556,068	285,338
Housing	2,833,944	6,183,417	5,901,197	282,220
Total charges to appropriations	<u>93,888,732</u>	<u>122,615,801</u>	<u>110,689,312</u>	<u>11,926,489</u>
Excess of appropriations over resources	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,138,062</u>	<u>\$ 4,138,062</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements
June 30, 2007

Note 1 - Summary of significant accounting policies

Reporting Entity

The Municipality of Carolina (the Municipality) is a political subdivision of the Commonwealth of Puerto Rico 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 and training, housing, transportation, welfare, employment opportunity, economic development and/or improvements of highways and streets, and other general and administrative services.

Government wide and Fund financial statements

The financial statements of 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 No. 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 an 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, 2007

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column as others.

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 disadvantages 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, 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, 2007

Measurement Focus

Government-wide Financial Statements. The governments wide financial statements (the statement of net assets and the statement of activities) report information of all of the nonfiduciary activities of the Municipality are reported using the accrual basis of accounting. . For the most part, the effect of interfund activity has been removed from these government-wide financial statements. 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.

The statement of net assets presents the reporting entities' nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

1. Invested in capital assets, net of related debt – these consist of capital assets, less accumulated depreciation and reduced by any outstanding debt that are attributed to the acquisition, construction or improvement of those assets.
2. Restricted net assets – these result when constraints placed on net asset use are either externally imposed by grantors, contributors, laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation which are: economic development, capital projects, debt service and others.
3. Unrestricted net assets – these consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, it is the Municipality's policy to use restricted resources first, then the unrestricted resources, as they are needed.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function. Amounts reported as program revenue include (1) charges to customers or applicants for services, licenses, or permits provided, (2) operating grants and contributions, and (3) capital grants and contributions.

Internally dedicated resources are reported as general revenues rather than as program revenues. Taxes and other items not properly included among program revenue are reported instead as general revenue.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

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.

Future adoption of accounting pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statement that the Municipality has not yet adopted:

GASB No. 45 "Accounting and Financial Reporting for Employers for Post-employment Benefits Other than Pensions" for the fiscal year 2007-08.

GASB No. 49 "Accounting and Financial Reporting for Pollution Remediation Obligations" for fiscal year 2008-09.

GASB No. 50 "Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27" for the fiscal year 2007-08.

GASB No. 51 "Accounting and Reporting for Intangible Assets" for the fiscal year 2009-10.

The impact of these statements on the Municipality's basic financial statements has not yet been determined.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

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, 2007 amounted to \$11,367,265 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.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

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 fund from the modified accrual basis of accounting to the budgetary basis for fiscal year June 30, 2007 are as follows:

Accounting per the statement of revenues, expenditures and changes in fund balance	\$ 533,607
Adjustments:	
Non-budgeted revenues received during the year	(35,657,240)
Non-budgeted expenditures during the year	39,461,695
Prior year encumbrances recognized as expenditures on the accounting basis	(2,500,000)
Excess of revenues (expenditures) over expenditures (revenues) budgetary basis	2,300,000
	<u>\$ 4,138,062</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

Deposits

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts and certificates of deposit with banks qualified as a depository of public funds by the Puerto Rico Treasury Department or in instruments of the Government Development Bank for Puerto Rico. 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. The Municipality considers all investments with an original maturity of three months or less to be cash equivalents.

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 3). 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.

Receivables

Accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables are resources provided by governmental entities that are deemed fully collectible. The accounts receivable from nongovernmental customers are net of estimated uncollectible amounts.

Interfund receivables and payables

The Municipality has the following types of transactions among funds:

- (1) Operating transfers – Operating transfers are legally required transfers that are reported when incurred as operations transfer-in by the recipient fund and as operating transfer-out by the disbursing fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

- (2) Intra-entity transactions - Transfers between the funds of the primary government are reported as interfund transfer with receivables and payables presented as amounts due to and due from other funds.

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 expense is recorded in the governmental-wide financial statements. 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. There is no depreciation recorded for land and construction in progress.

Bond costs

Bond issuance costs in the amount of \$367,391 and \$167,868 are included in noncurrent assets at June 30, 2007 and 2006, respectively, in the Statement of Net Assets. Bond issuance costs consist of legal and accounting fees incurred in the fiscal years 2006 and 2007 of the issuances of \$37.4 million (2005-06), \$27.4 million and \$2.8 million (2007) bond debts. Such costs will be amortized over the lives of the related bond issues using the straight-line method.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

Deferred revenues

Deferred revenue at the governmental fund level arises when potential revenue does not meet neither the "measurable" or the "available" criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Municipality has a legal claim to them, as when grant moneys are received prior all applicable eligibility requirements are met.

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.

Post employment benefits

Pursuant to Act. no. 207 of August 13, 1995, Act No. 40 of June 13, 2001 and Act No. 157 of June 27, 2003, the Municipality is required to cover annually the 3% increase (cost of living allowance) in the retirement plan of its retirees employees. Substantially all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Municipality. For the fiscal years ended June 30, 2007 and 2006, post employment benefits paid amounted to \$118,878 and \$88,581, respectively. These benefits are recorded as expenditures when paid in the General Fund.

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, 2007

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.

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 which are not covered by insurance coverage.

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 and infrastructure.
- 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

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 9.28% for real property and 7.28% for personal property of which 1.03% belongs to the Commonwealth of Puerto Rico and 8.25% and 6.25% of both percents belong to the Municipality. From the portion belonging to the Municipality, 6% and 4%, respectively, 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 2.25% 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 9). 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.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

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 \$1,983,342 and \$1,889,166 during fiscal years ended June 30, 2007 and 2006, respectively.

The following is a summary of the property tax advances, which resulted as an account receivable and payable, at June 30, 2007 and 2006, respectively. In addition, the Municipality reports outstanding debt dated from June 30, 2003 in the Government Wide Financial Statement.

<u>Accounts (Payable) and Receivable</u>	<u>2007</u>	<u>2006</u>
Amortization through collections of property taxes by the CRIM	\$ 51,907,158	\$ 51,157,691
Advanced received,	51,104,153	50,540,709
Due from CRIM (property taxes)	<u>803,005</u>	<u>616,982</u>
Due to CRIM-2000	<u>\$ 4,096,683</u>	<u>\$ 4,167,938</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:

Custodial credit risk:

The Municipality is authorized to deposit only in institutions approved by the Department of the Treasury of the Commonwealth of Puerto Rico. Such deposits should be kept in separate accounts in the name of the Municipality. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. During the year ended June 30, 2007 and 2006, the Municipality invested its funds in bank accounts bearing interest.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2007

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

	<u>2007</u>	<u>2006</u>
Insured by the federal deposits insurance corporation	\$ 500,000	\$ 100,000
Collateralized by securities held by the pledging financial institution's trust department in the Municipality's name	<u>145,070,187</u>	<u>148,136,518</u>
Total	<u>\$ 145,570,187</u>	<u>\$ 148,236,518</u>

In addition, as of June 30 2007 and 2006, the Municipality's custodial credit risk was approximately \$123 and 96 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.

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 23. The Municipality grants a 5% discount, if the taxes are paid on or before April 23. Otherwise, 50% of taxes payable must be paid within the first 15 days of each semester beginning with the first semester ending December 31.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

The Municipality recognized an account receivable for the estimated municipal license taxes to be collected during the first two months of fiscal year 2007-2008, 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:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>2007</u>	<u>2006</u>
General	Debt Service	\$ 688,936	\$ 566,709
	Capital Project	6,526,589	5,866,146
	Economic Development	1,091,053	390,371
	Other	6,414,739	6,113,384
		<u>14,721,317</u>	<u>12,936,610</u>
Debt Service	Economic Development	<u>1,000</u>	<u>1,000</u>
Other	General	-	297,940
	Economic Development	-	265,300
	Capital Project	616,521	-
		<u>616,521</u>	<u>563,240</u>
Economic Development	Other	<u>139,953</u>	<u>794</u>
Capital Project	General	771,222	692,716
	Economic Development	-	118,348
	Other	161,714	-
		<u>932,936</u>	<u>811,064</u>
Total		<u>\$ 16,411,727</u>	<u>\$ 14,312,708</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

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

Note 6- Sales taxes

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. 03, Series 2006-2007-12, which imposes the 1.5% sales and use tax authorized by the Act, effective July 1, 2006. Consequently, the Ordinance No. 15, Series 2007-2008-26, was amended in order to impose sales and use tax of 1% at the municipal level, such ordinance was effective since August 1, 2007. Sales tax collections during fiscal year 2006-07 amounted to \$24 million.

Note 7 - 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 8 - Bonds and notes payable

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

	<u>2007</u>	<u>2006</u>
Balance at beginning	\$ 219,556,017	\$ 194,540,121
Proceeds from new issuance	37,498,041	37,400,000
BAN's notes to proceed of new issuance	(1,326,651)	-
Less principal payments:		
Bonds	\$13,554,671	
Notes	715,000	
	<u>(14,269,671)</u>	<u>(12,384,104)</u>
Balance at end of year	<u>\$ 241,457,736</u>	<u>\$ 219,556,017</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

General long-term debt as of June 30, 2007 and 2006 consists of the following:

<u>Bonds</u>	<u>2007</u>	<u>2006</u>
Series of 2006 - \$1,450,000 payable in annual installments of \$70,000 to \$135,000 until January 1, 2021 with interest at 5.13%	\$1,383,000	\$ -
Series of 2006 - \$27,470,000 payable in semiannual installments of \$1,115,000 to \$2,325,000 until July 1, 2023 with interest at 5.00%	26,410,000	-
Series of 2006 - \$2,830,000 payable in semiannual installments of \$60,000 to \$195,000 until July 1, 2031 with interest at 5.00%	2,770,000	-
Series of 2006 - \$866,390 payable in annual installments of \$107,200 to \$141,690 until January 1, 2014 with interest at 4.13%	866,390	-
Series of 2005 - \$12,470,000 payable in semiannual installments of \$400,000 to \$955,000 until July 1, 2025 with interest at 5.00%	11,695,000	12,095,000
Series of 2005 - \$12,470,000 payable in semiannual installments of \$400,000 to \$955,000 until July 1, 2025 with interest at 5.00%	11,695,000	12,095,000
Series of 2005 - \$12,460,000 payable in semiannual installments of \$390,000 to \$950,000 until July 1, 2025 with interest at 5.00%	11,690,000	12,080,000
Series of 2004 - \$15,550,000 payable in semiannual installments of \$510,000 to \$1,190,000 until July 1, 2023 with interest at 5.00%	13,520,000	14,065,000
Series of 2003 - \$4,000,000 payable in semiannual installments of \$102,000 to \$259,000 until July 1, 2027 with interest at 4.50%	3,509,000	3,616,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

	<u>2007</u>	<u>2006</u>
<u>Bonds</u>		
Series of 2003 - \$1,310,000 payable in semiannual installments of \$30,000 to \$105,000 until July 1, 2027; with interest at 6.50%.	1,185,000	1,215,000
Series of 2003 - \$23,000,000 payable in semiannual installments of \$500,000 to \$1,625,000 until July 1, 2027; with interest at 5.5%.	20,495,000	21,050,000
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%.	1,229,000	1,264,000
Series of 2001 - \$20,120,000 payable in semiannual installments of \$550,000 to \$1,805,000 until July 1, 2020 with interest at 3.21 to 5.29%	15,940,000	16,670,000
Series of 2000 - \$30,285,000 payable in semiannual installments of \$1,445,000 to \$2,400,000 until July 1, 2017; with interest at 3.21 to 5.01%.	20,255,000	21,785,000
Series of 1998 - \$13,165,000 payable in semiannual installments of \$400,000 to \$1,175,000 until July 1, 2020; with interest at 5.52% to 6.56%.	10,040,000	10,470,000
Series of 1994 - \$7,320,000 payable in semiannual installments of \$680,000 to \$790,000 until July 1, 2008; with interest at 7.41% to 7.61%.	790,000	1,525,000
Series of 1993 - \$21,260,000 payable in semiannual installments of \$2,255,000 to \$2,450,000 until July 1, 2007; with interest at 7.41% to 7.51%.	-	2,450,000
Series of 1997 - \$1,248,000 payable in annual installments of \$121,000 to \$152,000 until January 1, 2011; with interest at 4.75%.	570,346	697,346

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

	<u>2007</u>	<u>2006</u>
<u>Bonds</u>		
Series of 1994 - \$2,035,000 payable in semiannual installments of \$175,000 to \$220,000 until July 1, 2009; with interest at 7.41% to 7.71%.	425,000	615,000
Series of 1995 - \$11,885,000 payable in semiannual installments of \$1,020,000 to \$1,285,000 until July 1, 2009; with interest at 7.41% to 7.71%.	2,475,000	3,575,000
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
Series of 1995 - \$16,630,000 payable in semiannual installments of \$540,000 to \$1,465,000 until July 1, 2019; with interest at 6.00% to 6.63%.	11,900,000	12,480,000
Series of 1996 - \$10,475,000 payable in semiannual installments of \$505,000 to \$1,010,000 until July 1, 2015; with interest at 6.00% to 6.58%.	6,260,000	6,805,000
Series of 1997 -\$2,370,000 payable in semiannual installments of \$60,000 to \$205,000 until July 1, 2022; with interest at 5.52% to 6.56%.	1,900,000	1,965,000
<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

COMMONWEALTH OF PUERTO RICO
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Notes to Financial Statements (continued)
June 30, 2007

	<u>2007</u>	<u>2006</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%.	21,235,000	21,750,000
Series of 2003 - \$5,040,000 payable in semiannual installments of \$105,000 to \$365,000 until July 1, 2027; with interest at 5.04%.	4,505,000	4,625,000
Series of 2003 - \$4,310,000 payable in semiannual installments of \$85,000 to \$330,000 until July 1, 2027; with interest at 5.60%	3,885,000	3,980,000
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>19,820,000</u>	<u>20,460,000</u>
Total General and Special Debt-Bonds	<u>\$226,447,736</u>	<u>\$208,831,017</u>
<u>Federal Notes</u>		
Series of 2006- \$5,000,000 Loan guarantee federal program payable in installments of \$250,000 until August 1, 2026 with variable interest rates.	5,000,000	-
Series of 2001- \$14,300,000 Loan guarantee federal program payable in installments of \$715,000 until August 1, 2020 with variable interest rates.	<u>10,010,000</u>	<u>10,725,000</u>
Total federal notes	<u>\$ 15,010,000</u>	<u>\$ 10,725,000</u>
Total bonds and notes payable	\$241,457,736	\$219,556,017
Less current portion	<u>(12,813,200)</u>	<u>(14,526,147)</u>
Long-term portion of bonds and notes payable	<u>\$228,644,536</u>	<u>\$205,029,870</u>

COMMONWEALTH OF PUERTO RICO
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Notes to Financial Statements (continued)
June 30, 2007

The annual requirements to amortize the bonds and notes payable at June 30, 2007, including payment of interest are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	12,813,200	13,319,501	26,132,701
2009	12,715,300	12,235,983	24,951,283
2010	11,822,700	11,583,102	23,405,802
2011	12,476,200	10,945,113	23,421,313
2012	13,015,446	10,301,569	23,317,015
2013-2017	73,963,890	40,342,863	114,306,753
2018-2022	66,139,000	20,305,242	86,444,242
2023-2027	37,704,000	5,200,394	42,904,394
2028-2031	808,000	96,460	904,460
Totals	<u>\$ 241,457,736</u>	<u>\$ 124,330,227</u>	<u>\$ 365,787,963</u>

The original loan guarantee notes payable of \$14,300,000 and \$5,000,000, with an outstanding balance of \$15,010,000, 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 6% and for personal property is 4%. Total property assessment, based on information reported by the Municipal Revenues Collection Center amounted to \$2,253,277,212 of which \$1,017,060,529 and \$1,236,216,683 are real and personal property, respectively.

In addition, debt issue costs by \$217,991 involve legal and accounting fees incurred in the new issuance of \$27,745 million and \$2,830 million bonds and federal note of \$5 million in the fiscal year 2006-2007. The prior year debt issue cost of \$167,868 relates to the of \$37,400 million debt issuance. Such costs are deferred charges and should be amortized over the debt term. Total amortized debt issue costs are reported in the statement of net assets, as non current assets amounted to \$367,391 by current and prior debt issuances.

Note 9 - 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, 2007

Note 10 - Capital assets

A summary of changes in capital assets follows:

	Balance June 30, 2006	Additions	Retirements, Disposition and Tranfers	Balance June 30, 2007
Capital Assets				
Governmental Actitvies:				
Non-depreciable assets:				
Land	\$ 1,288,542,128	\$ 9,108,658	\$ -	\$ 1,297,650,786
Construction in progress	134,073,645	18,117,031	(75,930,394)	76,260,282
Sub-totals	<u>1,422,615,773</u>	<u>27,225,689</u>	<u>(75,930,394)</u>	<u>1,373,911,068</u>
Infrastructure in progress	24,221,071	15,493,466	(2,159,237)	37,555,300
Total Non-depreciable assets	<u>\$ 1,446,836,844</u>	<u>\$ 42,719,155</u>	<u>\$ (78,089,631)</u>	<u>\$ 1,411,466,368</u>
Capital Assets				
Governmental Actitvies:				
Depreciable assets:				
Building, infrastructure and improvements	\$ 306,417,144	\$ 90,074,546	\$ -	\$ 396,491,690
Vehicle and equipment, furniture and fixtures	21,341,065	8,341,183	(229,333)	29,452,915
Sub-totals	<u>327,758,209</u>	<u>98,415,729</u>	<u>(229,333)</u>	<u>425,944,605</u>
Less accumulated depreciation	(62,860,758)	(6,287,600)	117,186	(69,031,172)
Depreciable assets, net	<u>\$ 264,897,451</u>	<u>\$ 92,128,129</u>	<u>\$ (112,147)</u>	<u>\$ 356,913,433</u>
Total Capital Assets	<u>\$ 1,711,734,295</u>			<u>\$ 1,768,379,801</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

	Balance June 30, 2005	Additions	Retirements, Disposition and Transfers	Balance June 30, 2006
Capital Assets				
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>
	Balance	Additions	Retirements, Disposition and Transfers	Balance
	June 30, 2005	Additions	and Transfers	June 30, 2006
Capital Assets				
Governmental Activities:				
Depreciable assets:				
Building, infraestructure and improvements:	\$ 274,134,024	\$ 32,283,120	\$ -	\$ 306,417,144
Vehicle and equipment, furniture and 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>(48,030,491)</u>	<u>(14,910,914)</u>	<u>80,647</u>	<u>(62,860,758)</u>
Depreciable assets, net	<u>\$ 245,271,142</u>	<u>\$ 19,626,309</u>	<u>\$ -</u>	<u>\$ 264,897,451</u>
Total Capital Assets	<u>\$ 1,686,591,899</u>			<u>\$ 1,711,734,295</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

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

	<u>2007</u>	<u>2006</u>
General Government	\$ 751,130	\$ 434,745
Economic Development	98,646	57,100
Welfare	12,249	7,094
Housing	232,543	134,542
Highway, streets and transportation	4,335,823	13,781,258
Recreation and Sports	89,347	51,720
Education and Training	169,525	98,120
Employment Opportunity	41,616	24,100
Sanitation	206,680	119,630
Public Safety	223,587	129,415
Health	126,454	73,190
Total	<u>\$ 6,287,600</u>	<u>\$ 14,910,914</u>

Note 11 - 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 known as Coordination Plan. The Supplementation Plan is only choice available to police, firefighters and mayors to contribute 8.275% of 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, 2007 and 2006 amounted to approximately \$3,132,238 and \$3,059,132, respectively.

COMMONWEALTH OF PUERTO RICO
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Notes to Financial Statements (continued)
June 30, 2007

On September 24, 1999, an amendment to Act No. 447 of May 15, 1991, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining on or after January 1, 2000 will only be allowed to become members of the System 2000. System 2000 will reduce the retirement age from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by the System together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employees' salary up to a maximum of 10%) will be invested in account which either; (1) earn a fixed rate based on the two year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

For the year ended June 30, 2007 and 2006, total covered payroll was approximately \$33,770,760 and \$32,982,555, 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, 2007

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, 2007

Note 12 - Other accrued liabilities

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

	Balance at <u>June 30, 2006</u>	<u>Additions</u>	<u>Deductions</u>	Balance at <u>June 30, 2007</u>	Due within <u>one year</u>
Accrued compensated absences	\$ 12,410,605	\$ 1,005,996	\$ (693,721)	\$ 12,722,880	\$ 534,620
Interest due for accounts sold	8,254,537	-	(317,480)	7,937,057	317,480
LIMS refinancing debt	3,473,619	-	(551,199)	2,922,420	584,483
Accrued legal claims	4,108,000	-	(460,690)	3,647,310	20,560
	<u>\$ 28,246,761</u>	<u>\$ 1,005,996</u>	<u>\$ (2,023,090)</u>	<u>\$ 27,229,667</u>	<u>\$ 1,457,143</u>

	Balance at <u>June 30, 2005</u>	<u>Additions</u>	<u>Deductions</u>	Balance at <u>June 30, 2006</u>	Due within <u>one year</u>
Accrued compensated absences	\$ 11,171,889	\$ 2,415,537	\$ (1,176,831)	\$ 12,410,595	\$ 500,000
Interest due for accounts sold	8,544,788	-	(317,480)	8,227,308	317,480
LIMS refinancing debt	3,993,430	-	(519,811)	3,473,619	551,200
Accrued legal claims	5,303,000	477,070	(1,672,070)	4,108,000	6,170
	<u>\$ 29,013,107</u>	<u>\$ 2,892,607</u>	<u>\$ (3,686,192)</u>	<u>\$ 28,219,522</u>	<u>\$ 1,374,850</u>

Note 13 - 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, 2007 and 2006, were approximately \$949,800 and \$1,198,000, respectively in all funds.

Capital Lease Obligations

The Employment Opportunity Municipal Agency (Workforce Investment) has four capital leases equipment 7.0% annually expiring in May 2008 with monthly payments between \$451 and \$677. At June 30, capital lease obligation was segregated as follow:

	<u>2007</u>	<u>2006</u>
Total Due	\$ 41,891	\$ 48,746
Portion Due in one year	(23,245)	(25,503)
Portion Due over one year	<u>\$ 18,646</u>	<u>\$ 23,245</u>

COMMONWEALTH OF PUERTO RICO
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Notes to Financial Statements (continued)
June 30, 2007

The long term debt expires within next year as follow:

	2007	2006
2008	\$ 18,646	\$ 23,245

Direct Financing Leases

The Municipality acquired two real properties 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 financing leases consist of the following at June 30:

	2007	2006
Total minimum lease payments to be received	\$ 6,787,675	\$ 6,787,675
Less unearned interest income	(1,964,033)	(1,964,033)
Net investment in direct financing leases	\$ 4,823,642	\$ 4,823,642

The minimum lease payments including interests for next fiscal year are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 4,823,642	\$ 1,964,033	\$ 6,787,675

Note 14 - 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, 2007 and 2006 of \$3,647,310 and \$4,108,000, respectively in the government-wide statements for anticipated unfavorable judgments.

COMMONWEALTH OF PUERTO RICO
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Notes to Financial Statements (continued)
June 30, 2007

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 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.

C. Construction projects

The Municipality has construction commitments for which the Municipality is obligated to an amount of approximately \$104 millions (94 millions of municipal funds and 10 millions of federal funds) as of June 30, 2007. These are commitments for the improvements of recreational and cultural facilities and for streets and general developments.

Note 15 - 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 for the fiscal years ended June 30, 2007 and 2006, respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

Note 16 - Prior period adjustments

Governmental fund statements

The beginning fund balances of total governmental funds at July 1, 2006 and 2005 have been restated by to account due to the corrections in the following non-exchange transactions, elimination of allowance doubtful accounts and overstated account payable balances:

	<u>2007</u>	<u>2006</u>
Overstatement in deferred federal revenue	\$ -	\$ 3,556,117
Elimination of allowance for doubtful accounts balance	159,167	-
Cancellation of accounts payable - prior year balances	<u>785,959</u>	<u>-</u>
	<u>\$ 945,126</u>	<u>\$ 3,556,117</u>

Government wide statements

The beginning net assets of governmental activities at July 1, 2006 and 2005 have been restated due to the following:

	<u>2007</u>	<u>2006</u>
Retroactive recognition of major capital assets, net of accumulated depreciation	\$ -	\$ 1,313,898,717
Interest due for accounts sold	-	(8,544,788)
LIMS refinancing debt	-	(3,993,430)
Elimination of allowance for doubtful accounts balance	159,167	-
Cancellation of accounts payable - prior year balances	785,959	-
Understatement in deferred revenues	-	(26,830,515)
Total	<u>\$ 945,126</u>	<u>\$ 1,274,529,984</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Notes to Financial Statements (continued)
June 30, 2007

Note 17 - Closure and post-closure care cost of landfill

The Municipality owns and operates a solid waste landfill. State and federal laws and regulations require the Municipality to place a final cover on the Municipality's landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. The Municipality recognized \$4,910,456 and \$3,776,286 for the fiscal years ended June 30, 2007 and 2006, respectively as the estimated obligation for landfill closure in 31.12 acres 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, 2007. The Municipality expects to finance this obligation with the issuance of general obligation bonds.

Note 18- Subsequent events

General/Obligation Bond

On June 26, 2007, the Municipal Legislature, through the Ordinance 99, Serial 2006-07-117 approved the issuance of General Obligation Bond Serial A by \$32.4 million. The proceed of the issuance received during fiscal year 2007-08 is 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>
2008	\$ 225,000
2009	150,000
2010	100,000
2011	100,000
	<u>\$ 575,000</u>

Note 19 - Reclassifications

At June 30, 2007 certain reclassifications have been made to the basic financial statements to conform to the 2007 presentation.