

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE CATAÑO
AUDITORIA 2006-2007

30 DE JUNIO DE 2007

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO**

**SINGLE AUDIT REPORT
Fiscal Year Ended
June 30, 2007**

**BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTAL SCHEDULE**

**With Independent Auditors' Report Thereon
June 30, 2007**

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**Commonwealth of Puerto Rico
Municipality of Cataño
June 30, 2007**

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BENITEZ-JAIME, CPA-PSC

Certified Public Accountants and Business Consultants

Independent Auditors' Report on Basic Financial Statements and Supplementary Schedule of Expenditures of Federal Awards

The Honorable Mayor, Members of the
Municipal Legislature and People of
the Municipality of Cataño
Cataño, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Cataño of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2007, which collectively comprise the Municipality's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 statements presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In accordance with Government Auditing Standards we have also issued our report dated November 27, 2007, on our consideration of the Municipality of Cataño of the Commonwealth of Puerto Rico internal control over financial reporting and on our test of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The accompanying Management's Discussion and Analysis and the Budgetary Comparison Schedule are not required parts of the basic financial statements referred to above, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States and Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements of the Municipality. The schedule of expenditures and federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

November 27, 2007
Toa Alta, Puerto Rico



CPA - PSC

Stamp No. 2235765
was affixed to the
original report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2007

As management of the Municipality of Cataño (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements for the fiscal year ended June 30, 2007. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the Municipality's financial statements, which follow this narrative.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's assets exceeded its liabilities (net assets) by \$78,670,191 at June 30, 2007. The Municipality's net assets decreased by \$4,528,757 (excess of expenses over revenues) during the fiscal year ended June 30, 2007.
- At June 30, 2007, the Municipality's assets decreased \$10,612,514 in comparison with the prior fiscal year.
- At June 30, 2007, the Municipality's liabilities decreased \$6,054,077 in comparison with the prior fiscal year.
- The revenues of the Municipality for the fiscal year ended June 30, 2007 decreased \$230,968 in comparison with the prior fiscal year.
- The Municipality's expenses for the fiscal year ended June 30, 2007 increased \$2,508,213 in comparison with the prior fiscal year.

Governmental Funds' Highlights:

- The total fund balances of governmental funds amounted to \$31,640,033 at June 30, 2007, which decreased by \$11,728,952 (excess of expenditures and other financing uses over revenues and other financing sources) during fiscal year ended June 30, 2007.
- At June 30, 2007, the total assets of governmental funds decreased \$16,082,087 in comparison with the prior fiscal year.
- At June 30, 2007, the total liabilities of governmental funds decreased \$4,323,455 in comparison with the prior fiscal year.
- The total revenues of governmental funds for the fiscal year ended June 30, 2007 increased \$1,886,477 in comparison with the prior fiscal year.
- The total expenditures of governmental funds for the fiscal year ended June 30, 2007 increased \$6,324,714 in comparison with the prior fiscal year.
- Other financing sources (uses), net, of governmental funds for the fiscal year ended June 30, 2007 decreased \$481,782 in comparison with the prior fiscal year.

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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 accompanying 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). This report also contains additional required and other supplementary information in addition to the basic financial statements themselves. 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 are composed of: (1) the statements of net assets (SNA) and (2) the 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 private-sector business. These 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 prepared using methods that are similar to those used by most private businesses.

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. On the other hand, the Municipality reports liabilities, such as claims and judgments, 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

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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). All services normally associated with the Municipality fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; public housing and welfare; and economic and urban development.

b) Governmental Fund Financial Statements

The Municipality's GFFS consist of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances – governmental funds, and (3) the statement of revenues and expenditures - budget and actual - budgetary basis - general fund. 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 Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal

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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.

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.

GFFS provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) general fund, (2) debt service fund, (3) special revenue funds, and (4) capital projects funds.

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 of time, 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 Municipality has three major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The three major governmental funds are: (1) general fund, (2) debt service fund and (3) capital improvements bond fund (a capital projects fund).

c) *Notes to Basic Financial Statements*

The NBFS provide additional information that is essential for a full understanding of the data provided in the GWFS and GFFS. The NBFS can be found immediately following the basic financial statements.

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d) Other Supplementary Information

The basic financial statements are followed by a section of other supplementary information consisting of: (1) combining balance sheet – non-major governmental funds, (2) combining statement of revenues, expenditures and changes in fund balances – non-major governmental funds, (3) budgetary comparison schedule – debt service fund, (4) notes to budgetary comparison schedule – debt service fund, and (5) schedule of capital assets used in the operation of governmental funds, as detailed in the accompanying table of contents.

FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Municipality's overall condensed financial position for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS:

	2006	2007
Assets:		
Current assets	\$ 67,979,405	\$ 53,216,962
Noncurrent assets:		
Capital assets, net	103,491,187	107,665,453
Other noncurrent assets	256,488	232,151
Total assets	\$ 171,727,080	\$ 161,114,566
Liabilities:		
Current liabilities, excluding long-term obligations	19,194,116	21,813,883
Long-term obligations due within one year	7,840,852	2,820,555
Long-term obligations due after one year	61,463,484	57,809,937
Total liabilities	88,498,452	82,444,375
Net assets (liabilities):		
Invested in capital assets, net of related debt	\$ 75,411,399	\$ 75,298,253
Restricted	12,604,544	8,048,331
Unrestricted	(4,787,315)	(4,676,393)
Total net assets	\$ 83,228,628	\$ 78,670,191

At June 30, 2007, the Municipality's current assets, amounting to \$53,216,962, are mainly composed of cash and cash equivalents (\$46,380,340), property taxes receivable (\$3,998,145), municipal license taxes receivable (\$630,343) and intergovernmental receivables (\$2,208,134).

The restricted cash represents resources legally designated for: (1) the payment 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. Restricted property taxes receivable represent resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

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The Municipality's noncurrent assets, amounting to \$107,897,604 at June 30, 2007, are substantially composed of capital assets, with a cost basis of \$142,554,688, which are reported net of accumulated depreciation and amortization of \$34,889,235.

During the fiscal year ended June 30, 2007, the assets of the Municipality decreased by \$10,612,514 in comparison with the prior fiscal year, principally for the decreased of \$11,614,846 in cash and cash equivalents. The decrease in cash and cash equivalents is principally due to the excess of expenses over revenues of \$4,528,757 for the fiscal year ended June 30, 2007 and the current year additions of capital assets (capital outlays) of \$9,282,634.

At June 30, 2007, the Municipality's current liabilities amounting to \$24,634,438 are mainly composed of unearned revenues (\$11,113,697), accounts payable and accrued liabilities (\$7,780,186), and the portions due within one year of compensated absences (\$2,336,832), bonds payable (\$2,920,000) and legal claims and judgments (\$198,000). Deferred revenues principally consist of unearned revenues associated with municipal license taxes. As noted in the condensed statement of net assets, the Municipality's current assets exceeded current liabilities by \$28,582,524 for a current ratio (current assets to current liabilities) of 2.16 to 1.00.

The Municipality's noncurrent liabilities, amounting to \$57,809,937 at June 30, 2007, are mainly composed of portions due after one year of bonds payable (\$48,000,000), notes payable (\$7,026,188), and compensated absences (\$2,520,178).

At June 30, 2007, the liabilities of the Municipality decreased by \$5,898,777 in comparison with the prior fiscal year, principally for the following facts:

- Bonds payable decreased by \$2,725,000 due to the related debt service principal payments made during the current fiscal year.
- Accrued legal claims and judgments decreased by \$1,808,479 due to current year payments of legal judgments or settlements.
- Notes payable decreased by \$834,260 due to the related debt service principal payments made during the current fiscal year.
- Accrued compensated absences decreased by \$230,554.

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial statement position. The assets of the Municipality exceeded liabilities by \$78,670,191 at June 30, 2007.

The most significant portion of net assets (\$75,298,253) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses the capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, as capital assets cannot be used to liquidate these liabilities.

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Another significant portion of net assets (\$8,048,331) at June 30, 2007, represents resources that are restricted for debt service payments and to finance the operations of federal and state funded programs. The remaining component of total net assets consists of unrestricted net liabilities amounting to (\$4,676,393) at June 30, 2007. These unrestricted net liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds payable, notes payable, compensated absences, claims and judgments, obligations under capital leases, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality decreased by \$4,528,757 for the fiscal year ended June 30, 2007. Such decrease is due to the deficiency of total revenues (\$50,866,812) under expenses (\$55,395,569) for the fiscal year ended June 30, 2007, and is principally composed as follows:

- A decrease of \$4,556,213 in restricted net assets due principally to a transfer of \$7,707,610 made during current year by the debt service fund to the general fund to cover certain operating needs.
- A decrease of \$110,922 in the unrestricted net liabilities.

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Fiscal Year Ended June 30, 2007

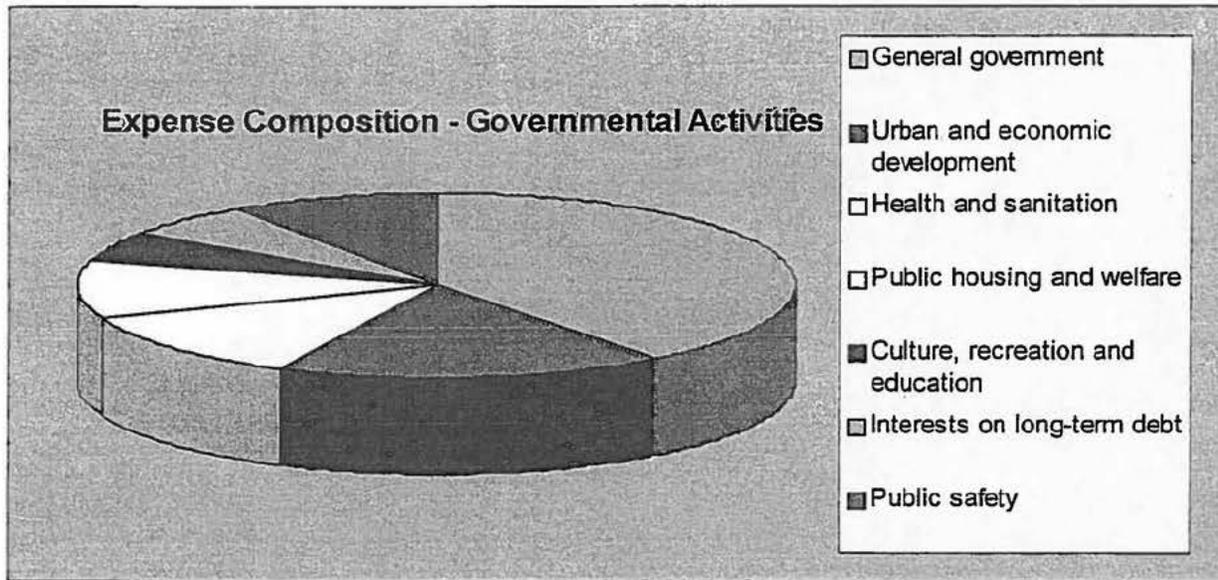
The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS for the fiscal years ended June 30, 2006 and 2007:

	<u>2006</u>	<u>2007</u>
Program revenues:		
Program-specific operating grants and contributions	\$ 1,643,086	\$ 2,350,261
Program-specific capital grants and contributions	1,305,114	939,438
Charges for services	2,025,065	578,687
Total program revenues	<u>4,973,265</u>	<u>3,868,386</u>
General revenues:		
Property taxes	26,614,615	27,168,378
Municipal license taxes	10,283,718	10,989,572
Construction excise taxes	1,407,654	1,390,177
Sales and use taxes	-	1,777,973
Unrestricted grants and contributions	3,290,516	2,568,514
Other general revenues, including interests	4,528,012	3,103,812
Total general revenues	<u>46,124,515</u>	<u>46,998,426</u>
Total revenues	<u>51,097,780</u>	<u>50,866,812</u>
Program expenses:		
General government	16,667,098	21,860,973
Urban and economic development	8,302,475	9,712,389
Health and sanitation	7,911,487	6,718,195
Public safety	5,990,384	5,191,969
Public housing and welfare	6,829,150	5,537,342
Culture, recreation and education	3,601,144	2,953,719
Interest on long-term obligations	3,585,618	3,420,982
Total expenses	<u>52,887,356</u>	<u>55,395,569</u>
Net decrease in net assets	(1,789,576)	(4,528,757)
Net assets, at beginning of fiscal year	71,865,886	83,228,628
Prior-period adjustments	13,152,318	(29,680)
Net assets, at end of fiscal year	<u>\$ 83,228,628</u>	<u>\$ 78,670,191</u>

As previously mentioned, the Municipality's net assets decreased by \$4,528,757 during current fiscal year. Approximately 81% (\$41,326,100) of the Municipality's total revenues for the current fiscal year came from property taxes, municipal license taxes, construction excise taxes and sales and use taxes, while 12% (\$5,858,213) resulted from restricted and unrestricted capital and operating grants and contributions.

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The following chart presents the composition of expenses for the fiscal year ended June 30, 2007:



FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS

**Condensed Balance Sheet - Governmental Funds
June 30, 2006 and 2007**

	<u>2006</u>	<u>2007</u>
Assets:		
Total assets - major governmental funds	\$ 67,249,604	\$ 51,744,962
Total assets - other governmental funds	3,120,790	2,543,345
Combined total assets	<u>70,370,394</u>	<u>54,288,307</u>
Liabilities:		
Total liabilities - major governmental funds	25,562,801	20,983,278
Total liabilities - other governmental funds	1,408,928	1,664,996
Combined total liabilities	<u>26,971,729</u>	<u>22,648,274</u>
Fund balances:		
Reserved - major governmental funds	38,085,498	27,872,676
Reserved - other governmental funds	1,711,862	878,349
Unreserved - major governmental funds	3,601,305	2,889,008
Combined total fund balances	<u>43,398,665</u>	<u>31,640,033</u>
Total liabilities and fund balances	<u>\$ 70,370,394</u>	<u>\$ 54,288,307</u>

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Analysis of Financial Position of Governmental Funds

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 June 30, 2007, the total assets of governmental funds decreased by \$16,082,087 in comparison with the prior fiscal year principally for the decrease of \$11,614,846 in cash and cash equivalents. In the other hand, at June 30, 2007, the total liabilities of governmental funds decreased by \$4,323,455 in comparison with the prior fiscal year.

For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most of these fluctuations has been made.

At the end of the current fiscal year, total unreserved fund balances of the governmental funds amounted to \$2,889,008, while total fund balance reached \$31,640,033. The total fund balances decreased by \$11,758,632 during the current fiscal year.

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

Major Governmental Funds

General fund (GF) - The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$20,618,324 at June 30, 2007. Such assets consist principally of: (1) cash and cash equivalents (\$14,371,456), and (2) taxes receivables (\$4,169,158).

The GF's total liabilities amounted to \$15,629,691 at June 30, 2007. Such liabilities are composed mainly of: (1) deferred revenues (\$12,076,154), and (2) accounts payable and accrued liabilities, including amounts due to other governments (\$3,553,537).

At the end of the current fiscal year, unreserved fund balance of the GF's amounted to \$2,889,008, while total fund balance reached \$4,988,633. As a measure of the GF's liquidity it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 6% of the total GF's expenditures, while total fund balance represents 11% of that same amount.

Debt service fund (DSF)- The DSF's total assets amounted to \$12,339,447 at June 30, 2007, which consists mainly of restricted cash in fiscal agent (\$11,363,360) and restricted property taxes receivable (\$933,753). The DSF's total liabilities amounted to \$4,473,035 at June 30, 2007, which are composed of: (1) matured bonds due and payable (\$2,920,000), (2) matured interest due and payable (\$1,439,581) and (3) due to general fund (\$113,454). At the end of the current fiscal year, DSF's total and reserved fund balance reached \$7,866,412.

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Capital improvements bond fund (CIBF)- The CIBF's total assets amounted to \$18,787,191 at June 30, 2007, which consist mainly of restricted cash in fiscal agent (\$18,734,403) to be used in the acquisition, construction or improvement of major capital assets. The CIBF's total liabilities amounted to \$880,552 at June 30, 2007, which are mainly composed of accounts payable to suppliers (\$694,282). At the end of the current fiscal year, CIBF's total and reserved fund balance reached \$17,906,639.

Other governmental funds (OGF)- The OGF's total assets amounted to \$2,543,345 at June 30, 2007, which consist mainly of restricted cash (\$1,802,488) and receivables from intergovernmental grants and contributions (\$674,170). The OGF's total liabilities amounted to \$1,664,996 at June 30, 2007, which are composed of deferred revenues (\$375,683), accounts payable and accrued liabilities (\$517,692) and amounts due to other funds (\$771,621). At the end of the current fiscal year, OGF's total and reserved fund balance reached \$878,349.

**Condensed Statement of Revenues, Expenditures and Changes
in Fund Balances - Governmental Funds
Fiscal Years Ended June 30, 2006 and 2007**

	2006	2007
Revenues:		
Total revenues - major governmental funds	\$ 46,335,657	\$ 47,879,145
Total revenues - other governmental funds	2,961,221	3,304,210
Combined total revenues	49,296,878	51,183,355
Expenditures:		
Total expenditures - major governmental funds	52,348,966	59,037,239
Total expenditures - other governmental funds	4,238,627	3,875,068
Combined total expenditures	56,587,593	62,912,307
Excess of expenditures over revenues	(7,290,715)	(11,728,952)
Other financing sources, net:		
Other financing sources (uses), net - major governmental funds	(506,841)	262,655
Other financing sources (uses), net - other governmental funds	988,623	(262,655)
Combined other financing sources (uses), net	481,782	-
Deficiency of revenues and other financing sources under expenditures and other financing uses	\$ (6,808,933)	\$ (11,728,952)
Fund balance, at beginning of fiscal year	49,952,435	43,398,665
Prior-period adjustments	255,163	(29,680)
Fund balance, at end of fiscal year	\$ 43,398,665	\$ 31,640,033

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2007

Analysis of Operating Results of Governmental Funds

Major Governmental Funds

General fund (GF) – The total fund balance of the GF increased by \$57,764 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$38,155,233, \$46,854,072 and \$8,756,603, respectively, for the fiscal year ended June 30, 2007.

Approximately 87% (\$33,141,534) of the GF's total revenues for the current fiscal year came from property taxes, municipal license taxes, construction excise taxes and sales and use taxes, while 7% (\$2,585,725) resulted from intergovernmental grants and contributions.

The GF's most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

- During the current fiscal year, the Municipality established a sales and use tax system that resulted in new tax revenues of \$1,777,973.
- Municipal license taxes revenues increased by \$1,511,225 due to increased collection efforts made by the Department of Finance.
- Construction excise taxes increased by \$953,315 due to increased collection efforts made by the Department of Finance.
- Charges for services decreased by \$1,448,984 due to decreased service transactions made during the current fiscal year.
- Miscellaneous revenues decreased by \$991,462.
- Intergovernmental grants and contributions decreased by \$377,822 mainly due to the aggregate decrease in: (1) the contributions in lieu of taxes from the Puerto Rico Electric Power Authority, (2) the contributions received from the Puerto Rico Department of Treasury as a partial reimbursement of the Christmas bonuses paid by the Municipality to its employees, and (3) other intergovernmental grants and contributions.

The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the general government expenditures, which increased by \$4,089,966.

Debt service fund (DSF) – The total fund balance of the DSF decreased by \$4,569,196 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$8,937,574, \$5,799,160 and \$7,707,610, respectively, for the fiscal year ended June 30, 2007.

Approximately 95% (\$8,493,592) of DSF's total revenues for the current fiscal year came from restricted property taxes.

The increase of \$34,533 in total DSF's expenditures when compared to the prior fiscal year is specifically because of the increase in debt service expenditures. The increase of \$1,172,938 in other financing uses,

COMMONWEALTH OF PUERTO RICO
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net, is due principally to an excess cash in the debt service fund that was transferred to the general fund during current fiscal year, as permitted by law.

Capital improvements bond fund (CIBF) – The total fund balance of the CIBF decreased by \$6,384,007 during current fiscal year specifically due to the investment of \$6,384,007 in works and permanent improvement projects as well as the acquisition of other capital assets during the current fiscal year. The investment in works and permanent improvements projects is mainly composed of capital outlays related to the construction in progress of a new diagnostic and health treatment center, the construction of a stadium and other permanent improvement projects developed. Total revenues, expenditures and other financing uses (net) amounted to \$786,338, \$6,384,007 and \$786,338, respectively, for the fiscal year ended June 30, 2007.

All revenues of the CIBF came from interests on cash balances deposited in fiscal agent for future use in permanent improvement projects. All expenditures were capital outlays (\$6,384,007) for the fiscal year ended June 30, 2007.

Other governmental funds (OGF) – The total fund balance of the OGF decreased by \$833,513 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$3,304,210, \$3,875,068 and \$262,655, respectively, for the fiscal year ended June 30, 2007.

Substantially all revenues of OGF came from intergovernmental grants and contributions (\$3,289,699) from the governments of the Commonwealth of Puerto Rico and the United States of America, while the most significant expenditures were related to capital outlays (\$2,584,443).

BUDGETARY HIGHLIGHTS

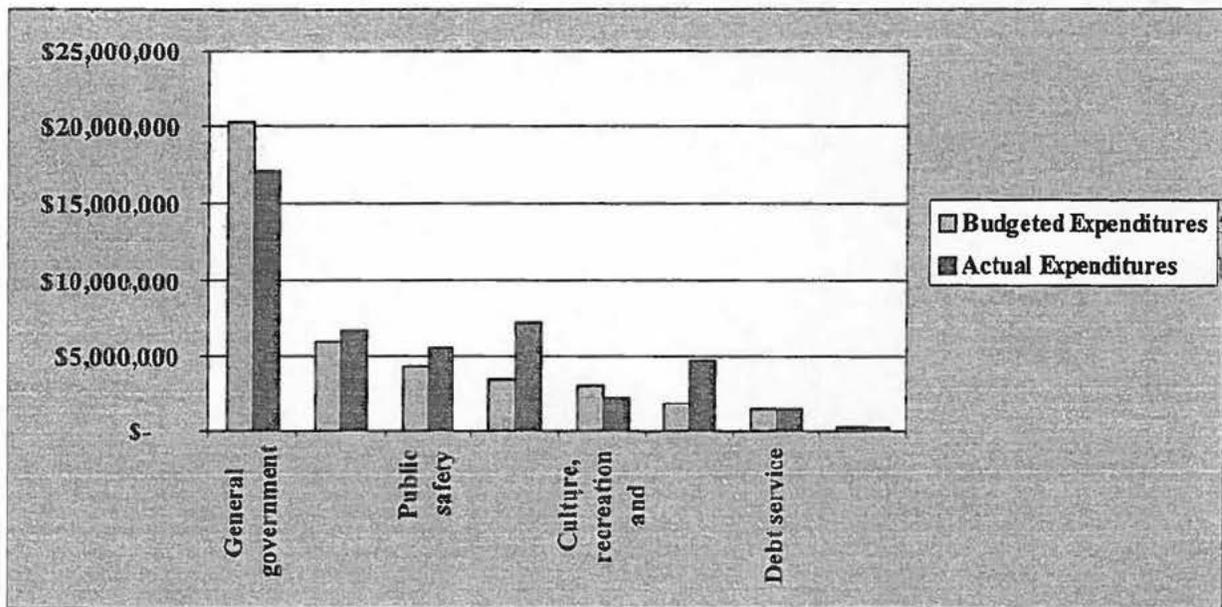
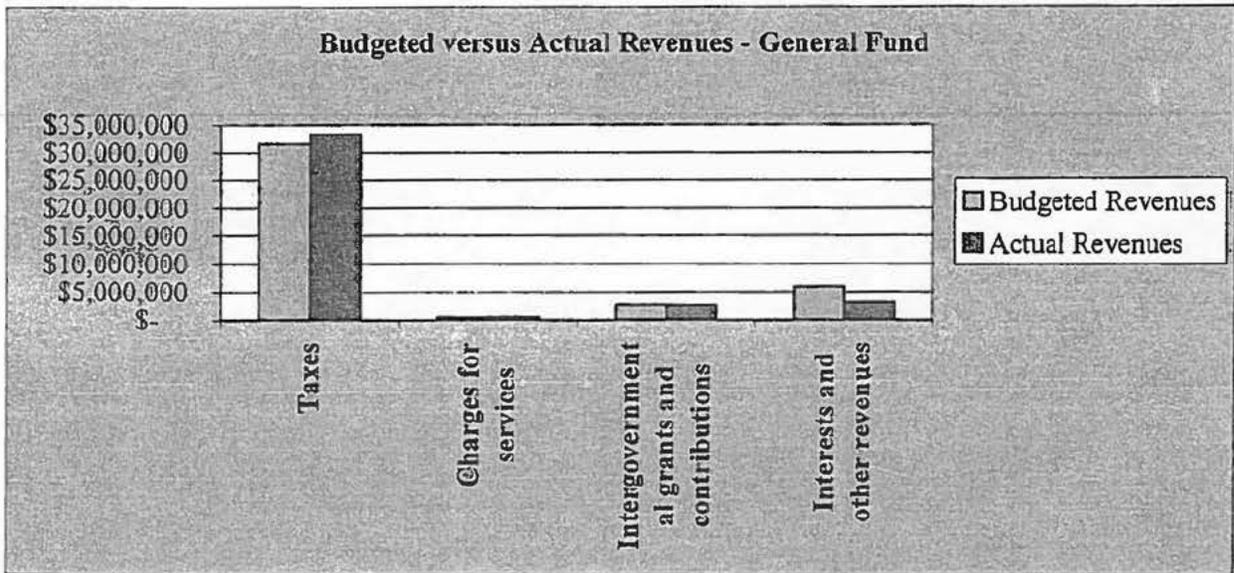
a) General Fund

The original budget of the general fund for the fiscal year ended June 30, 2007 amounted to \$37,798,143, which increased to \$40,679,187 after the budget amendments were approved.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2007 were \$39,592,542, which is (\$1,086,645) less than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2007 were \$45,220,558, which is (\$4,541,371) more than the budgeted expenditures. The most significant fluctuations in actual revenues (budgetary basis) occurred with: (1) sales and use taxes revenues which were \$1,517,102 more than their respective budgeted amounts, and (2) miscellaneous revenues which were \$4,153,656 less than the budgeted expenditures.

The most significant fluctuations in actual disbursements (budgetary basis) occurred with general government costs which were \$3,233,569 more than their respective budgeted amounts. Such fluctuation is mainly due to the effect of the actual expenditures of non-budgetary funds classified as part of the general fund for financial reporting purposes. Such funds were not considered as part of the budgeted expenditures of the Municipality's general fund for the fiscal year ended June 30, 2007. The following tables present the actual revenues and expenditures (budgetary basis) of the GF for the fiscal year ended June 30, 2007:

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 Management's Discussion and Analysis
 Fiscal Year Ended June 30, 2007



b) Debt Service Fund

The original and final budget of the debt service fund for the fiscal year ended June 30, 2007 was originally approved in the amount of \$6,122,630.

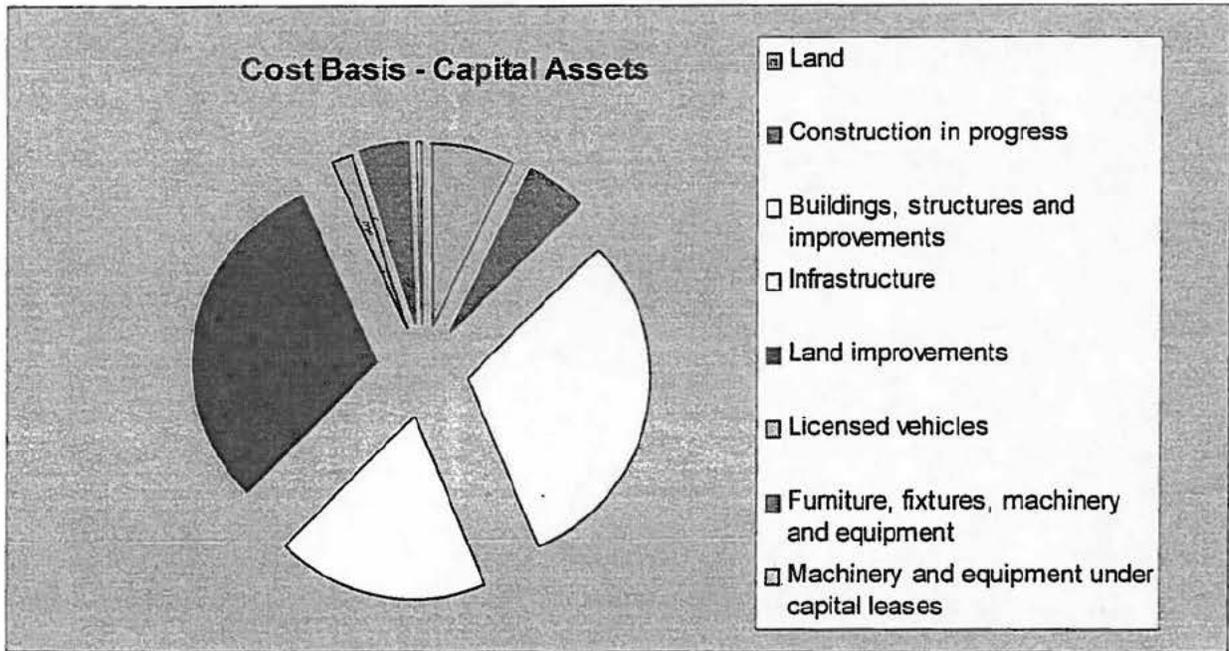
We encourage readers to consider the budgetary information presented here in conjunction with additional information that is furnished in Note 1f of the Municipality's basic financial statements and the accompanying supplementary information, which follow this narrative.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
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CAPITAL ASSETS AND DEBT ADMINISTRATION

a) Capital Assets

The Municipality has invested \$142,554,688 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$34,889,235 at June 30, 2007. During the current fiscal year, the Municipality made capital additions (\$9,282,634), which were partially offset by the depreciation expense (\$5,108,368) for the same period. The following chart presents the composition of capital assets at June 30, 2007:



Approximately 98% percent of the total capital additions made to capital assets during the fiscal year ended June 30, 2007 were related to construction in progress (\$9,100,423). Other capital additions for the fiscal year ended June 30, 2007 were the following:

Machinery, equipment, furniture and fixtures	\$ 108,462
Licensed software	84,549
Other capital additions for the fiscal year ended June 30, 2007	\$ 193,011

We encourage readers to consider the capital assets information presented here in conjunction with more detailed capital assets information furnished in Notes 1 and 7 of the accompanying financial statements.

b) Debt Administration

The Municipality finances a significant portion of its construction activities through bond and note issuances, and through state and federal grants. The proceeds from bond issuances designated for

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construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

At June 30, 2007, the Municipality's total bonded debt amounted to \$50,920,000, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality.

The following is a summary of the most significant transactions of the debt activity for the fiscal year ended June 30, 2007:

- Bonds payable decreased by \$2,725,000 due to the related debt service principal payments made during the current fiscal year.
- Accrued legal claims and judgments decreased by \$1,808,479 due to current year payments of legal judgments or settlements.
- Notes payable decreased by \$834,260 due to the related debt service principal payments made during the current fiscal year.
- Accrued compensated absences decreased by \$230,554.

We encourage readers to consider the information presented here in conjunction with more detailed long-term debt information furnished in Notes 1 and 9 of the accompanying financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The territory of Cataño covers an area of approximately 4.8 square miles. Cataño is a municipality with a population 30,071 persons, with average ages of approximately 31 years. Cataño is characterized by being one of the economic integration centers of the north metropolitan area of Puerto Rico since it is considered one of the principal source of jobs and services of warehousing and distribution of Puerto Rico.

The people of Cataño have an average family income of \$16,968 per year while the per capita income is approximately \$8,400 per year. Accordingly, 46.7% of the residents of Cataño live under the poverty limits. The unemployment rate in Cataño is approximately 10.3%.

Based on the projections of the Planning Board of the Commonwealth of Puerto Rico, the economy of Puerto Rico, including the Municipality, reflected a real decrease of almost 1 percent for the fiscal year ended June 30, 2007. In nominal terms, the economy decreased approximately 1 percent during fiscal year 2006-2007.

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out its governmental activities. Historically, property and municipal license taxes have been very predictable with increases or decreases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2006-2007 fiscal year. The budgets of the GF and the DSF for the fiscal year 2006-2007 amounted to \$340,679,187 and \$6,122,630, respectively.

COMMONWEALTH OF PUERTO RICO
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Management's Discussion and Analysis
Fiscal Year Ended June 30, 2007

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Cataño, Department of Finance, P.O. Box 428, Cataño, Puerto Rico, 00963.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Statement of Net Assets
June 30, 2007

Assets		<u>Governmental activities</u>
Current assets:		
Cash in commercial banks, including cash equivalents of \$14,000,000		\$ 14,371,456
Accounts receivable, net of allowance for doubtful accounts of \$13,136,257:		
Taxes:		
Property taxes	\$ 3,064,392	
Municipal license taxes	630,343	
Construction excise taxes	213,552	
Sales and use taxes	260,871	
Accrued interests on deposits	135,705	
Intergovernmental grants and contributions	707,525	
Other	<u>22,563</u>	
Total accounts receivable		5,034,951
Inventories and other current assets		193,748
Restricted assets:		
Cash and cash equivalents:		
Cash in commercial banks, including cash equivalents of \$400,000	\$ 1,802,488	
Cash in fiscal agent	30,206,396	
Accounts receivable:		
Intergovernmental grants and contributions	674,170	
Property taxes, net of reserve for doubtful accounts of \$4,002,759	<u>933,753</u>	
Total restricted assets		<u>33,616,807</u>
Total current assets		<u>53,216,962</u>
Noncurrent assets:		
Capital assets, at cost:		
Depreciable capital assets	\$ 124,186,520	
Nondepreciable capital assets	<u>18,368,168</u>	
Total capital assets, at cost	142,554,688	
Less: accumulated depreciation and amortization	<u>(34,889,235)</u>	
Total capital assets, net of accumulated depreciation and amortization		107,665,453
Deferred charges, net of accumulated amortization of \$215,846		<u>232,151</u>
Total noncurrent assets		<u>107,897,604</u>
Total assets		<u>\$ 161,114,566</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Statement of Net Assets (concluded)
June 30, 2007

Liabilities and net assets	Governmental activities
Current liabilities (due within one year):	
Accounts payable:	
Excess of checks drawn over bank balance	\$ 991,441
Accounts payable to suppliers	2,388,859
Intergovernmental payables	519,723
Accrued liabilities:	
Accrued employees' bonuses	1,193,497
Accrued interests on notes and obligations under leases	35,111
Total accounts payable and accrued liabilities	\$ 5,128,631
Unearned revenues	10,738,014
Liabilities related to restricted assets:	
Accounts payable to suppliers	1,211,974
Unearned revenues	375,683
Accrued interests on bonds	1,439,581
Current portion of bonds payable	2,920,000
Total current liabilities related to restricted assets:	5,947,238
Current portion of other long-term obligations:	
Notes payable	135,540
Obligations under capital leases	150,183
Compensated absences	2,336,832
Claims and judgments	198,000
Total current portion of long-term obligations	2,820,555
Total current liabilities	24,634,438
Noncurrent liabilities, excluding current portion (due in more than one year) :	
Noncurrent portion of liabilities related to restricted assets - bonds payable	48,000,000
Notes payable	7,026,188
Obligations under capital leases	263,571
Compensated absences	2,520,178
Total noncurrent liabilities	57,809,937
Total liabilities	82,444,375
Net assets (liabilities):	
Invested in capital assets, net of related debt	75,298,253
Restricted for:	
Debt service	\$ 7,866,412
Federal and state funded programs	181,919
Total restricted net assets	8,048,331
Unrestricted net liabilities	(4,676,393)
Total net assets	\$ 78,670,191

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Statement of Activities
Fiscal Year Ended June 30, 2007

Functions/programs	Expenses, including depreciation expense of \$5,108,368	Charges for services	Program revenues		Net (expenses) and changes in net assets
			Program – specific operating grants and contributions	Program – specific capital grants and contributions	
<i>Governmental activities:</i>					
General government	\$21,860,973	578,213	-	-	\$ (21,282,760)
Urban and economic development	9,712,389	-	1,639,679	-	(8,072,710)
Health and sanitation	6,718,195	474	-	-	(6,717,721)
Public safety	5,191,969	-	134,779	-	(5,057,190)
Public housing and welfare	5,537,342	-	575,803	939,438	(4,022,101)
Culture, recreation and education	2,953,719	-	-	-	(2,953,719)
Interest on long-term obligations	3,420,982	-	-	-	(3,420,982)
Total governmental activities	<u>\$55,395,569</u>	<u>578,687</u>	<u>2,350,261</u>	<u>939,438</u>	<u>(51,527,183)</u>
 General revenues:					
Taxes:					
Property taxes					\$ 27,168,378
Municipal license taxes					10,989,572
Construction excise taxes					1,390,177
Sales and use taxes					1,777,973
Total tax revenues					<u>41,326,100</u>
Intergovernmental grants and contributions, not restricted to specific programs					2,568,514
Interest on deposits					2,374,760
Miscellaneous					729,052
Total general revenues					<u>46,998,426</u>
Net decrease in net assets					<u>(4,528,757)</u>
Net assets at beginning of fiscal year					83,228,628
Prior-period adjustments					(29,680)
Net assets at the beginning of fiscal year, as restated					<u>83,198,948</u>
Net assets at end of fiscal year					<u>\$ 78,670,191</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Balance Sheet – Governmental Funds
June 30, 2007

Assets	Major governmental funds				Total governmental Funds
	General Fund	Debt service fund	Capital improvements bond fund	Other governmental funds	
Cash and cash equivalents in commercial banks	\$ 14,371,456	-	-	-	\$ 14,371,456
Accounts receivable, net of reserve for doubtful accounts of \$13,136,257:					
Taxes:					
Property taxes	3,064,392	-	-	-	3,064,392
Municipal license taxes	630,343	-	-	-	630,343
Construction excise taxes	213,552	-	-	-	213,552
Sales and use taxes	260,871	-	-	-	260,871
Accrued interests on deposits	39,194	42,334	52,788	1,389	135,705
Intergovernmental grants and contributions	707,525	-	-	-	707,525
Due from other funds	1,061,205	-	-	-	1,061,205
Other	22,563	-	-	-	22,563
Inventories and other assets	193,748	-	-	-	193,748
Restricted assets:					
Cash and cash equivalents:					
Cash in commercial banks, including cash equivalents of \$400,000	-	-	-	1,802,488	1,802,488
Cash in fiscal agent	53,475	11,363,360	18,734,403	55,158	30,206,396
Accounts receivable:					
Intergovernmental grants and contributions	-	-	-	674,170	674,170
Due from other funds	-	-	-	10,140	10,140
Property taxes, net of allowance for doubtful accounts of \$4,002,759	-	933,753	-	-	933,753
Total assets	<u>\$ 20,618,324</u>	<u>12,339,447</u>	<u>18,787,191</u>	<u>2,543,345</u>	<u>\$ 54,288,307</u>
Liabilities					
Accounts payable and accrued liabilities:					
Excess of checks drawn over bank balance	991,441	-	-	-	991,441
Accounts payable to suppliers	2,066,889	-	-	-	2,066,889
Intergovernmental payables	495,207	-	-	-	495,207
Deferred revenues:					
Unearned municipal license taxes	10,738,014	-	-	-	10,738,014
Earned and unavailable revenues	1,338,140	-	-	-	1,338,140
Liabilities related to restricted assets:					
Accounts payable to suppliers	-	-	694,282	517,692	1,211,974
Due to other funds	-	113,454	186,270	771,621	1,071,345
Unearned revenues	-	-	-	375,683	375,683
Matured bonds due and payable	-	2,920,000	-	-	2,920,000
Matured interest due and payable	-	1,439,581	-	-	1,439,581
Total liabilities	<u>15,629,691</u>	<u>4,473,035</u>	<u>880,552</u>	<u>1,664,996</u>	<u>22,648,274</u>
Fund balances					
Reserved for:					
Encumbrances	1,810,877	-	-	-	1,810,877
Debt service	-	7,866,412	-	-	7,866,412
Capital projects	-	-	17,906,639	696,430	18,603,069
Advances from other funds	95,000	-	-	-	95,000
Inventories and other assets	193,748	-	-	-	193,748
Federal and state funded programs	-	-	-	181,919	181,919
Unreserved	2,889,008	-	-	-	2,889,008
Total fund balances	<u>4,988,633</u>	<u>7,866,412</u>	<u>17,906,639</u>	<u>878,349</u>	<u>31,640,033</u>
Total liabilities and fund balances	<u>\$ 20,618,324</u>	<u>12,339,447</u>	<u>18,787,191</u>	<u>2,543,345</u>	<u>\$ 54,288,307</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Reconciliation of the Balance Sheet – Governmental Funds
to the Statement of Net Assets
June 30, 2007

The amounts of governmental activities reported in the statement of net assets and the balance sheet – governmental funds, are different for the following reasons:

Total fund balances reported in the balance sheet – governmental funds	\$31,640,033
Add (Deduct):	
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds. This is the carrying amount of capital assets, net of accumulated depreciation and amortization of \$34,889,235 at June 30, 2007.	107,665,453
Certain deferred revenues in the governmental funds are recognized as revenues in the statement of activities. This is the amount of revenues that are measurable but not available at June 30, 2007 (municipal licenses, intergovernmental grants and contributions and charges for services).	1,338,140
Debt issued by the Municipality has associated costs (debt issuance costs) that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets and reported net of accumulated amortization of \$215,846.	232,151
The following liabilities are not due (mature) in the current fiscal year, therefore, are not reported in the governmental funds at June 30, 2007 pursuant to GASB Interpretation No. 6, <i>Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Funds Financial Statements</i> :	
Bonds payable	(48,000,000)
Notes payable	(7,161,728)
Obligations under capital leases	(413,754)
Compensated absences	(4,857,010)
Claims and judgments	(198,000)
Accounts payable, including excess of checks drawn over bank balance	(321,970)
Intergovernmental payables	(24,516)
Accrued interests on notes payable	(35,111)
Accrued employees' bonuses	(1,193,497)
Net assets – governmental activities, as reported in the statement of net assets	\$78,670,191

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds
Fiscal Year Ended June 30, 2007

	<u>Major governmental funds</u>				<u>Total governmental funds</u>
	<u>General fund</u>	<u>Debt service fund</u>	<u>Capital improvements bond fund</u>	<u>Other governmental funds</u>	
Revenues:					
Taxes:					
Property taxes	\$ 18,674,786	8,493,592	-	-	\$ 27,168,378
Municipal license taxes	11,298,598	-	-	-	11,298,598
Construction excise taxes	1,390,177	-	-	-	1,390,177
Sales and use taxes	1,777,973	-	-	-	1,777,973
Total tax revenues	<u>33,141,534</u>	<u>8,493,592</u>	<u>-</u>	<u>-</u>	<u>41,635,126</u>
Intergovernmental grants and contributions	2,585,725	-	-	3,289,699	5,875,424
Interests on deposits	1,130,403	443,982	786,338	14,037	2,374,760
Charges for services	568,519	-	-	474	568,993
Miscellaneous	729,052	-	-	-	729,052
Total revenues	<u>38,155,233</u>	<u>8,937,574</u>	<u>786,338</u>	<u>3,304,210</u>	<u>51,183,355</u>
Expenditures:					
Current:					
General government	17,184,526	-	-	8,247	17,192,773
Urban and economic development	8,703,505	-	-	-	8,703,505
Health and sanitation	7,044,125	-	-	5,191	7,049,316
Public safety	5,211,237	-	-	130,579	5,341,816
Public housing and welfare	4,661,576	-	-	1,146,608	5,808,184
Culture, recreation and education	2,236,377	-	-	-	2,236,377
Debt service:					
Principal	989,811	2,920,000	-	-	3,909,811
Interest	508,731	2,879,160	-	-	3,387,891
Capital outlays	314,184	-	6,384,007	2,584,443	9,282,634
Total expenditures	<u>46,854,072</u>	<u>5,799,160</u>	<u>6,384,007</u>	<u>3,875,068</u>	<u>62,912,307</u>
Revenues over (under) expenditures	<u>(8,698,839)</u>	<u>3,138,414</u>	<u>(5,597,669)</u>	<u>(570,858)</u>	<u>(11,728,952)</u>
Other financing sources (uses):					
Transfers-in from other governmental funds	8,903,062	-	-	146,459	9,049,521
Transfers-out to other governmental funds	(146,459)	(7,707,610)	(786,338)	(409,114)	(9,049,521)
Total other financing sources (uses), net	<u>8,756,603</u>	<u>(7,707,610)</u>	<u>(786,338)</u>	<u>(262,655)</u>	<u>-</u>
Net increase (decrease) in fund balances	<u>57,764</u>	<u>(4,569,196)</u>	<u>(6,384,007)</u>	<u>(833,513)</u>	<u>(11,728,952)</u>
Fund balance at beginning of fiscal year	4,960,549	12,435,608	24,290,646	1,711,862	43,398,665
Prior-period adjustments	(29,680)	-	-	-	(29,680)
Fund balance at beginning of fiscal year, as restated	<u>4,930,869</u>	<u>12,435,608</u>	<u>24,290,646</u>	<u>1,711,862</u>	<u>43,368,985</u>
Fund balance at end of fiscal year	<u>\$ 4,988,633</u>	<u>7,866,412</u>	<u>17,906,639</u>	<u>878,349</u>	<u>\$ 31,640,033</u>

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

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02/02/08

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Reconciliation of the Statement of Revenues, Expenditures
and Changes in Fund Balance – Governmental Funds to the Statement of Activities
Fiscal Year Ended June 30, 2007

The amounts of governmental activities reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances - governmental funds, are different for the following reasons:

Total net decrease in fund balances reported in the statement of revenues, expenditures and changes in fund balances – governmental funds	\$ (11,728,952)
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Add (Deduct):

The following revenues recorded in the statement of activities do not necessarily provide current financial resources, therefore, sometimes are deferred in the governmental funds. This is the net change in deferred revenues of the following revenue items, which are measurable but not available at fiscal year end:

Municipal license taxes	(309,026)
Intergovernmental grants and contributions	(17,211)
Charges for services	9,694

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 and amortization expense. This is the amount by which capital outlay expenditures (\$9,282,634) exceeded depreciation expense (\$5,108,368) for the fiscal year ended June 30, 2007.	4,174,266
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Repayment of principal of long-term obligations is reported as an expenditure in the governmental funds, however, the repayment reduces long-term liabilities in the statement of net assets.	3,909,811
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Certain accrued interest expense reported in the statement of activities do not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	(33,091)
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Amortization of deferred charges reported in the statement of activities does not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	(24,337)
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Some expenses, net, reported in the statement of activities do not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	<u>(509,911)</u>
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Net decrease in net assets, as reported in statement of activities	<u>\$ (4,528,757)</u>
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The accompanying notes to the basic financial statements are an integral part to this statement.

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2007

1. Summary of Significant Accounting Policies

The Municipality of Cataño (the Municipality) is a local municipal government constituted in 1927 in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

The Commonwealth's Constitution provides for the separation of powers of the executive, legislative and judicial branches of the Commonwealth and the municipalities. However, the Municipality's governmental system consists of executive and legislative branches only. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power of the Municipality is exercised by the Municipal Legislature, whose members are also elected every four years. The judiciary power is exercised by the General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality.

The Municipality assumes either partial or full responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, education, urban development, economic development, and many other fiscal, general and administrative services.

a) Financial Reporting Model

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the fiscal year ended June 30, 2007, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

According to the financial reporting model established by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34), the required basic financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

RSI, consisting of a Management's Discussion and Analysis (MD&A), is information presented along with, but separate from, Municipality's basic financial statements.

MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2007, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

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Other supplementary information presented in this report for purposes of additional analysis consist of: (1) combining and individual non-major governmental fund financial statements, (2) ~~budgetary comparison schedule—debt service fund, and (3) schedules of capital assets used in the~~ operations of governmental funds, as listed in the accompanying table of contents.

On July 1, 2005, the Municipality adopted the provisions of Statement No. 44, *Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement 1* (GASB No. 44). This statement amended the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, which provides guidance for the preparation of the statistical section of the Municipality's Comprehensive Annual Financial Report (CAFR). Accordingly, the statistical section of this Comprehensive Annual Financial Report has been modified to present more detailed information, typically in ten-year trends, that assists users in utilizing: (1) the basic financial statements, (2) the notes to basic financial statements, and (3) the required supplementary information, to assess the economic condition of a government.

b) Financial Reporting Entity

The accompanying basic financial statements include all departments, agencies and municipal operational units that are under the legal and administrative control of the Mayor, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Act No. 81.

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14), as amended, has set forth criteria to be considered in determining financial accountability for financial reporting purposes. These criteria include appointing a voting majority of an organization's governing body and: (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

According to GASB No. 39, a legally separate, tax-exempt organization should be reported as a discretely presented component unit of a reporting entity if all of the following criteria are met:

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- The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2007.

c) *Government-wide Financial Statements*

The accompanying GWFS are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements report information of all governmental activities of the Municipality as a whole. These statements are aimed at presenting a broad overview of the Municipality's finances by reporting its financial position and results of operations using methods that are similar to those used by most private businesses.

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity) and or net liabilities. This statement assists management in assessing the level of services that can be provided by the Municipality in the future and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets and discloses legal and contractual restrictions on resources.

Net assets are classified in the accompanying statement of net assets within the following three categories:

- **Invested in capital assets, net of related debt** – This net asset category consists of capital assets, net of accumulated depreciation and amortization, amounting to \$107,665,453,

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reduced by the outstanding balances of all bonds payable and capital lease obligations which were used for the acquisition, construction or improvement of capital assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets (consisting of all bonds payable and obligations under capital leases of \$50,920,000 and \$413,754, respectively, outstanding at June 30, 2007) has been reduced by the related unspent debt proceeds of \$18,734,403 and the related unamortized debt issuance costs of \$232,151.

- **Restricted net assets** – This net asset category consists of net resources restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

On July 1, 2005, the Municipality adopted the provisions of Statement No. 46, *Net Assets Restricted by Enabling Legislation* (GASB No. 46). This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This Statement clarified that a legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. This Statement states that the legal enforceability of an enabling legislation should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration. Although the determination that a particular restriction is not legally enforceable may cause the Municipality to review the enforceability of other restrictions, it should not necessarily lead the Municipality to the same conclusion for all enabling legislation restrictions.

The classification of restricted net assets identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net assets. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

The Municipality has reported the following types of restricted net assets in the accompanying statement of net assets:

- (1) **Debt service** – Represent net resources available to cover future debt service payments of bonds payable.
- (2) **Federal and state funded programs** – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs.

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- **Unrestricted net liabilities** – This category consists of the excess of liabilities over related assets that are neither externally nor legally restricted, neither invested in capital assets. However, assets reported within unrestricted net liabilities often are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints 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 generally use restricted resources first, and then unrestricted resources as they are needed.

The accompanying statement of activities presents the Municipality's results of operations by showing, how the Municipality's net assets or net liabilities changed during the fiscal year ended June 30, 2007, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education and (6) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General government:

- Municipal legislature
- Mayor's office
- Department of finance
- Department of planning and budget
- Department of human resources
- Department of legal services
- Department of municipal secretary
- Department of internal audit
- Department of public relations
- Center for governmental operations

Urban and economic development:

- Department of public works
- Department of public terminals and convention center
- Market Square

Public safety:

- Department of emergency management – civil defense
- Department of municipal police
- Department of private police

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Health and sanitation:

Department of recycling services
Eulalia Kuilan diagnostic and treatment center

Culture, recreation and education:

Department of sports and recreation
Juana Matos multi-service center
Cultural center
La Esperanza recreational facilities
Schooling director
Alberto Dávila library

Public housing and welfare:

Department of public housing
Department of federal programs
Wilson Ramos elderly center
Department of citizen affairs

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at: (1) the net cost of the function/program that must be financed from the Municipality's general revenues or (2) the net program revenue that contributes to the Municipality's general revenues. The accompanying statement of activities reports the following categories of program revenues:

- **Charges for services** – These revenues generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific operating and capital grants and contributions** – These revenues consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Capital grants and contributions consist of revenues or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

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General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes and construction excise taxes are reported as general revenues. All other non-tax revenues (including unrestricted interest on deposits, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

The general government function/program reported in the accompanying statement of activities includes expenses that are, in essence, indirect or costs of other functions/programs of the Municipality. Even though some of these costs have been charged to certain funds in the GFFS as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect costs as direct expenses of the general government function. Accordingly, the Municipality generally does not allocate general government (indirect) costs to other functions.

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets and activities.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the GFFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is financed primarily through user charges; or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

d) *Governmental Fund Financial Statements*

A fund is a fiscal and accounting entity consisting of a self-balancing set of accounts used to record assets, liabilities and residual equities, deficits or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with GAAP and/or special regulations, restrictions or limitations.

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances – governmental funds and (3) the statement of revenues and expenditures – budget and actual – budgetary basis – general fund.

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These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major governmental funds, as defined below, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current fiscal year have complied with public decisions concerning the raising and spending of public moneys in the short term (generally one fiscal year).

The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

- **General fund** – The general fund is the Municipality's main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Debt service fund** – The debt service fund is a major governmental fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. During the fiscal year ended June 30, 2007, the financial activity accounted for in the debt service fund was specifically related to bonds payable. Most of its revenues consist of property taxes and interests on deposits.

The outstanding balance of general long-term debts for which debt service payments do not involve the advance accumulation of resources (such as notes payable, obligations under capital leases, accrued compensated absences, and the reserve for federal cost disallowances are only accounted for in the accompanying statement of net assets. The debt service payments of such debts are generally accounted for as debt service – principal and debt service – interest expenditures in the general fund.

Special revenue funds - The special revenue funds are non-major governmental funds, as defined below, used by the Municipality to account for revenues derived from grants, contributions or other revenue sources that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in major capital projects which are accounted for in the capital projects fund). The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to

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expenditures for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

- **Capital projects funds** – Capital projects funds are non-major governmental funds, as defined below, used to account for the financial resources used for the acquisition, construction or improvement of major capital facilities and other assets. Significant capital outlays financed from proceeds of general obligation, public improvement or special obligation bonds accounted for also in the capital projects funds.

The use of the capital projects funds has been reserved only for major capital acquisitions, construction or improvement activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capitalizable assets (such as furniture, office equipment, vehicles and other minor capital assets or improvements) have been reported in the governmental fund from which financial resources were used for the payment.

The focus of the GFFS is on major governmental funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds between major and non-major categories within the GFFS. Major individual governmental funds are reported individually as separate columns in the GFFS, while data from all non-major governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund would be classified as a major governmental fund in the GFFS if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and non-operating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are: (1) the general fund, (2) the debt service fund and (3) the capital improvements bond fund.

The capital improvements bond fund is a major governmental (capital projects) fund used by the Municipality to account for the proceeds of bonds issued to finance the acquisition, construction or improvement of major capital facilities and other assets. Accordingly, most of the expenditures of this fund consist of capital outlays.

The accompanying GFFS are accompanied by the following schedules required by GAAP: (1) the reconciliation of the balance sheet – governmental funds to the statement of net assets, and (2) the

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reconciliation of the statement of revenues, expenditures and changes in fund balances -- governmental funds to the statement of activities.

e) Measurement Focus and Basis of Accounting

Government-wide financial statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest on deposits and investments) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* (GASB No. 33). GASB No. 33 established accounting and reporting standards for non-exchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a non-exchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its non-exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions.

In the case of derived tax revenue transactions, which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

In the case of imposed non-exchange revenue transactions (such as property taxes and municipal license taxes), which result from assessments made by the Municipality on non-governmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and municipal license are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted.

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to the Municipality and the provider government requires the Municipality to use those resources for a

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specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary non-exchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, willingly entered into by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above. Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues.

According to GASB No. 34, all general capital assets and the unmatured long-term liabilities are recorded only in the accompanying statement of net assets. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the GFFS.

Governmental fund financial statements – The accompanying GFFS are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues to be available if collected within 90 days after June 30, 2007, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2007.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, interest on deposits, and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues (see note 8).

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

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All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred for expenditure-driven grants).

Interest on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2007.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. GASBI No. 6 modified the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting prior to GASB No. 34, and clarified a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities. Therefore, the accompanying balance sheet – governmental funds generally reflects only assets that will be converted into cash to satisfy current liabilities. Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds.

Modifications to the accrual basis of accounting in accordance with GASBI No. 6 include:

- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest of bonds due on July 1, 2007, which are recorded as governmental fund liabilities at June 30, 2007 which is the date when resources were available in the debt service fund.
- Obligations under capital leases, compensated absences, and the accrued claims and judgments are recorded only when they mature (when payment is due).
- Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (unmatured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.

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- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying statement of activities, but are not recorded in the accompanying GFFS.

f) Stewardship, Compliance and Accountability

Budgetary Control

According to Act No. 81, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budgets are prepared.

The Mayor must submit, for the fiscal year commencing on the next July 1, an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of the Commonwealth (the Commissioner) and the Municipal Legislature no later than May 10 and May 15, respectively. The Commissioner preliminarily verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before June 13.

The Municipal Legislature has 10 business days, up to the immediately preceding June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This permits the Municipality to continue doing payments for its operations and other purposes until the new budgets are approved.

The annual budgets may be updated for any estimate revisions as well as fiscal year-end encumbrances, and may include any additional information requested by the Municipal

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Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

Budgetary Accounting

The Municipality's annual budgets are prepared using the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

According to the budgetary basis of accounting, revenue is generally recorded when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one fiscal year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at fiscal year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying statement of revenues and expenditures – budget and actual – budgetary basis – general fund, provides information about the general fund's original budget, its amendments, and the actual results of operations of such governmental fund under the budgetary basis of accounting for the fiscal year ended June 30, 2007. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2007, which is prepared by the Municipality's Department of

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Finance. Copies of that report may be obtained by writing to the Municipality's Director of Finance at PO Box 428, Cataño, Puerto Rico 00963.

Because accounting principles applied for the purposes of the developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the general fund's budgetary basis and GAAP actual amounts is presented as follows:

Revenues and other financing sources over expenditures	
and other financing uses – budgetary basis – general fund	\$ 707,628
<i>Timing differences:</i>	
Net effect of current year encumbrances recorded as expenditures for budgetary purposes versus prior year encumbrances recorded as current year expenditures for GAAP purposes	1,503,301
<i>Entity differences:</i>	
Non-budgeted expenditures	(318,403)
<i>Basis of accounting differences:</i>	
Net increase in property taxes receivable	108,763
Net decrease in municipal license taxes receivable	(1,160,643)
Net decrease in construction excise taxes receivable	(2,528,471)
Net increase in sales and use taxes receivable	260,871
Net decrease in intergovernmental receivables	(17,211)
Net decrease in accrued interest receivable	(14,950)
Net increase in other receivables	9,694
Net decrease in due from other funds	(950,443)
Net decrease in inventories and other assets	(100,836)
Net decrease in deferred revenue	3,136,723
Net increase in accounts payable and accrued liabilities	(568,494)
Net increase in intergovernmental payables and accrued liabilities	<u>(9,765)</u>
Revenues and other financing sources over expenditures	
and other financing uses –general fund– GAAP basis	<u>\$ 57,764</u>

g) Unrestricted and Restricted Deposits

The Municipality's deposits are composed of: (1) demand deposits in commercial banks (2) demand deposits in the Government Development Bank for Puerto Rico (GDB, fiscal agent) and (3) cash equivalents in commercial banks. Cash equivalents consist of certificates of deposit with original maturities of three months or less, which amounted to \$14,000,000 in the general fund and \$400,000 in the nonmajor governmental funds at June 30, 2007. Cash equivalents are recorded at cost, which approximates fair value.

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The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements and any unrestricted excess, if any, is invested in certificates of deposit with commercial banks. Any deficiency in the pooled cash account is assumed by the general fund and covered through future budgetary appropriations. At June 30, 2007, the deficiency in the pooled cash account amounted to \$991,441, which has been recorded within accounts payable and accrued liabilities. However, no resources have been provided by the general fund for such purposes at June 30, 2007.

Under the laws and regulations of the Commonwealth of Puerto Rico, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Commonwealth's Secretary of the Treasury, but not in the Municipality's name.

Cash in fiscal agent in the general and debt service funds consists principally of property tax collections amounting to \$53,475 and \$11,363,360, respectively, which are restricted for the payment of the Municipality's debt service, as required by law. Cash with fiscal agent recorded in the capital improvements bond fund consists principally of unspent proceeds of bonds amounting to \$18,734,403, which are restricted for the acquisition, construction or improvements of major capital assets. Cash with fiscal agent recorded in the non-major governmental funds consists of the balance of interest and non-interest bearing accounts amounting to \$55,158, which are restricted to finance the operations of certain federal and state funded programs and the acquisition, construction or improvements of major capital assets.

Restricted cash in commercial banks for other governmental funds, amounting to \$1,802,488, represents the balance of interest and non-interest bearing accounts restricted to finance the operations of various federal and state funded programs.

h) Unrestricted and Restricted Accounts Receivable

Receivables consist of all revenues earned but not collected at June 30, 2007. These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

Activities among governmental funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans) or "advances to/from other funds" (i.e. the non-current portion of interfund loans), as applicable. All other outstanding balances between funds are reported as "due to/from other funds".

i) Inventories and Other Assets

Inventories consist of construction materials and inventories of office supplies, food and medicines, which are held for consumption. Other current assets consist of prepaid costs. Generally, inventories are capitalized and stated at cost using the first-in, first-out method (FIFO) in the GFFS and the GWFS. Inventories and prepaid expenses in the GFFS are generally capitalized as an asset (consumption method) when purchased (paid) rather than expensed.

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j) Deferred Charges

Deferred charges in the accompanying statement of net assets consist of bond issuance costs, net of accumulated amortization. Deferred charges are amortized over the term of the related debt using the straight-line method. In the GFFS, bond issuance costs are recorded in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

k) Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as capital outlays (expenditures).

In the statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2002 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2002 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

Major outlays for capital assets and improvements are capitalized in the statement of net assets as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

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	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20
Machinery and equipment under capital leases	3 to 5

Depreciation and amortization expense of capital assets is recorded as a direct expense of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various functions/programs but instead is reported as direct expenses of the urban and economic development function.

l) Deferred Revenues

In the GFFS, deferred revenue arises when one of the following situations occur:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period (unavailable revenue). As previously discussed, available is defined as due (or past due) at June 30, 2007 and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria are met, the liability for deferred revenue is removed and revenue is recognized.
- The Municipality receives resources before it has a legal claim to them (unearned revenue). In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

m) Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2007 and (2) is not contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

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The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of social security taxes and medicare taxes).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. In addition upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed previously. After 10 years of services, any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

The liability for compensated absences is reported in the statement of net assets. A liability for compensated absences is reported in the GFFS only when matured (when payment is due), for example, as a result of employee resignations or retirements.

n) Long-Term Debt

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds payable, notes payable, obligations under capital leases, accrued compensated absences, and federal cost disallowances.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due on July 1, 2007 are recorded as governmental fund liabilities in the GFFS when resources are available in the debt service fund (June 30, 2007). In the GFFS, the face amount of debt issued (gross debt reported) is reported as other financing sources when issued.

In the GWFS debt issuance costs are reported as deferred charges, which are amortized under the straight-line method over the life of the debt, while in the GFFS such costs are recognized as expenditures during the current period.

Non-interest bearing notes payable are accounted for under the provisions of Opinion No. 21, *Interest on Receivables and Payables*, issued by the Accounting Principles Board (APB No. 21). According to APB No. 21, the Municipality has recorded such notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The discount is amortized over the life of the notes using the effective interest method. Amortization

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of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses during the current period.

o) Leases

The Municipality classifies its lease agreements either as operating or capital leases according to Statement No.13, *Accounting for Leases*, issued by FASB (FASB No. 13). Capital lease agreements are generally non-cancelable and involve, substance over form, the transfer of substantially all benefits and risks inherent in the ownership of the leased property, while operating leases do not involve such transfer. Accordingly, a capital lease involves the recording of an asset and a related lease obligation at the inception of the lease. According to FASB No. 13, the Municipality classifies a lease agreement as a capital lease if at its inception the lease meets one or more of the following four criteria:

- By the end of the lease term, ownership of the leased property is transferred to the Municipality.
- The lease agreement contains a bargain purchase option.
- The lease term is substantially equal (75 percent or more) to the estimated useful life of the leased property.
- At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90 percent or more of the estimated fair value of the leased property.

Although the Municipality is prevented legally from entering into obligations extending beyond one fiscal year, most capital lease agreements entered by the Municipality contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have a fiscal funding or a cancellation clause have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered remote. The Municipality's lease agreements do not include contingent rental payments nor escalation clauses.

In the GWFS, the obligation under capital leases is recorded at the lesser of the estimated fair value of the leased property or the present value of the minimum lease payments, excluding any portion representing executory costs and profit thereon to be paid by the lessor. A portion of each minimum lease payment is allocated to interest expense and the balance is applied to reduce the lease obligation using the effective interest method.

In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded simultaneously as: (1) expenditures and (2) other financing sources. Minimum lease payments are recorded as expenditures in the GFFS.

p) Accounting for Pension Costs

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the state government of the

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Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth of Puerto Rico. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth of Puerto Rico report the total amount of the net pension obligation of ERS, including any amount that may correspond to the Municipality.

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

q) Risk Management

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by the Municipal Revenue Collection Center ("CRIM", by its Spanish acronym), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration (ACAA), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of

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illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a cost reimbursement basis.

The Municipality also obtains medical insurance coverage from several health insurance companies for its employees. Different health insurance coverage and premium options are negotiated each year by the Department of Treasury on behalf of the Municipality. The current insurance policies have not been canceled or terminated at June 30, 2007. Premiums are paid on a monthly basis directly to the insurance company. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

r) Reservations of Fund Balances

Reservations of fund balances represent portions of fund balances in the GFFS that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has recorded the following types of reservations of fund balances in the GFFS:

- **Encumbrances** – Represent reservations of fund balances for commitments related to unperformed (executory) contracts for goods or services (future expenditures under purchase orders, contracts and other commitments). These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future fiscal years as the goods or services are received.
- **Debt service** – Represent fund balances available to cover future debt service payments (principal and interest) on bonds payable, which are accounted for in the debt service fund.
- **Capital projects** – Represent the reservation of financial resources to be used for the acquisition, construction or improvement of capital assets under contracts and other commitments. These amounts are generally accounted for in the non-major capital projects and special revenue funds.
- **Advances from other funds** – Represent long-term amounts due from other governmental funds, which are not considered current available financial resources at June 30, 2007.
- **Inventories and other assets** – Represent the reservation of financial resources set aside for inventories and prepaid costs, which are not considered current available financial resources at June 30, 2007.
- **Federal and state funded programs** – Represent financial resources set aside for use in federal and state grant programs.

s) Interfund Activities

The Municipality has the following types of reciprocal and non-reciprocal interfund activities recorded among governmental funds in the accompanying GFFS:

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- **Interfund loans** – Represent amounts provided with a requirement for repayment, which are recorded as “due from” in the lender governmental fund and “due to” in the borrower governmental fund. Interfund receivables, which are not considered to be currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period of time, interfund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as an operating transfer from the governmental fund that made the loan.
- **Interfund transfers** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Operating transfers are reported as other financing sources in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.
- **Interfund reimbursements** – Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

In the GFFS, interfund activity has not been eliminated, as permitted by GAAP.

t) Use of Estimates

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

u) Future Adoption of Accounting Pronouncements

In June 2005, GASB issued its Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB No. 45). This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities/assets, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local government employers. The requirements of this statement are effective for the Municipality’s fiscal year commencing on July 1, 2008.

In September 2006, GASB issued its Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB No. 48). This Statement established standards for the measurement, recognition, and display of transactions where governments sometimes exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments, generally, a single lump sum. This Statement establishes criteria that the Municipality will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The requirements of this statement are effective for the Municipality’s fiscal year commencing on July 1, 2007.

In December 2006, GASB issued its Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB No. 49). This Statement identifies the circumstances

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under which a governmental entity would be required to report a liability related to pollution remediation. According to the standard, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals but will be employed for the first time by governments. GASB No. 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

The requirements of this statement are effective for the Municipality's fiscal year commencing on July 1, 2008.

In May 2007, GASB issued its Statement No. 50, *Pension Disclosures* (GASB No. 50). This Statement more closely aligns current pension disclosure requirements for governments with those that governments are beginning to implement for retiree health insurance and other post-employment benefits. Specifically, GASB No. 50 amends GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, by requiring:

- Disclosure in the notes to the financial statements of pension plans and certain employer governments of the current funded status of the plan—in other words, the degree to which the actuarial accrued liabilities for benefits are covered by assets that have been set aside to pay the benefits—as of the most recent actuarial valuation date.
- Governments that use the aggregate actuarial cost method to disclose the funded status and present a multi-year schedule of funding progress using the entry age actuarial cost method as a surrogate; these governments previously were not required to provide this information.
- Disclosure by governments participating in multi-employer cost-sharing pension plans of how the contractually required contribution rate is determined.

The requirements of this statement are effective for the Municipality's fiscal year commencing on July 1, 2007.

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In June 2007, GASB issued its Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (GASB No. 51). This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The guidance specific to intangible assets referred to above includes guidance on recognition. This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This guidance serves as an application of the specified-conditions approach described above to the development cycle of computer software. This Statement also establishes guidance specific to intangible assets related to amortization. This Statement provides guidance on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions. If there are no factors that limit the useful life of an intangible asset, the Statement provides that the intangible asset be considered to have an indefinite useful life. Intangible assets with indefinite useful lives should not be amortized unless their useful life is subsequently determined to no longer be indefinite due to a change in circumstances.

The requirements of this statement are effective for the Municipality's fiscal year commencing on July 1, 2009.

The Municipality's management has concluded that the future adoption of GASB Statements No. 45, 48, 49, 50 and 51 will not have a significant impact on the Municipality's basic financial statements.

2. Deposits

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and the Government Development Bank for Puerto Rico (GDB). Proceeds from all bonds and the funds related to certain federal grant awards are required by law to be held with GDB.

On July 1, 2004, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, and (4) foreign exchange exposure.

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth of Puerto Rico, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly, the Municipality is only allowed to invest in obligations of the Commonwealth

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of Puerto Rico, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments (debt securities) for which credit risk exposure may be significant. Consequently, at June 30, 2007 and for the fiscal year then ended, the Municipality invested only in certificates of deposit in commercial banks, which are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$100,000 per depositor. No investments in debt or equity securities were made during the fiscal year ended June 30, 2007. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2007.

- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2007, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. At June 30, 2007, the interest rate risk associated with the Municipality's cash and cash equivalent is considered low since the investment portfolio of the Municipality consists of certificates of deposit and do not include debt securities or any type of investments that could be affected by changes in interest rates.
- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits of GDB, amounting to \$30,206,396 at June 30, 2007, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2007. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2007, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.
- **Foreign exchange risk** – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2007.

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Cash and cash equivalents at June 30, 2007, are classified in the accompanying balance sheet – governmental funds as follows:

	Major governmental funds				Total
	General fund	Debt service fund	Capital improvements bond fund	Other governmental funds	
<i>Unrestricted:</i>					
Cash in commercial banks	\$ 371,456	-	-	-	\$ 371,456
Cash equivalents in commercial banks	14,000,000	-	-	-	14,000,000
<i>Restricted:</i>					
Cash in commercial banks	-	-	-	1,402,488	1,402,488
Cash equivalents in commercial banks	-	-	-	400,000	400,000
Cash in fiscal agent	53,475	11,363,360	18,734,403	55,158	30,206,396
Total carrying amount of deposits	<u>\$ 14,424,931</u>	<u>11,363,360</u>	<u>18,734,403</u>	<u>1,857,646</u>	<u>\$46,380,340</u>
Excess of checks drawn over bank balance in commercial banks	\$ 991,441	-	-	-	\$ 991,441

3. Municipal License Taxes

The Municipality is authorized by Act No. 81 to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of Cataño. This is a self-assessed tax generally based on the business volume of taxpayers, measured by gross revenues. The Municipality establishes the applicable tax rates. At June 30, 2007, the municipal license tax rates imposed by the Municipality were 1.50 percent for financial institutions and 0.50 percent for other types of taxpayers. Any taxpayers that have been granted with a partial tax exemption under any of the tax incentive acts of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must assess the corresponding municipal license tax by declaring the volume of business through a tax return to be filed every April 15, based on the actual volume of business (revenues) generated in the preceding calendar year. Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their tax return filings. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration on April 15. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5 percent discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as deferred revenues in the GWFS and the GFFS. Total municipal license tax receivable amounted to \$630,343 at June 30, 2007. Unearned municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$10,738,014 respectively at June 30, 2007. Deferred (earned and unavailable) municipal license tax revenues recorded in the accompanying GFFS amounted to \$608,052 respectively at June 30, 2007.

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4. Property Taxes

The Municipality is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1 of each calendar year: (1) is engaged in trade or business and is the owner of personal or real property used in trade or business or (2) owns residential real property with a value in excess of \$15,000 (at 1957 market prices).

CRIM is responsible for the billings and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs to the Municipality the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the fiscal year, CRIM advances funds to the Municipality based on the initial estimated collection amounts for the fiscal year. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and the property tax amounts actually collected from taxpayers during the fiscal year. This settlement has to be completed on a preliminary basis not later than December 31 following the fiscal year end. If in any given fiscal year, CRIM remits to the Municipality property tax advances, which are more or less than the property tax actually collected, the differences are adjusted prospectively against the next fiscal year's property tax advances.

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (lien; levy date) and reporting such taxable value through a personal property tax return filed on May 15 (due date and collection date) subsequent to the assessment date. The total personal property tax rate in force at June 30, 2007 was 6.83 percent (of which taxpayers pay 6.63 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 (lien; levy date) and is based on estimated current values of the property, deflated to 1957 market prices. Real property taxes are due and collectible on January 1 and July of every fiscal year. The total real property tax rate in force at June 30, 2007 was 8.83 percent (of which 8.63 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

Residential real property occupied by its owner (not engaged in trade or business) is exempt from property taxes only on the first \$15,000 of the assessed value (at 1957 market prices). For exempt amounts, the Department of Treasury assumes the payment of the basic tax (4.00 percent and 6.00 percent for personal and real property, respectively), except for property assessed for less than \$3,500 (at 1957 market prices), for which no payment is made by the Department of Treasury.

According to Act No. 81, included within the total personal and real property tax rates of 6.83 percent and 8.83 percent, respectively, there is a levy of an annual special tax of 1.03 percent of the assessed value of all real and personal property not exonerated from taxation. This special tax is levied by the Commonwealth but is collected by CRIM. Collections of this special tax are directly remitted by CRIM to the Commonwealth's debt service fund, for the payment of the general long-term debt of the Commonwealth.

In addition, included within the total personal and real property tax rates of 6.83 percent and 8.83 percent, respectively, there is a portion of the tax rate in the amount of 1.80 percent that is restricted

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for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

Furthermore, included within the total personal and real property tax rates of 6.83 percent and 8.83 percent, respectively, there is a portion of the tax rates that is recorded in the Municipality's general fund, of which a portion is restricted for the payment of: (1) the insurance premiums acquired through the Department of Treasury, (2) the monthly contributions to CRIM, which are statutorily required as the Municipality's share of CRIM's operating expenses, (3) statutory contributions to the Puerto Rico Health Services Administration (PRHSA), as the Municipality's share of the cost of the public health insurance coverage provided to qualifying low-income citizens, (4) certain notes payable to CRIM and, (5) certain amounts due to certain agencies and component units of the Commonwealth, which are recorded within intergovernmental payables in the accompanying GWFS and GFFS. The 0.20 percent of unrestricted personal and real property taxes paid by the Department of Treasury as a subsidy is recorded in the Municipality's general fund.

The Additional Lottery System of the Commonwealth (the Additional Lottery) is an operational unit reported as an enterprise fund in the Commonwealth's basic financial statements, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every fiscal year to distribute a portion of its excess of revenues over expenses as follows:

- Thirty five percent of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the thirty-five percent corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to PRHSA.

The composition of property taxes receivable is as follows at June 30, 2007:

	Gross receivable	Allowance for doubtful accounts	Net Receivable
Unrestricted - General fund	\$ 16,200,649	(13,136,257)	\$ 3,064,392
Restricted - Debt service fund	4,936,512	(4,002,759)	933,753
Totals	\$ 21,137,161	(17,139,016)	\$ 3,998,145

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5. Intergovernmental Receivables and Payables

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows:

	Major governmental funds	Other governmental funds	Total governmental funds	Statement of net assets
<i>Intergovernmental receivables:</i>				
Grants and contributions:				
Puerto Rico Treasury Department – general fund	\$ 707,725	-	-	\$ 707,725
U.S. Department of Homeland Security:				
Homeland Security Grant	-	4,200	4,200	4,200
TANF Funds	-	8,178	8,178	8,178
Puerto Rico Department of Justice	-	86,098	86,098	86,098
U.S. Department of Health and Human Services:				
Child Care Sendec Program	-	17,920	17,920	17,920
Even Start Program	-	246,999	246,999	246,999
U.S. Department of Housing and Urban Development	-	310,775	310,775	310,775
Total intergovernmental receivables	<u>\$ 707,725</u>	<u>674,170</u>	<u>674,170</u>	<u>\$ 1,381,895</u>
<i>Intergovernmental payables:</i>				
Payroll withholdings (general fund):				
Association of Employees of Commonwealth of Puerto Rico	75,061	-	75,061	75,061
Puerto Rico Treasury Department	37,686	-	37,686	37,686
Puerto Rico State Insurance Fund Corporation	-	-	-	24,516
Employees Retirement System of the Government of the Commonwealth of Puerto Rico	291,707	-	291,707	291,707
Utilities (general fund):				
Puerto Rico Aqueduct and Sewer Authority	43,776	-	43,776	43,776
Municipality of Toa Baja, Commonwealth of Puerto Rico	46,977	-	46,977	46,977
Total intergovernmental payables	<u>\$ 495,207</u>	<u>-</u>	<u>495,207</u>	<u>\$ 519,723</u>

6. Interfund Transactions

The composition of interfund balances at June 30, 2007 and for the fiscal year then ended is as follows:

<u>Due to:</u>	<u>Due from:</u>		
	<u>General fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>
Major governmental funds:			
Debt service fund	\$ 113,454	-	\$ 113,454
Capital improvements bond fund	186,270	-	186,270
Other governmental funds	761,481	10,140	771,621
Total	<u>\$ 1,061,205</u>	<u>10,140</u>	<u>\$ 1,071,345</u>

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<u>Transfers out:</u>	<u>Transfers in:</u>		
	<u>General fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>
Major governmental funds:			
General fund	\$ -	146,459	\$ 146,459
Debt service fund	7,707,610	-	7,707,610
Capital improvements bond fund	786,338	-	786,338
Other governmental funds	409,114	-	409,114
Total	<u>\$ 8,903,062</u>	<u>146,459</u>	<u>\$ 9,049,521</u>

The principal purposes of interfund receivables and payables are:

- Recognize in the general fund the due from the debt service fund, amounting to \$113,454, related to the accrued interests for the quarter ended June 30, 2007, which were subsequently transferred to the general fund on July 2007.
- Recognize in the general fund the due from the capital improvements bond fund, amounting to \$186,270, related to the accrued interests for the month of June 2007, which were subsequently transferred to the general fund on July 2007.
- Recognize in the general fund the outstanding balance of the loans granted to nonmajor capital project and special revenue funds (\$761,481) to temporarily cover the payroll and other operating costs of several federally and state funded programs.

The principal purposes of interfund transfers are to:

- Make a routinary transfer of interest income, amounting to \$493,934, from the debt service fund to the general fund, as permitted by law. This interest income is generated by the debt service fund's deposits and is transferred on a quarterly basis to the general fund.
- Make a non-routinary transfer of \$7,213,676 from the excess cash in fiscal agent of the debt service fund to the general fund to cover certain operating needs of the Municipality.
- Make a routinary transfer of interest income, amounting to \$786,338, from the capital improvements bond fund to the general fund, as permitted by law. This amount represents interest income that is generated by the unspent proceeds of bond issuances that is transferred on a monthly basis to the general fund.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers, which are considered by management to be fully realizable at June 30, 2007.

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7. Capital Assets

Capital assets activity for the fiscal year ended June 30, 2007:

	Balance at beginning of Fiscal year	Additions/ depreciation and amortization expense	Reclassification of completed works and permanent improvement projects	Balance at end of fiscal year
<i>Governmental activities:</i>				
Cost basis:				
Capital assets, not being depreciated/amortized:				
Land	\$ 10,886,735	-	-	\$ 10,886,735
Construction in progress	1,567,158	9,089,623	(3,186,148)	7,470,633
Total capital assets, not being depreciated/amortized	<u>12,453,893</u>	<u>9,089,623</u>	<u>(3,186,148)</u>	<u>18,357,368</u>
Capital assets, being depreciated/amortized:				
Land improvements	44,101,584	-	349,125	44,450,709
Buildings, structures, and improvements	42,338,872	-	1,350,337	43,689,209
Infrastructure	25,015,857	-	1,486,686	26,502,543
Machinery and equipment, and furniture and fixtures	5,500,376	108,462	-	5,608,838
Office and medical equipment under capital leases	798,925	-	-	798,925
Licensed vehicles	2,909,629	84,549	-	2,994,178
Licensed software	152,918	-	-	152,918
Total capital assets, being depreciated/amortized	<u>120,818,161</u>	<u>193,011</u>	<u>3,186,148</u>	<u>124,197,320</u>
Total cost basis of capital assets	<u>133,272,054</u>	<u>9,282,634</u>	<u>-</u>	<u>142,554,688</u>
Accumulated depreciation and amortization:				
Land improvements	7,790,436	1,744,384	-	9,534,820
Buildings, structures, and improvements	10,757,268	1,403,115	-	12,160,383
Infrastructure	5,085,154	799,241	-	5,884,395
Machinery and equipment, and furniture and fixtures	4,104,197	456,061	-	4,560,258
Office and medical equipment under capital leases	263,724	174,167	-	437,891
Licensed vehicles	1,644,670	513,900	-	2,158,570
Licensed software	135,418	17,500	-	152,918
Total accumulated depreciation and amortization	<u>29,780,867</u>	<u>5,108,368</u>	<u>-</u>	<u>34,889,235</u>
Net capital assets	<u>\$103,491,187</u>	<u>4,174,266</u>	<u>-</u>	<u>\$ 107,665,453</u>

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Depreciation and amortization expense of capital assets was charged to functions in the accompanying government-wide statement of activities as follows:

<i>Governmental activities:</i>	
General government	\$ 2,273,857
Public safety	222,172
Economic and urban development	1,380,903
Health and sanitation	40,898
Public housing and welfare	101,177
Culture, recreation, and education	<u>1,089,361</u>
Total depreciation and amortization expense	<u>\$ 5,108,368</u>

8. Deferred Revenues

At June 30, 2007, deferred revenues recorded in the GWFS and the GFFS are as follows:

	General fund	Other governmental funds	Total governmental funds	Statement of net assets
<i>Measurable and unavailable revenues:</i>				
Municipal license taxes	\$ 608,052	-	608,052	\$ -
Charges for services	22,563	-	22,563	-
Intergovernmental grants and contributions	707,525	-	707,525	-
Total measurable and unavailable revenues	<u>1,338,140</u>	<u>-</u>	<u>1,338,140</u>	<u>-</u>
<i>Unearned revenues:</i>				
Municipal license taxes	10,738,014	-	10,738,014	10,738,014
Intergovernmental grants and contributions	-	375,683	375,683	375,683
Total unearned revenues	<u>10,738,014</u>	<u>375,683</u>	<u>11,113,697</u>	<u>11,113,697</u>
Total deferred revenues	<u>\$ 12,076,154</u>	<u>375,683</u>	<u>12,451,837</u>	<u>\$ 11,113,697</u>

9. Long-Term Obligations

The general long-term debt activity for the fiscal year ended June 30, 2007 is as follows:

	Balance at beginning of fiscal year	Borrowings or additions	Payments or deductions	Balance at end of fiscal year	Balance due within one year
<i>Bonds payable:</i>					
General obligation serial bonds	\$ 44,405,000	-	(1,985,000)	42,420,000	\$ 2,120,000
Public improvement serial bonds	9,240,000	-	(740,000)	8,500,000	800,000
<i>Notes payable:</i>					
Federal Emergency Management Agency	725,615	-	(725,615)	-	-
CRIM - Act No. 146 of October 11, 2001	544,357	-	-	544,357	19,960
CRIM - Act No. 42 of January 26, 2000	6,726,016	-	(108,645)	6,617,371	115,580
Obligations under capital leases	569,305	-	(155,551)	413,754	150,183
Compensated absences	5,087,564	1,889,008	(2,119,562)	4,857,010	2,336,832
Claims and judgments	2,006,479	-	(1,808,479)	198,000	198,000
Total	<u>\$ 69,304,336</u>	<u>1,889,008</u>	<u>(7,642,852)</u>	<u>63,550,492</u>	<u>\$ 5,740,555</u>

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Historically, the general fund has been used to liquidate certain notes payable, compensated absences, obligations under capital leases, federal cost disallowances and any other long-term liabilities other than bonds.

a) Debt Limitation

The Municipal Legislature is legally authorized to approve the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth of Puerto Rico also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and bond anticipation notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued by the Municipality if the amount of the principal of, and the interest on, such bonds and bond anticipation notes (and on all bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or bond anticipation notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable and bond anticipation notes to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement.

b) Bonds Payable

The Municipality issues general obligation, special obligation and public improvement bonds to finance the acquisition, construction and improvement of capital assets, as well as, to finance certain operating needs, including the payment to suppliers in certain circumstances.

The laws and regulations of the Commonwealth of Puerto Rico provide that the Municipality's public debt will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and bond anticipation notes. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of bonds.

As described in Note 4, the Municipality levies an annual additional special tax of 1.80 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2007:

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	<u>Outstanding amount</u>
<u>General Obligation Bonds:</u>	
2003 serial bonds (face amount of \$845,000) due in annual principal installments ranging from \$145,000 to \$190,000; plus interests due in semiannually installments at variable rates (4.23% at June 30, 2007) through July, 1, 2007	\$ 190,000
2004 serial bonds (face amount of \$1,720,000) due in annual principal installments ranging from \$260,000 to \$315,000; plus interests due in semiannually installments at variable rates (4.23% at June 30, 2007) through July, 1, 2010	1,190,000
2001 serial bonds (face amount of \$7,240,000) due in annual principal installments ranging from \$195,000 to \$715,000; plus interests due in semiannually installments at variable rates (3.21% at June 30, 2007) through July, 1, 2019	6,100,000
2004 serial bonds (face amount \$10,450,000) due in annual principal installments ranging from \$315,000 to \$800,000; plus interests due in semiannually installments at variable rates (4.23% at June 30, 2007) through July, 1, 2024	9,805,000
2000 serial bonds (face amount \$11,850,000) due in annual principal installments ranging from \$315,000 to \$1,170,000; plus interests due in semiannually installments at variable rates (3.21% at June 30, 2007) through July 1, 2018	9,530,000
1998 serial bonds (face amount of \$18,825,000) due in annual principal installments ranging from \$260,000 to \$1,635,000; plus interests due in semiannually installments at variable rates (5.52% at June 30, 2007) through July 1, 2022	<u>15,605,000</u>
Total general obligation bonds	<u>42,420,000</u>
<u>Public Improvement Bonds:</u>	
1998 serial bonds (face amount of \$14,520,000) due in annual principal installments ranging from \$315,000 to \$1,370,000; plus interests due in semiannually installments at variable rates (7.41% at June 30, 2007) through July 1, 2014	<u>8,500,000</u>
Total bonds payable	<u>\$ 50,920,000</u>

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Variable interest rates on serial bonds are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper: (1) in the taxable and tax-exempt markets of the United States of America, (2) in the Eurodollar market, and (3) to corporations having tax exemptions under the Commonwealth's Industrial Incentives Acts and, which qualify for benefits provided by the former Section 936 of the U.S. Internal Revenue Code.

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

Fiscal year ending June 30,	Principal	Interest	Total
2008	\$ 2,920,000	2,828,615	\$ 5,748,615
2009	2,920,000	2,669,697	5,589,697
2010	3,135,000	2,502,037	5,637,037
2011	3,280,000	1,941,138	5,221,138
2012	3,370,000	2,318,796	5,688,796
2013-2017	17,615,000	8,488,070	26,103,070
2018-2022	14,840,000	4,581,038	19,421,038
2023-2027	2,840,000	934,394	3,774,394
Totals	<u>\$ 50,920,000</u>	<u>26,263,785</u>	<u>\$ 77,183,785</u>

At June 30, 2007, accrued interest payable on bonds amounted to \$1,439,581, which are recorded in the debt service fund and the statement of net assets.

c) Notes Payable to Federal Emergency Management Agency

On June 16, 2004, the Office of the Authorized Representative of the Governor of the Commonwealth of Puerto Rico at the Federal Emergency Management Agency and the Federal Emergency Management Agency (FEMA) issued an audit report for the solid waste disposal related to the Hurricane Georges disaster that occurred in 1998. Such report shows \$1,705,660 of ineligible costs, which subsequently were reduced to \$1,204,028. On January 19, 2005, the Municipality entered into a payment plan for \$1,204,028 payable in installments of \$50,187, commenced in July 2005, and twenty-three consecutive installments of \$50,167 through June 16, 2007. The note did not bear interests and had an imputed interest rate of 5.50 percent.

d) Notes Payable to Municipal Revenue Collection Center (CRIM)

The Municipality had the following notes payables to CRIM at June 30, 2007:

- **Public Act No. 146** – On September 24, 2002, CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Public Act No. 146 of October 11, 2001, as amended (Act No. 146). The purpose of this

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financing agreement was to extinguish in advance certain bonds payable issued by Public Finance Corporation (PFC), a subsidiary of GDB, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996, which were acquired by PFC with recourse.

The original face amount of the note allocated by CRIM to the Municipality was \$731,579, for a term not exceeding 30 years. The note bears interest at 6.50 percent during its first five years. Subsequently, from years 6 through 30, the loan shall bear variable interest at a rate of 125 points over the 5-year LIBOR rate, which will be adjusted every five years. During the first five years of the note, commenced on July 1, 2003, the Municipality shall pay only interest through the fiscal year ended June 30, 2007. At the end of the first five years of the note, the repayment terms and conditions of the note shall be renegotiated to allow the Municipality to pay the outstanding balance of the note in equal installments of principal plus interest, through maturity. Interest payments on this financing agreement are accounted for in the general fund.

The outstanding principal of the note payable to CRIM amounted to \$544,357, at June 30, 2007. The principal and interest maturities are as follows:

Fiscal year Ending June 30,	Principal	Interest	Total
2008	\$ 19,960	34,843	\$ 54,803
2009	21,774	33,437	55,211
2010	21,774	32,022	53,796
2011	21,774	27,776	49,550
2012	21,774	24,237	46,011
2013-2017	108,870	103,497	212,367
2018-2022	108,870	68,113	176,983
2023-2027	108,870	32,730	141,600
2028-2032	110,691	3,185	113,876
Totals	<u>\$ 544,357</u>	<u>359,840</u>	<u>\$ 904,197</u>

- **Public Act No. 42** – The Commonwealth's Public Act No. 42 of January 26, 2000 (Act No. 42) was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement authorized CRIM to finance a debt that the municipalities of Puerto Rico had with such entity, which arose from the difference between the yearly final settlements of property tax advances made by CRIM to the municipalities and the actual property tax collections received by CRIM from taxpayers through fiscal year 2000. The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth are assigned through Act No. 42 to repay such note. The increase in this subsidy was the result of Public Act No. 238 of August 15, 1999.

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In addition, on December 16, 2002 the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$7,092,328 of excess of property tax advances from fiscal years 2000, 2001 and other previous fiscal years. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each fiscal year. The repayment agreement bears interest at variable rates determined by GDB (6.30 percent at June 30, 2005) but not exceeding 8.00 percent. Principal and interest payments on this financing agreement are accounted for in the general fund. The outstanding principal and accrued interest balances of this note amounted to \$6,617,371 and \$32,826, respectively, at June 30, 2007. The principal and interest maturities are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2008	\$ 115,580	34,843	\$ 150,423
2009	122,958	33,437	156,395
2010	130,807	32,022	162,829
2011	139,157	30,607	169,764
2012	168,186	26,361	194,547
2013-2017	840,930	131,803	972,733
2018-2022	1,145,857	96,420	1,242,277
2023-2027	1,561,353	61,037	1,622,390
2028-2032	2,127,515	25,653	2,153,168
2033-2036	265,028	885	265,913
Totals	<u>\$ 6,617,371</u>	<u>473,068</u>	<u>\$ 7,090,439</u>

e) Capital Lease Obligations

The Municipality is obligated under capital leases with third parties that expire through 2011 for the acquisition of machinery and equipment. At June 30, 2007, the capitalized costs and the related accumulated depreciation of the leased machinery and equipment amounted to \$798,925 and \$437,891, respectively, which are accounted for as capital assets in the accompanying statement of net assets. Amortization charges applicable to capital leases and included within depreciation expense amounted to \$174,167 for the fiscal year ended June 30, 2007. The present value of the future minimum capital lease payments reported in the accompanying statement of net assets is as follows:

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	Fiscal year ending June 30,	Amount
	2008	\$ 177,599
	2009	152,989
	2010	117,225
	2011	15,445
Total future minimum lease payments		463,258
Less: amounts representing future interests at a rate of 8.00%		(49,504)
Present value of minimum lease payments at June 30, 2007		413,754
Less: current portion of obligation under capital leases		(150,183)
Obligation under capital leases, excluding current portion		\$ 263,571

f) Compensated Absences

At June 30, 2007, the liability for compensated absences is composed as follows:

Vacations	\$ 2,269,210
Sick leave	2,350,579
Compensatory time	237,221
Total compensated absences	\$ 4,857,010

10. Employees' Retirement Systems

a) Plan Description

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. Substantially all full-time employees of the Commonwealth and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed.

ERS members, other than those joining it after March 31, 1990, are eligible for the benefits described below:

- *Retirement Annuity*

ERS members are eligible for a retirement annuity upon reaching the following age:

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Policemen and firemen:	Other employees:
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

ERS members are eligible for monthly benefit payments determined by the application of the stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a member is eligible, is limited to a minimum of \$300 per month and a maximum of 75 percent of the average compensation.

- ***Merit Annuity***

ERS members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65 percent and a maximum of 75 percent of the average compensation.

- ***Deferred Retirement Annuity***

A participating employee who ceases to be an employee of the Municipality after having accumulated a minimum of ten years of credited service qualifies for retirement benefits provided his/her contributions are left in ERS until reaching 58 years of age.

- ***Coordinated Plan***

On the coordinated plan, by the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

- (a) \$165 per month, if retired with 55 years of age and 30 years of credited service.
- (b) \$110 per month, if retired with less than 55 years of age and 30 years of credited service.
- (c) All other between \$82 and \$100 per month.
- (d) Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over \$165 per month.

- ***Non-Coordinated Plan***

On the non-coordinated plan the participating employee and does not have any change on the pension benefits upon receiving social security benefits.

- ***Reversionary Annuity***

An ERS member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than \$240 per year or greater than the annuity payments being received by the retiree.

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- ***Occupational Disability Annuity***

A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50 percent of the compensation received at the time of the disability.

- ***Nonoccupational Disability Annuity***

A participating employee, totally and permanently disabled for causes not related to his/her occupation and with no less than 10 years of credited service, is eligible for an annuity of 1.50 percent of the average compensation of the first 20 years of credited services, increased by 2 percent for every additional year of credited service in excess of 20 years.

- ***Death Benefits***

Occupational:

- (a) **Surviving spouse** – annuity equal to 50 percent of the participating employee's salary at the date of the death.
- (b) **Children** - \$10 per month for each child, minor or student, up to a maximum benefit per family of \$100.

Nonoccupational:

Beneficiary – the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

Post-retirement:

Beneficiary with surviving spouse age 60 or over and a child, 18 or under, up to 30 percent (60 percent, if not covered under Title II of the Social Security Act) (increased to 50 percent effective January 1, 2005) of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

- ***Refunds***

A participating employee who ceases his/her employment with the Municipality without the right to a retirement annuity has the right to a refund of the contributions to ERS plus any interest earned thereon.

- ***Cost of Living Adjustment for Pension Benefits***

Public Act No. 10 of May 21, 1992 (Act No. 10) provided for increases of 3 percent every three or more years of retirement. Act No. 10 requires further legislation to grant this

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increase every three years subject to the presentation of actuarial studies regarding its costs and the source of financing. To protect the financial health of ERS, the increase granted during 2001 and the one granted on January 1, 2005 are being financed by the Municipality and the other participating employers.

To avoid any economic impact on ERS, the employers are responsible for contributing to ERS the amounts to cover the benefit payments and the employer and employee contributions with respect to the participants covered until the participants reach the normal retirement age.

- *Amendment to Act No. 447 effective January 1, 2000 to create a Defined Contribution Plan*

On September 24, 1999, Public Act No. 305, an amendment to Act No. 447, was enacted to establish a defined contribution plan, known as System 2000, to cover employees joining ERS on or after January 1, 2000.

Employees that participated in the original plan as of December 31, 1999, had the opportunity to elect to either stay in the defined benefit plan or transfer to System 2000. Employees that joined the Municipality on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

Historically, the state government of the Commonwealth has reported ERS and System 2000 in its basic financial statements as pension trust funds. Accordingly, the Commonwealth is currently assuming any actuarial deficiency that may exist or arise related to the Municipality's participating employees because ERS does not allocate to the Municipality any actuarial deficiencies pertaining to participating municipal employees. The Municipality is only required by law to make statutory contributions at the rates detailed below.

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• *Recent Amendments to Act No. 447*

The Senate and the House of Representatives of the Commonwealth of Puerto Rico have the authority for establishing or amending the contribution requirements of System 2000 by approving the necessary amendments or laws, subject to the final approval of the Governor of the Commonwealth of Puerto Rico.

In June and July 2003, the Governor of the Commonwealth signed three Public Acts that provided the following certain benefits to retirees:

- (a) Increase in minimum monthly pension payments to \$300, effective January 1, 2005.
- (b) Triennial 3 percent increase in all pensions, effective January 1, 2005.
- (c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2005.

All the benefits granted will be funded through budgetary assignments in the Municipality's general fund with respect to its retired employees.

The Board of Trustees of ERS approved, effective November 17, 2003, an increase in the amount granted on personal loans to participating employees from \$3,000 to \$5,000.

b) Funding Policy

The contribution requirements to ERS is established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
<i>Employees:</i>	
Coordination plan:	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent gross salary in excess of \$6,600.
Supplementation plan:	8.28 percent of gross salary. This is the only choice available to policemen, firemen and mayors

The contribution requirement to System 2000 is also established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
<i>Employees:</i>	
	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent gross salary in excess of \$6,600.

During the fiscal years ended June 30, 2005, 2006, and 2007, the Municipality and the participating employees contributed at least 100 percent of the required contributions to ERS and

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System 2000. The combined actual contributions made by the Municipality and its participating employees to ERS and System 2000 (which equal or exceed the required contribution amounts) were as follows during the last three fiscal years:

Fiscal year ended June 30,	Employer contributions	Employee contributions
2005	\$1,210,161	\$ 1,019,387
2006	1,305,423	1,159,463
2007	1,378,392	1,224,562

The above actual employer contributions for the fiscal years ended June 30, 2005, 2006, and 2007 include the employer contributions to System 2000 amounting to \$530,050, 543,572 and \$639,110, respectively. In addition, the above actual employee contributions for the fiscal years ended June 30, 2005, 2006, and 2007 include the employee contributions to System 2000 amounting to \$495,913, \$488,227 and \$573,180, respectively.

The authority under which obligations to contribute to ERS and System 2000 by the plans' members, employers and other contributing entities (i.e., state or municipal contributions) are established or may be amended by law by the House of Representatives, the Senate and the Governor of the Commonwealth of Puerto Rico.

Readers can obtain copies of the audited basic financial statements (GAAP basis) of ERS and System 2000 by writing to Mr. Juan Cancel, Executive Director of the Retirement Systems Administration of the Commonwealth of Puerto Rico (the entity that administers ERS and System 2000) at PO Box 42003, Minillas Station, Santurce, Puerto Rico 00940.

11. Commitments and Contingencies

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Public Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Public Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, the Municipality has reported liabilities of \$198,000 for awarded or anticipated unfavorable judgments as of June 30, 2007. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significant, if any.

The Municipality has reported, outstanding encumbrances amounting to \$1,810,877 in the general fund at June 30, 2007. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

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The Municipality has outstanding construction project commitments amounting to approximately \$7 million at June 30, 2007, which principally consist of the construction of a new Diagnostic and Treatment Center to be constructed during the fiscal year 2007-2008.

The Municipality receives financial assistance from the federal Governments of the United States of America and the Commonwealth in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. Disallowance as a result of these audits may become liabilities of the Municipality.

The "Reports on Compliance and Internal Control in Accordance with Government Auditing Standards and the Requirements of OMB Circular A-133" for the fiscal year ended June 30, 2007, disclosed various instances of noncompliance with applicable laws and regulations and with internal accounting and administrative controls. If expenditures are disallowed due to noncompliance with grant programs regulations, the Municipality may be required to reimburse the grantor the disallowed amounts. Management believes that the Municipality will be able to comply with the terms of corrective action plans that may be requested by the federal grantors, if any. Consequently, the accompanying basic financial statements do not include any provision or reserve for possible disallowed costs arising from the federal funds disbursed during the fiscal year ended June 30, 2007.

12. Liquidity and Cash Flows

During the last three fiscal years, the Municipality's general fund has reported recurring excesses of expenditures over revenues, which have lead to significant transfers of financial resources from the debt service fund to the general fund to mitigate budgetary and cash flows shortfalls during the last two fiscal years. Accordingly, during the current fiscal year the Municipality transferred \$7,707,610 from the debt service fund to the general fund, as permitted by law, to provide additional financial resources to mitigate the general fund's excess of expenditures over revenues of \$8,698,839 for the fiscal year ended June 30, 2007. Management of the Municipality is currently evaluating different alternatives for the permanent financing of the Municipality's operations, principally to increase its revenue sources and implementing continuous cost reductions policies.

13. New Sales and Use Tax System and Subsequent Events

On July 1, 2006, the Legislature of the Commonwealth of Puerto Rico approved Law No. 117, known as *Tax Justice Law of Puerto Rico* (Law No. 117). Law No. 117 established a seven percent (7%) sales and use tax to substantially all products and services sold in Puerto Rico, of which 5.5% represents a state tax and 1.5% represents a municipal tax pertaining to the Municipality. The state tax was effective for substantially all products and services sold starting November 15, 2006. Municipal sales and use tax revenues recorded in the general fund amounted to \$1,777,973 for the fiscal year ended June 30, 2007. In addition, at June 30, 2007, the municipal sales and use taxes receivable amounted to \$260,871.

On July 29, 2007, the Legislature of the Commonwealth of Puerto Rico approved Law No. 80 (Law No. 80) to amend the provisions of Law No. 117. The amendments of Law No. 80 made obligatory the implementation of a uniform sales and use tax of 1.5% in all municipalities of Puerto Rico that as

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of June 30, 2007 had not approved such kind of tax. The total tax rate of 1.5% will be divided as 1.00% to be collected by each municipality and 0.5% will be collected by the Puerto Rico Treasury Department.

The 0.5% referred to above will be administered by the Government Development Bank for Puerto Rico for the following purposes: (1) 0.2% will be deposited in the new "Municipal Debt Service Fund", strictly for granting loans to the municipalities of Puerto Rico, (2) 0.2% for the creation of the "Municipal Development Fund" % to be distributed among all municipalities pursuant to a formula established by Law No. 80, and (3) 0.1% for the creation of the "Permanent Improvements Fund", to be distributed by the Legislature of the Commonwealth of Puerto Rico to carry out public works and permanent improvement projects.

14. Prior-Period Adjustments and Restatements

On July 1, 2006, the Municipality recorded a prior-period adjustment of \$29,680 in the accompanying statement of net assets and the balance sheet – governmental funds to correct the beginning balances of cash.

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Statement of Revenues and Expenditures – Budget and
Actual –Budgetary Basis – General Fund
Fiscal Year Ended June 30, 2007

	Budgeted amounts		Actual	Variance
	Original	Final	(budgetary	with final
			basis)	budget -
			(see Note 1)	over (under)
Revenues:				
Taxes:				
Property taxes	\$ 17,734,179	17,734,179	18,566,023	\$ 831,844
Municipal license taxes	12,250,000	12,250,000	12,072,058	(177,942)
Construction excise taxes	1,605,000	1,605,000	1,176,625	(428,375)
Sales and use taxes	-	-	1,517,102	1,517,102
Charges for services	505,333	505,333	568,519	63,186
Intergovernmental grants and contributions	2,601,967	2,601,967	2,585,725	(16,242)
Interest on deposits and investments	1,100,000	1,100,000	2,377,438	1,277,438
Miscellaneous	2,001,664	4,882,708	729,052	(4,153,656)
Total revenues	<u>37,798,143</u>	<u>40,679,187</u>	<u>39,592,542</u>	<u>(1,086,645)</u>
Expenditures:				
Current:				
General government	19,447,425	20,334,831	17,101,262	3,233,569
Urban and economic development	5,074,634	5,870,862	6,660,908	(790,046)
Public safety	3,165,924	4,340,545	5,505,063	(1,164,518)
Health and sanitation	3,598,970	3,427,418	7,241,060	(3,813,642)
Culture, recreation and education	1,074,640	3,042,341	2,211,538	830,803
Public housing and welfare	3,623,824	1,850,464	4,688,001	(2,837,537)
Debt service:				
Principal	989,811	989,811	989,811	-
Interest	508,731	508,731	508,731	-
Capital outlays	314,184	314,184	314,184	-
Total expenditures	<u>37,798,143</u>	<u>40,679,187</u>	<u>45,220,558</u>	<u>(4,541,371)</u>
Revenues under expenditures	-	-	(5,628,016)	(5,628,016)
Other financing sources (uses):				
Operating transfers-in from other funds	-	-	8,903,062	8,903,062
Operating transfers-out to other funds	-	-	(2,567,418)	(2,567,418)
Total other financing sources (uses), net	-	-	<u>6,335,644</u>	<u>6,335,644</u>
Revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>-</u>	<u>707,628</u>	<u>\$ 707,628</u>

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

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Schedule of Expenditures of Federal Awards
June 30, 2007

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Expenditures</u>
U.S. Department of Housing and Urban Development			
Pass-through State – Commissioner Office of Municipal Affairs Community Development Block Grant- Small Cities (SBGP)	14.219	N/A*	\$1,641,045
Emergency Shelter Grants Program	14.231	S-05-DC-72-001	21,190
Total U.S. Department of Housing and Urban Development			<u>1,662,235</u>
U.S. Department of Health and Human Services			
Passed through the Office of Administration for Children and Families Child Care and Development Block Grant	93.575	241-2007-000118	94,382
Total U.S. Department of Health and Human Services			<u>94,382</u>
U.S. Department of Education			
Even Start – State Educational Agencies	84.213	N/A*	340,283
Total U.S. Department of Education			<u>340,283</u>
U.S. Department of Agriculture			
Child and Adult Care Food Program	10.558	N/A	18,271
Total U.S. Department of Transportation			<u>18,271</u>
U.S. Department of Homeland Security			
Homeland Security Grant Program	97.067	N/A	4,200
Total U.S. Department of Homeland Security			<u>4,200</u>
Total Federal Financial Assistance			<u>\$ 2,119,371</u>

- Major Programs

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Expenditures of Federal Awards
June 30, 2007

NOTE 1 - GENERAL

~~The accompanying Schedule of Expenditures of Federal Awards includes the federal grant~~ activity of the Municipality of Cataño of the Commonwealth of Puerto Rico and is presented on the accrual basis of accounting. The Municipality of Cataño reporting entity is defined in Note 1 to the Municipality's basic financial statements. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in our used in the preparation of the basic financial statements.

NOTE 2 - RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Revenues and expenditures of the federal awards are included in the Municipality's basic financial statements within the Major and Nonmajor Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Expenditures in the basic financial statements:

Major Funds	\$ 59,037,239
Nonmajor Governmental Funds	<u>3,875,068</u>
	62,912,307
Less non-federal expenditures	<u>(60,792,936)</u>
 Expenditures in the Schedule of Expenditures of Federal Awards	 <u>\$ 2,119,371</u>



BENITEZ-JAIME, CPA-PSC

Certified Public Accountants and Business Consultants

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF CATAÑO

Report on Compliance and on Internal Control over Financial Reporting Based on an
audit of Financial Statements performed in accordance with Government Auditing Standards

June 30, 2007

To the Honorable Mayor
and the Municipality of Cataño
Cataño, Puerto Rico

We have audited the financial statements of the Municipality of Cataño of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2007, and have issued our report thereon dated November 27, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Municipality's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality of Cataño of the Commonwealth of Puerto Rico internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over financial reporting.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the organization's financial statements that is more than inconsequential will not be prevented or detected by the organization's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting as items 07-01 thru 07-08.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO

Report on Compliance and on Internal Control over Financial Reporting Based on an
audit of Financial Statements performed in accordance with Government Auditing Standards
June 30, 2007

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 07-01, 07-02, 07-03 and 07-04c to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of Cataño of the Commonwealth of Puerto Rico financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 07-09 thru 07-22.

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

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

Toa Alta, Puerto Rico
November 27, 2007

Stamp No. 2235766
was affixed to the
original report.

 CPA-PSC



BENITEZ-JAIME, CPA-PSC

Certified Public Accountants and Business Consultants

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF CATAÑO

Report on compliance with requirements applicable to each major program and on
Internal Control over compliance in accordance with OMB Circular A-133

June 30, 2007

To the Honorable Mayor
and the Municipality of Cataño
Cataño, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Cataño of the Commonwealth of Puerto Rico (the Municipality) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. Municipality's major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality's management. Our responsibility is to express an opinion on Municipality's compliance based on our audit.

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

As described in items 07-10, 07-11, 07-15, 07-16, 07-17 and 07-18 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with the procurement, suspension and debarment, equipment and real property management, cash management, reporting requirements, special tests and provisions, and earmarking requirements that are applicable to its Community Development Block Grant – Small Cities. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

As described in items 07-10, 07-11, 07-19, 07-20, and 07-22 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with the procurement, suspension and debarment, equipment and real property management, matching-level of effort and earmarking and reporting requirements that are applicable to its Even Start – State Educational Agencies Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO

Report on compliance with requirements applicable to each major program and on
Internal Control over compliance in accordance with OMB Circular A-133

June 30, 2007

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, the Municipality of Cataño, Commonwealth of Puerto Rico did not comply, in all material respects, with the requirements referred to above that are applicable to the Even Start-State Educational Agencies Program. Also, in our opinion the Municipality of Cataño, Commonwealth of Puerto Rico, except for the instances

of noncompliance described in preceding paragraphs the Community Development Block Grant – State Program complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007.

The results of our auditing procedures also disclosed other instance of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as items 07-09, 07-12, 07-13, 07-14 and 07-21.

Internal Control Over Compliance

The management of Municipality of Cataño, Commonwealth of Puerto Rico is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over compliance.

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 07-01 thru 07-08 significant deficiencies.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO

Report on compliance with requirements applicable to each major program and on
Internal Control over compliance in accordance with OMB Circular A-133

June 30, 2007

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 07-01, 07-02, 07-03 and 07-04c to be material weaknesses.

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

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

Toa Alta, Puerto Rico
November 27, 2007

Stamp No. 2235767
was affixed to the
original report.

A large, stylized handwritten signature in black ink, followed by the handwritten text "CPA-PSC". The signature appears to be a cursive name, possibly "Benitez", with a long vertical stroke extending downwards.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness (es) identified? yes no

Control deficiencies identified
not considered to be material weakness? yes none reported

Noncompliance material to financial statements
noted? yes no

Federal Awards

Internal Control over major programs:

Material weakness (es) identified? yes no

Control deficiencies
not considered to be material weaknesses? yes none reported

Type of auditor's report issued on compliance

For major programs: Qualified-Community Development Block Grant-Small Cities
Adverse- Even Start-State Educational Agencies Program

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

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
14.219	Community Development Block Grant - Small cities Program
84.213	Even Start-State Educational Agencies Program

Dollar threshold used to distinguish
Between Type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee? yes no

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Section II - Financial Statement Findings

The current year findings and questioned costs were discussed with the Municipality's management which generally concurred with our comments and recommendations. The Municipality of Cataño will respond to the following findings through the issuance of a separate letter addressed to the Cognizant Agency.

07-01 DEFICIENCIES IN THE UNIFORM ACCOUNTING SYSTEM AND OTHER ACCOUNTING RECORDS

The Uniform Accounting System (UAS) and the accounting records currently used by the Municipality do not have the necessary capabilities, procedures, internal controls and records to ensure accurate financial reporting and to prepare the Municipality's basic financial statements and federal programs' reports in conformity with Accounting Principles Generally Accepted in the United States of America for State and Local Governments (GAAP). The UAS is a system promulgated by the Office of the Commissioner of Municipal Affairs of Puerto Rico (OCAM, by its Spanish acronyms), a governmental entity created by law to provide technical assistance to the municipalities of Puerto Rico in several administrative and fiscal matters.

The Municipality's UAS mostly provides for the recording of revenue collections, disbursements and other limited transactions. In addition, the accounting records are not fully integrated, and a double entry system is not generally followed. Accounting records are maintained on the cash basis and budgetary accounting bases (two accounting bases that differ significantly from GAAP) and do not comply with Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended.

The following specific additional conditions were noted in relation to the UAS of the Municipality:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the UAS. The balance sheet accounts in the UAS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.
- The UAS does not have the capabilities of: (1) distinguish between expenditures (expenses) incurred and encumbered, (2) recording and processing all types of capital asset transactions, principally the accounting of depreciation and amortization expense, (3) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (4) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, estimated liability for municipal solid waste landfill closure and post-closure maintenance costs, etc.
- No adequate year-end closing procedures are made to account for all transactions affecting all funds.
- No adequate segregation is made between items representing actual accounts payable and those representing outstanding encumbrances. Accordingly, material amounts of unrecorded liabilities are generally recorded at fiscal year-end.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

- The management of the federal programs administered by the Municipality maintains separate accounting records for each federal program, which are not reconciled with the UAS (the official accounting system of the Municipality).

- No adequate and complete accounting records are kept for inter-fund balances and transactions.
- The audit adjustments resulting from Single Audits are not completely posted in the UAS.

The basic financial statements of the Municipality must be prepared using the financial information obtained from various municipal departments and accounting records outside of the official UAS, and from information obtained from regulators and independent third parties. In addition, the Department of Finance does not maintain accounting records and working papers supporting the balances and disclosures reported in the basic financial statements, principally those related to government-wide financial reporting.

The Department of Finance does not maintain accounting records supporting the following procedures performed as part of the preparation of the basic financial statements of the Municipality:

- The conversion of accounting records from the cash basis of accounting to the modified accrual basis of accounting used by governmental funds;
- The conversion of governmental funds from the modified accrual basis to the accrual basis of accounting used by government-wide financial statements; and
- Working papers and analyses of significant balances reported in the basic financial statements, such as capital assets, accounts receivable (municipal licenses, grants and contributions, etc.), deferred revenues, accounts payable, and long-term obligations (for which the general practice is to rely upon the notifications received from the Government Development Bank for Puerto Rico, the Puerto Rico Treasury Department, the Federal Government and the Municipal Revenue Collection Center for the balance of its outstanding debt and the withholding for its debt service).

CRITERIA:

Article 8.010(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality must maintain its fund accounting in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP), as promulgated by the Governmental Accounting Standards Board (GASB), the National Committee on Governmental Accounting (NCGA) and the Governmental Accounting, Auditing and Financial Reporting book (commonly known as Blue Book).

In addition, Article 8.010(c) of Law No. 81 states that uniform accounting system used by the Municipality must: (1) produce reliable reports and financial statements, (2) provide complete information about the results of operations of the Municipality, and (3) include the necessary internal controls to account all funds, capital assets and other assets of the Municipality.

Furthermore, Section 5 of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico*, which were created pursuant to Article 19.011 of Law No. 81 and approved by the Office of the Commissioner of Municipal Affairs, state that the accounting system of the Municipality should include:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

- Final entry books that allow for the preparation of month-end summaries of transactions for posting in the original entry records and for the gathering of information needed for the preparation of basic financial statements and other reports;

- Fiscal procedures for the system's operations, establishing proper internal controls and the prevention of irregularities. These procedures should provide for the timely and accurate performance of operations. It should include the necessary records, files, reconciliations, adjustments, closing entries, reports, and all other necessary documentation to support the basic financial statements.

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2006 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

The continued failure to have an adequate accounting system does not allow the Municipality to have timely and accurate financial information for its decision making process. In addition, financial reports prepared may have errors or omissions that will affect future financial decisions. Another effect is the use of inaccurate financial information as a base for the preparation of annual budgets, which, therefore, may result in budgetary compliance problems.

RECOMMENDATION:

We recommend the Municipality to explore different alternatives for the implementation of a new accounting system in compliance with all applicable federal and local laws and regulations. This process should include only accounting systems that will enable the Municipality to prepare its basic financial statements in a timely manner and in conformity with GAAP. The systems to be evaluated must provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements, including:

- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for federal funds;
- The preparation of periodic financial reports to be submitted to the Director of finance, the Mayor, the Municipal Legislature and the federal grantors; and
- Adequate training to all accounting personnel to improve the understanding of the system and to promote operational efficiency

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

The Department of Finance must establish and document new accounting policies and procedures addressed to correct the non-compliance situations referred to above. Accounting policies and procedures shall be promulgated by an appropriate level of management to emphasize their importance and authority. The ~~documentation of such accounting policies and procedures shall be updated periodically according to a predetermined schedule.~~

07-02 INACTIVE AND UNNECESSARY FUNDS

The Municipality is maintaining an excessive number of funds that have been inactive for a long period. The accounting records include over 54 different funds (20 pertaining to the Special Revenue and 34 pertaining to the Capital Projects Funds) which amounted to \$669,074, many of which have been inactive or had insignificant movement or operations during the year under audit.

This situation results from the need to analyze and close inactive funds when the fund's objective has been achieved or are no longer of significance. The internal control structure should provide for the accurate maintenance of the books, records, funds and accounts necessary to carry out the Municipality's operations.

CRITERIA:

Article 8.007(b) of the Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that funds without specific fiscal years should be closed when the fund's objectives have been completed.

NCGA Statement No. 1, paragraph 4, states that "governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established since unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration".

In addition, the recommended practice on "*Improving the Effectiveness of Fund Accounting*" (2004), issued by the Government Finance Officers Association of the United States and Canada (GFOA), states that it is important in this regard to distinguish accounting from financial reporting. Whereas an accounting system must collect all of the data needed to ensure and demonstrate legal compliance, financial reporting is concerned with only those aspects of compliance that are of importance to users of general purpose external financial reports.

This situation occurred because the Municipality has not analyzed and closed inactive funds and bank accounts when the fund's objectives have been met or are no longer relevant. The continued maintenance of these funds and accounts exposes the Municipality to the unauthorized use of funds from inactive accounts for activities not intended to be financed with these funds. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

RECOMMENDATION:

The Municipality should close all unnecessary and inactive funds or accounts. Budgetary balances or deficits remaining in those funds should be investigated and properly closed or established by law. The Municipality should determine whether the intended objectives of these funds were met. For all funds that have complied with the requirements, the Municipality should close them. Remaining balances in those funds should be disposed of in accordance with local and federal laws and regulations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

07-03 LACK OF MONITORING AND FRAUD PREVENTION ACTIVITIES

As part of our evaluation of internal controls of the Municipality we noted that the Municipality have not designed, documented nor placed in operations specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material inadequate financial reporting. In addition, does not keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality's core processes. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

CRITERIA:

Article 6.004 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states the Municipality shall perform interventions, audits and monitoring activities over all municipal operations financed with public funds, including: (1) the acquisition, use and disposition of capital assets, (2) transactions and operations of all administrative units (municipal departments), and (3) all accounts, records, books, contracts, budgets and any other financial activities.

These conditions arose by the lack of effective controls and procedures for the evaluation of significant risk factors in all municipal areas, the lack of proper planning of continued monitoring activities, and the lack of proper allocation of human resources and time schedules to perform the activities required by law.

RECOMMENDATION:

We also recommend the Municipality to prepare a manual of policies and procedures specifically designed to prevent and detect fraud. The Municipality should also keep formal documentation of all fraud prevention and monitoring activities performed by management, including the identification and evaluation of all fraud risk factors. Fraud risk assessments should be reviewed periodically to consider changes in the operating policies of the Municipality and the control environment.

07-04 CASH AND BANK ACCOUNTS

The Municipality has not established sufficient controls in the handling of bank accounts to prevent errors and irregularities from being timely detected. The following control deficiencies were noted during our examination:

- a) The cash balance shown by the Municipality's Treasury Department for the Debt Service Fund as of June 30, 2007, did not agree with the notification of the Account Activity of the Municipal Revenues Collection Center, known by its Spanish acronym as CRIM. This is due to transactions for the fiscal year which were not recorded for in the Municipality's books. Although such information was received late from the CRIM, the Municipality had not closed the books at that date and such transactions could have been properly recorded.

RECOMMENDATION:

We recommend that transactions affecting funds held by the CRIM for the Municipality's Debt Service Fund should be recorded on a timely basis and balances reconciled periodically, especially at year end.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
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June 30, 2007

- b) Reconciling items or differences have been outstanding for more than one year without adequate explanation. The bank reconciliations are the following:

<u>BANK ACCOUNT NAME</u>	<u>RECONCILING ITEMS</u> <u>AMOUNT</u>
• Cuenta corriente	\$ 5,078
• Aportación de Padres Municipal	44
• Reforma de Salud IPA	<u>2,232</u>
	<u>\$ 7,354</u>

- c) Per our audit work in the Cash and Bank Accounts Area, we noted that the reconciled balance of the "Cuenta Corriente" account reflected an incorrect balance at June 30, 2007. On June 29, 2007 the Municipality opened a certificate of deposit amounting to \$3,000,000 in another financial institution by issuing a check from its "Cuenta Corriente" account. Such check was not included as part of the list of outstanding checks at June 30, 2007. As a result of this error in recording the transaction the reconciled cash account balance at year end was overstated by \$3,000,000. The aforementioned conditions represent material weakness in the Municipality's internal controls over financial reporting.

RECOMMENDATION:

Monthly bank reconciliations are a strong internal control feature over cash and could indicate any potential misapplications of cash. We recommend the Municipality identify and resolve reconciling items each month in order to provide a more accurate accounting of cash accounts, enhance the internal controls over the cash function, and improve cash management.

07-05 MUNICIPAL LICENSE TAX

We selected 40 municipal license taxpayers' files for examination amounting to \$4,994,869. The following deficiencies were noted during our test:

- In 16 (40%) municipal license taxpayers files examined amounting to \$392,852, the municipal license issued were not present in file.
- In 3 (8%) municipal license taxpayer files amounting to \$95, the Modelo #5 -- Registro de Patente de Industria y Comercio" were not present in file.
- In 1 (3%) municipal license tax payer file amounting to \$41, the income section of the volume of business tax return did not agree with the volume of the business tax return.
- In 3 (8%) municipal license taxpayers' files amounting to \$75, the income tax return was not present in file.
- In 1 (3%) municipal license taxpayer file amounting to \$244, the required audited financial statement for Volume of Business exceeding \$1,000,000 was not present in file.

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June 30, 2007

- In 1 (3%) municipal license taxpayer file amounting to \$161, the Volume of Business tax return was not sworn.

RECOMMENDATION:

According to Sec. 651i (a) (F) (i) Law No. 113 of July 10, 1974 as amended, for a volume of business less than \$1,000,000 the taxpayer must include a copy of the income section of the income tax return submitted to Puerto Rico Treasury Department. This document must be accompanied by a certification indicating that it is an exact copy of the documents submitted to the Treasury Department of the income tax return. All tax declarations without this certification will be considered not filed by the taxpayer.

The Municipality should improve the existing procedures related to the municipal license taxpayer files, to ascertain its completeness and accuracy. Also, the Municipality should implement a checklist to be used for each taxpayer to assure completeness of the required documentation.

07-06 DISBURSEMENT TEST

As part of our test of cash disbursements during the year (amounting to approximately \$88 million), we selected 40 disbursement vouchers amounting to \$197,223. The following deficiencies were noted during our examination:

- In 22 (55%) disbursements vouchers amounting to \$167,955 we could not trace them to the General ledger.
- In 7 (18%) disbursements vouchers amounting to \$108,037 we could not trace them to the Orders and Contracts Book since they were not posted.

CRITERIA:

According to the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico, the pre-auditing unit or person in charge of pre-auditing the documents shall keep a record of the authorized signatures of the Municipality. He shall check against such record to ascertain that the officers certifying the documents are so authorized. He shall check the documents' correctness in all of its parts and that the transactions are in order pursuant to the correct legislation, ordinances, resolutions, contracts and regulations. Once everything is found to be in order, the document shall be certified as preaudited and shall be sent for the approval of the Finance Director. In addition, of the aforementioned regulation, the vouchers, all canceled checks and any other document, that justifies a payment, shall be filed by the Finance Director to be audited by the Puerto Rico Comptroller's Office or any other agency as required by law.

RECOMMENDATION:

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the process of acquisition of materials and supplies, equipment, and construction and service contracts.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

07-07 PERSONNEL FILES AND RELATED PAYROLL PROCEDURES

During our audit, we tested a sample of 40 employee files and noted that several files lacked documentation supporting the employee's salary, status or eligibility. The following exceptions were noted during our examination:

Health examinations	1 file	2%
Employee evaluations	18 files	45%
Eligibility verification form (Form I-9)	3 files	8%
Job Description OCAP-16	5 files	13%
Good Behavior certificate	5 files	13%
Regular or sick leave records	7 files	18%
Drug detection tests	1 file	2%
Child Support Form ASM-5	2 files	5%
PR Retirement System Documents	5 files	13%
Authorization for deductions	1 file	2%

RECOMMENDATION:

The Personnel Department should review each employee file and ascertain their completeness. Management could design a standard checklist where the file reviewer could determine if documents are missing from each file. Signed exemptions certificates and authorizations for non-statutory withholdings should always support the amounts withheld from employees.

07-08 CASH RECEIPT TEST

As part of our test of cash receipts during the year (amounting to approximately \$77 million), we selected 40 receipts amounting to \$488,532, representing .05% of the total receipts. The following deficiencies were noted during our examination:

- The Municipality could not provide us 7 validated deposit slips amounting to \$33,322, pertaining to cash receipts transactions for the fiscal year 2006-2007. Such validated deposit slips were not available for examination.
- In 33 (83%) cash receipts amounting to \$407,403, we could not traced them to the General Ledger.

According to Law 81, the books, documents and funds in the possession of the collectors must remain available for examination by Officers from the Office of the Comptroller, the Treasury Department, the Administration or any other duly authorized agency.

RECOMMENDATION:

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the revenues and cash receipts cycle.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Section III - Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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**GENERAL MATTERS APPLICABLE TO MORE
THAN ONE PROGRAM**

All Federal Programs	07-09 FEDERAL FINANCIAL REPORTS	
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The accounting records maintained by the Federal Programs Office are not reconciled with the accounting records maintained by the Municipality's central accounting department records. The Municipality has not established procedures for the reconciliation of the transactions recorded in the Program's accounting records with those recorded in the Municipality's central accounting department records. As a result, this condition may lead to inaccurate reporting of programs supported activities.

NONE

Criteria:

OMB Circular A-102, 20 (b) (2) requires recipient of federal funds to have a financial management system that provides for the maintenance of accurate, current and complete records of the financial results of federally assisted activities in accordance with the financial reporting requirements of the Federal Program. The Municipality should prepare federal financial reports based on the Programs underlying accounting records.

All Federal Programs	07-10 PROCUREMENT, SUSPENSION AND DEBARMENT	
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Statement of Condition:

The Municipality has not established effective procurement procedures to verify in the acquisition of goods and services that the supplier was not suspended or debarred or otherwise excluded. The Municipality did not performed any step to ascertain that supplier is not included in the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), obtaining a certification from the entity or adding a written clause or condition to the covered transaction with that entity.

NONE

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Criteria:

2 CFR, Part 180 and 70 FR 51863 state that contractors receiving individual awards for \$25,000 or more and all sub recipients must certify that the organization and its principals are not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), collecting a certification from the entity or adding a clause or condition to the covered transaction with the entity.

Recommendation:

We recommend the Municipality to obtain the EPLS in printed or electronic format in order to use it as part of the procurement cycle. The printed version is published on a monthly basis. Copies can be obtained by purchasing a yearly subscription to the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by calling the Government Printing Office Inquiry and Order Desk at (202) 783-3238. The electronic version can be obtained on the Internet (<http://epls.arnet.gov>). The Municipality should enforce strict compliance with the prescribed federal requirement.

All Federal Programs

07-11 EQUIPMENT AND REAL PROPERTY MANAGEMENT

Statement of Condition:

The Municipality has not complied with the property management requirements. There were no physical inventories performed during the fiscal year ended June 30, 2007.

The Federal Programs has subsidiary ledger of equipment acquired with federal funds, however, such subsidiary ledger does not comply with federal requirements because it does not: (1) have information needed to calculate the federal share of the cost of the equipment, (2) have information about the identification number of the asset, such as the manufacturer's serial numbers, (3) identify the grant under which the program acquired the equipment, (4) have information about the location, use and condition of the equipment and the date the information was obtained, and (5) have all pertinent information on the ultimate transfer,

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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replacement, or disposal of the equipment (6) have information about acquisition date and unit acquisition cost.

Furthermore, there is no evidence that the total amount of capital expenditures and the composition of capital assets incurred by Federal Programs have been reconciled with the general ledger or other control account to enhance the controls to prevent unauthorized disposition of assets.

Criteria:

29 CFR 97.32 (d) (2) established that the Municipality should take the physical inventory and reconcile the results with the property records. In addition, section (d) (3) establishes that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property.

Federal regulations also require that, every two years, at a minimum, a physical inventory shall be conducted and the results shall be reconciled with property records to verify the existence, current utilization, and continued need for the equipment. Any discrepancies between quantities determined by the physical inspection with those shown in the accounting records shall be investigated to determine the causes of the differences. Property records shall be accurate. Property records shall include the following for each item:

- A description of the equipment including manufacturer's serial numbers.
- Identification number, as the manufacturer's serial numbers.
- Identification of the grant under which the recipient acquired the equipment.
- The information needed to calculate the federal share of the cost of the equipment.
- Acquisition date and unit acquisition cost.
- Location, use and condition of the equipment and the date the information was obtained.
- All pertinent information on the ultimate transfer, replacement or disposal of the equipment.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Recommendation:

A physical inventory of the Federal Programs capital assets should be taken as soon as possible. Physical inventory amounts should be reconciled with the property recorded on the subsidiary ledgers. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions. Dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance.

CSBG
CFDA No. 93.569

07-12 FEDERAL CASH MANAGEMENT SYSTEM

Statement of Condition:

The Municipality has not established effective cash management procedures. The program has an average cash balance of \$16,232, during the fiscal year. There were months which reported balances as high as \$16,529, at the end of the month.

NONE

Criteria:

Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.

Recommendation:

In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely as possible to the actual disbursements.

Emergency Shelter
CFDA No. 14.231

07-13 FEDERAL CASH MANAGEMENT SYSTEM

Statement of Condition:

The Municipality has not established effective cash management procedures. The program has an average cash balance of \$13,377, during the fiscal year. There were months which reported balances as high as \$71,249, at the end of the month.

NONE

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Program Findings/Noncompliance Recommendations Questioned Cost

Criteria:

Federal Regulation required that grantees shall conform to the standards applicable to advances from Federal Agencies. Amounts requested should be limited to the Program's immediate cash needs.

Recommendation:

In accordance with Federal Regulations, the Municipality should estimate drawdown of Federal funds as closely as possible to the actual disbursements.

Child Care
CFDA No. 93.575

07-14 FEDERAL CASH MANAGEMENT SYSTEM

Statement of Condition:

The Municipality has not established effective cash management procedures. The program has an average cash balance of \$17,439, during the fiscal year. There were months which reported balances as high as \$36,978, at the end of the month.

NONE

Criteria:

Federal Regulation required that grantees shall conform to the standards applicable to advances from Federal Agencies. Amounts requested should be limited to the Program's immediate cash needs.

Recommendation:

In accordance with Federal Regulations, the Municipality should estimate drawdown of Federal funds as closely as possible to the actual disbursements.

SBGP Program
CFDA NO. 14.219

07-15 FEDERAL MANAGEMENT SYSTEM

Statement of Condition:

The Municipality has not established effective cash management procedures. The program has an average cash balance of \$12,029 during the fiscal year. There were months which reported balances as high as \$31,254, at the end of the month.

NONE

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Program Findings/Noncompliance Recommendations Questioned Cost

Criteria:

Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.

Recommendation:

In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely as possible to the actual disbursements.

SBGP Program
CFDA NO. 14.219

07-16 FINANCIAL REPORTING

Statement of Condition:

Our review of the quarterly financial reports submitted to Oficina del Comisionado de Asuntos Municipales (OCAM), disclosed that the information presented in the financial reports did not agree with the information recorded in the Program General Ledger. Several discrepancies were noted in the following accounts.

NONE

Account

<u>number</u>	<u>Account Name</u>	<u>Quarter</u>	<u>Report</u>	<u>General Ledger</u>
9101	Administrative salaries	1 st quarter	\$57,540	\$47,701
9456	Reembolso de intereses	2 nd quarter	67,929	67,996

Criteria:

Federal regulations require that the financial management system must meet some requirements, including the financial reporting. It states that accurate, current and complete disclosure of the financial results of the financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.

Recommendation:

The Municipality should prepare financial reports based on the Program's underlying accounting records. Any difference should be investigated and reconciled, accordingly.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP CFDA No. 14.219	07-17 INADEQUATE DOCUMENTATION OF PARTICIPANT FILES	

Statement of Condition:

As part of our test to determine whether the grantee assure that the rehabilitation work is properly completed, we selected a sample of 39 participants. The following documents were not available for examination:

NONE

1. Inspection of the rehabilitation work upon completion	35 Files	88%
2. Pre-rehabilitation inspection describing deficiencies	1 File	3%
3. Contract not signed	1 File	3%
4. Family income not below low income table	3 Files	8%
5. Deficiencies to be corrected not incorporated to contract	3 Files	8%
6. Evidence of construction material return	1 File	3%

Criteria:

According to 24 CFR, 570.506 the grantee must assure that the work is properly completed. For each residential rehabilitation activity the following records are needed:

- a) Re-habilitation contract describing the deficiencies in each structure to be corrected.
- b) An inspection of the rehabilitation work upon completion to assure that it was carried out in accordance with contract specifications.

Recommendation:

The Municipality must inspect the rehabilitation work upon completion to assure that it is carried out in accordance with the contract specifications.

SBGP
Program year 2000
Program year 2002
CFDA No. 14.219

07-18 EARMARKING REQUIREMENT

Statement of Condition:

As of June 30, 2007, the Municipality expended less than 70 percent of the funds over a period of up to three years, for activities that benefit low-and moderate-income persons as required by the federal regulation.

NONE

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Program Findings/Noncompliance Recommendations Questioned Cost

Criteria:

According to 24 CFR, 570.506 the grantee must assure hat not less than 70 percent of the funds must be used over a period of up to three years, as specified by the grantee in its certification, for activities that benefit low-and moderate-income persons.

Recommendation:

The Municipality should establish procedures to ascertain that comply with the earmarking requirement in accordance with 24 CFR sections 570.420 and 570.430.

07-19 MATCHING, LEVEL OF EFFORT AND EARMARKING

Even Start Program
CFDA No. 84.213

Statement of Condition:

The Even Start Program has not complied with the matching requirements established by Subpart 3, Part B of Title I, William F. Goodling Even Start Family Literacy Programs and Title IX of the Elementary and Secondary Educational Act of 1965, as amended, OMB Circular A-87, OMB Circular A-102 as applicable. The Even Start Program did not have adequate internal controls and procedures to ensure compliance with the required level of matching contributions and the adequate documentation of it. Based on our examination of the annual In-Kind Contributions Certifications submitted by the Even Start Program to the Department of Education for the fiscal year ended June 30, 2007, we noted the following in-kind matching contributions for which no adequate documentation was available to support their allowability:

\$ 340,283

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
	<ul style="list-style-type: none">• Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.• Are provided for in the approved budget.• Unrecovered indirect costs may be included as part of cost sharing or matching.• Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles. If the awarding agency authorizes recipients to donate buildings or land for construction/facilities acquisition projects or long-term use, the value of the donated property for cost sharing or matching shall be the lesser of: (1) the certified value of the remaining life of the property recorded in the recipient's accounting records at the time of donation; or (2) the current fair market value.• Volunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program. Rates for volunteer services shall be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient's organization, rates shall be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved. In either case, fringe benefits consistent with those paid that are reasonable, allowable, and allocable may be included in the valuation.• When an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overhead costs), provided these services are in the same skill for which the employee is normally paid.• Donated supplies may include such items as expendable property, office supplies, laboratory	

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Program Findings/Noncompliance Recommendations Questioned Cost

supplies or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation.

- Volunteer services shall be documented and, to the extent feasible, supported by the same methods used by the recipient for its own employees, including time records.
- The basis for determining the valuation for personal service, material, equipment, buildings and land shall be documented.

Recommendation:

We recommend the Even Start Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of matching requirements of 45 CFR 74.23. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements, including adopting the necessary procedures to ensure adequate documentation of the in-kind contributions made to this federal financially assisted program.

Even Start
CFDA NO. 84.213

07-20 FINANCIAL REPORTING

a) Statement of Condition:

During our tests of the quarterly financial reports submitted to the Puerto Rico Department of Education, we could not examine the Quarterly Disbursement Report pertaining to the first, second and fourth quarter since they were not available for examination.

NONE

Criteria:

According to contract with the State Department of Education, quarterly financial reports must be submitted at least 15 days after the close of each quarter.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Quarterly Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

b) Statement of Condition:

Our review of the final financial reports submitted to the Puerto Rico Department of Education, disclosed that they were submitted after the required submission date, as detailed below.

NONE

<u>Program Year</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>Past Due Days</u>
2006-2007	Sept 30, 2007	Oct. 30, 2007	30 days

Criteria:

According to contract with the Puerto Rico Department of Education annual fiscal reports, must be submitted at least 30 days after the close of each annual contract.

Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Annual Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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c) Statement of Condition:

Our review of the quarterly and annual financial reports submitted to Department of Education, disclosed that the information presented in the financial reports did not agree with the information recorded in the Program General Ledger, since it is recorded on a cash basis. Quarterly and Annual reports were prepared using the information included Order and Contract Register.

NONE

Criteria:

Federal regulations require that the financial management system must meet some requirements, including the financial reporting. It states that accurate, current and complete disclosure of the financial results of the financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.

Recommendation:

The Municipality should prepare financial reports based on the Program's underlying accounting records. Any difference should be investigated and reconciled, accordingly.

d) Statement of Condition:

Our review of the final financial reports submitted to the Department of Education for program year 2005-2006, we could not determined the timely submission of report, since there is no evidence of submission date.

NONE

Criteria:

According to contract with the Department of Education annual fiscal reports, must be submitted at least 30 days after the close of each annual contract.

Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Annual Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Even Start
CFDA No. 84.213

an additional tool to help the Municipality in complying with the federal regulation.

07-21 INADEQUATE DOCUMENTATION OF PARTICIPANT FILES

Statement of Condition

As part of our eligibility test for participant, we selected 12 participants' files. The following deficiency was noted during our examination.

- In one (8%) participant file the birth certificate was not present on file.
- In one (8%) participant file the social security card was not present on file.
- In 3 (25%) participants files the utilities invoices were not present on file.
- In 2 (16%) participants files the school transcript was not present on file.
- In one (8%) participant file the school withdrawal letter was not present on file.
- In 2 (16%) participants files the immunization certificate was not present on file.
- In 2 (16%) participants files the participant son/daughter immunization certificate was not present on file.

Criteria:

According to program requirements the program application must be submitted with the following documentation:

- a- Birth certificate (adult and child)
- b- Social security (adult and child)
- c- Utilities invoice
- d- School transcript or school certification
- e- School withdrawal letter
- f- Immunization certificate (adult and child)
- g- Income evidence

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Schedule of Finding and Questioned Costs
June 30, 2007

Program Findings/Noncompliance Recommendations Questioned Cost

Recommendation:

The Municipality should implement procedures to assure that all required information is present on file at time of admittance to the program.

Even Start
CFDA NO. 84.213

07-22 PROGRAMMATIC REPORTS

Statement of Condition:

During our tests of the monthly programmatic reports submitted to the Department of Education, we could not determined the timely submission of reports pertaining to the months of July 2006 through June 2007, since there is no evidence of submission date.

NONE

Criteria:

According to contract with the Department of Education, monthly programmatic reports must be submitted with quarterly financial reports within 15 days of start of each quarter.

Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the monthly programmatic reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

Total Questioned Costs

\$ 340,283

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Summary schedule of prior years audit findings
Fiscal Year 2005-2006
June 30, 2007

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2006. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2006-2007).
- NR - Not resolved yet. Finding repeated in fiscal year 2006-2007.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
06-01	Deficiencies in the Uniform Accounting System and other Accounting Records	NR
06-02	Inactive and Unnecessary Funds	NR
06-03	Lack of monitoring and fraud prevention activities	NR
06-04	Municipal license tax	NR
06-05	Disbursement test	NR
06-06	Personnel files and related payroll procedures	NR
06-07	Cash receipts test	NR
06-08	Bidding procedures	FR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Summary schedule of prior years audit findings
Fiscal Year 2005-2006
June 30, 2007

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2006. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2006-2007).
- NR - Not resolved yet. Finding repeated in fiscal year 2006-2007.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
06-09	Accounting system	NR
06-10	Federal cash management system	NR
06-11	Federal cash management system	NR
06-12	Federal cash management system	NR
06-13	Federal cash management system	NR
06-14	Federal cash management system	NR
06-15	Financial Reporting	NR
06-16	Inadequate documentation of participant files	NR
06-17	Davis-Bacon Act	NR
06-18	Earmarking Requirement	NR
06-19	Equipment and Real Property Management	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Summary schedule of prior years audit findings
Fiscal Year 2004-2005
June 30, 2007

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2005. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2006-2007).
- NR - Not resolved yet. Finding repeated in fiscal year 2006-2007.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
05-01	Accounting System	NR
05-02	Cash and bank accounts	NR
05-03	Long – term debt	NR
05-04	Interfund transactions	NR
05-05	Accounts payable and encumbrances	NR
05-06	Cash management	NR
05-07	Municipal license tax	NR
05-08	Disbursement test	NR
05-09	Personnel files and related payroll procedures	NR
05-10	Cash receipts test	NR
05-11	Inactive and unnecessary funds and inactive bank accounts	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
Summary schedule of prior years audit findings
Fiscal Year 2004-2005
June 30, 2007

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2005. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2006-2007).
- NR - Not resolved yet. Finding repeated in fiscal year 2006-2007.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
05-12	Accounting system	NR
05-13	Federal cash management system	NR
05-14	Federal cash management system	NR
05-15	Federal cash management system	NR
05-16	Federal cash management system	NR
05-17	Federal cash management system	NR
05-18	Inadequate documentation of participant files	NR
05-19	Davis-Bacon Act	NR
05-20	Earmarking requirement	NR

**Commonwealth of Puerto Rico
Municipality of Cataño**

COMISIONADO
2007 MAR 31 PM 1:49
UNIDAD DE CORRIO

Calle J. 1/609

**Corrective Action Plan
As Revised
Single Audit Under
OMB Circular A-133, As Amended
For the Fiscal Year Ended June 30, 2007**

Submitted by:

**Departments of Finance, Internal Audit,
Human Resources and Federal Programs**
PO Box 428, Cataño, Puerto Rico 00962-0428
Tel. (787) 788-0404 Fax. (787) 788-8060
email: departamento_de_finanzas@yahoo.com

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
PO BOX 428, CATAÑO, PUERTO RICO 00962-0428
Tel. (787) 788-0404 FAX. (787) 788-8060

CORRECTIVE ACTION PLAN
FISCAL YEAR ENDED JUNE 30, 2007

March 28, 2008

Federal Audit Clearinghouse
1201 E. Tenth Street
Jeffersonville, IN 47132

Dear Ladies and Gentlemen:

The Municipality of Cataño of the Commonwealth of Puerto Rico respectfully submits the following corrective action plan related to its Single Audit under OMB Circular A-133, as amended, for the fiscal year ended June 30, 2007. The following is the general information of our government:

Auditee Name:	Municipality of Cataño
Auditee Identificaton Number:	66-0433540
Name and address of independent public accounting firm:	Benítez-Jaime, CPA-PSC PO Box 191503 San Juan, Puerto Rico 00919-1503 Telephone: (787) 603-1600 Fax: (787) 779-4315 Email: c_e_benitez@hotmail.com
Audit Period:	Fiscal year ended June 30, 2007
Auditee Principal Contact:	Mrs. Cathy Negrón Hernández <i>Finance Director</i>

March 28, 2007

Federal Audit Clearinghouse

Page 2

The findings from the June 30, 2007 Schedule of Findings and Questioned Costs (the Schedule) are discussed in the accompanying Exhibit A. The findings are numbered consistently with the numbers assigned in the Schedule.

If the Cognizant or Oversight Agency has questions regarding this plan, please contact Mrs. Cathy Negrón Hernández at 787-788-0404.

Cordially yours,

A handwritten signature in blue ink, appearing to read "Cathy Negrón Hernández", with a long, sweeping flourish extending to the right.

Mrs. Cathy Negrón Hernández
Director of Finance

Cc: Hon. Wilson Soto Molina
Mayor

COMMONWEALTH OF PUERTO RICO
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Finding Control Number: 07-01

Deficiencies in the Uniform Accounting System and Other Accounting Records

The Uniform Accounting System (UAS) and the accounting records currently used by the Municipality do not have the necessary capabilities, procedures, internal controls and records to ensure accurate financial reporting and to prepare the Municipality's basic financial statements and federal programs' reports in conformity with Accounting Principles Generally Accepted in the United States of America for State and Local Governments (GAAP). The UAS is a system promulgated by the Office of the Commissioner of Municipal Affairs of Puerto Rico (OCAM, by its Spanish acronyms), a governmental entity created by law to provide technical assistance to the municipalities of Puerto Rico in several administrative and fiscal matters.

The Municipality's UAS mostly provides for the recording of revenue collections, disbursements and other limited transactions. In addition, the accounting records are not fully integrated, and a double entry system is not generally followed. Accounting records are maintained on the cash basis and budgetary accounting bases (two accounting bases that differ significantly from GAAP) and do not comply with Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended.

The following specific additional conditions were noted in relation to the UAS of the Municipality:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the UAS. The balance sheet accounts in the UAS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.
- The UAS does not have the capabilities of: (1) distinguish between expenditures (expenses) incurred and encumbered, (2) recording and processing all types of capital asset transactions, principally the accounting of depreciation and amortization expense, (3) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (4) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, estimated liability for municipal solid waste landfill closure and post-closure maintenance costs, etc.
- No adequate year-end closing procedures are made to account for all transactions affecting all funds.

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- No adequate segregation is made between items representing actual accounts payable and those representing outstanding encumbrances. Accordingly, material amounts of unrecorded liabilities are generally recorded at fiscal year-end.
- The management of the federal programs administered by the Municipality maintains separate accounting records for each federal program, which are not reconciled with the UAS (the official accounting system of the Municipality).
- No adequate and complete accounting records are kept for inter-fund balances and transactions.
- The audit adjustments resulting from Single Audits are not completely posted in the UAS.

The basic financial statements of the Municipality must be prepared using the financial information obtained from various municipal departments and accounting records outside of the official UAS, and from information obtained from regulators and independent third parties. In addition, the Department of Finance does not maintain accounting records and working papers supporting the balances and disclosures reported in the basic financial statements, principally those related to government-wide financial reporting.

The Department of Finance does not maintain accounting records supporting the following procedures performed as part of the preparation of the basic financial statements of the Municipality:

- The conversion of accounting records from the cash basis of accounting to the modified accrual basis of accounting used by governmental funds;
- The conversion of governmental funds from the modified accrual basis to the accrual basis of accounting used by government-wide financial statements; and
- Working papers and analyses of significant balances reported in the basic financial statements, such as capital assets, accounts receivable (municipal licenses, grants and contributions, etc.), deferred revenues, accounts payable, and long-term obligations (for which the general practice is to rely upon the notifications received from the Government Development Bank for Puerto Rico, the Puerto Rico Treasury Department, the Federal Government and the Municipal Revenue Collection Center for the balance of its outstanding debt and the withholding for its debt service).

Criteria:

Article 8.010(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality must maintain its fund accounting in accordance with Accounting Principles Generally Accepted in the United States of America

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(GAAP), as promulgated by the Governmental Accounting Standards Board (GASB), the National Committee on Governmental Accounting (NCGA) and the Governmental Accounting, Auditing and Financial Reporting book (commonly known as Blue Book).

In addition, Article 8.010(c) of Law No. 81 states that uniform accounting system used by the Municipality must: (1) produce reliable reports and financial statements, (2) provide complete information about the results of operations of the Municipality, and (3) include the necessary internal controls to account all funds, capital assets and other assets of the Municipality.

Furthermore, Section 5 of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico*, which were created pursuant to Article 19.011 of Law No. 81 and approved by the Office of the Commissioner of Municipal Affairs, state that the accounting system of the Municipality should include:

- Final entry books that allow for the preparation of month-end summaries of transactions for posting in the original entry records and for the gathering of information needed for the preparation of basic financial statements and other reports;
- Fiscal procedures for the system's operations, establishing proper internal controls and the prevention of irregularities. These procedures should provide for the timely and accurate performance of operations. It should include the necessary records, files, reconciliations, adjustments, closing entries, reports, and all other necessary documentation to support the basic financial statements.

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2007 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

The continued failure to have an adequate accounting system does not allow the Municipality to have timely and accurate financial information for its decision making process. In addition, financial reports prepared may have errors or omissions that will affect future financial decisions. Another effect is the use of inaccurate financial information as a base for the preparation of annual budgets, which, therefore, may result in budgetary compliance problems.

Questioned Costs: None

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Independent Auditors' Recommendation:

We recommend the Municipality to explore different alternatives for the implementation of a new accounting system in compliance with all applicable federal and local laws and regulations. This process should include only accounting systems that will enable the Municipality to prepare its basic financial statements in a timely manner and in conformity with GAAP. The systems to be evaluated must provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements, including:

- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for federal funds;
- The preparation of periodic financial reports to be submitted to the Director of finance, the Mayor, the Municipal Legislature and the federal grantors; and
- Adequate training to all accounting personnel to improve the understanding of the system and to promote operational efficiency

The Department of Finance must establish and document new accounting policies and procedures addressed to correct the non-compliance situations referred to above. Accounting policies and procedures shall be promulgated by an appropriate level of management to emphasize their importance and authority. The documentation of such accounting policies and procedures shall be updated periodically according to a predetermined schedule.

Response by Department of Finance – Finding Control Number 07-01:

We concur with this finding. However, a major goal of the Municipality's Department of Finance is to improve the quality of its current accounting, auditing, and financial reporting practices. During the last three fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the current accounting system used by the Municipality and reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The principal of the abovementioned internal control measures adopted by the Municipality was the establishment of a *Financial Reporting Task Force* composed of the management team of the Department of Finance and outside certified public accountants and consultants specialized in governmental accounting and auditing. Such team works together throughout the year to prepare the Municipality's financial statements, including all of the accounting records and reports needed to support the balances and disclosures reported in the financial statements as of and for the fiscal year ended June 30, 2007. These control measures minimized the risks of possible

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errors, omissions or deviations from generally accepted accounting principles in the Municipality's basic financial statements.

This conclusion is evidenced by the following facts: (1) the Independent Auditors' Report on the Municipality's financial statements was unqualified for the fiscal year ended June 30, 2007, (2) the Municipality was recently awarded by the Government Finance Officers Association with the Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007 and expects to be awarded again for its CAFR for the fiscal year ending June 30, 2008, and (3) audit adjustments recorded in the financial statements were minimal and not material to the financial statements taken as a whole. *The Financial Reporting Task Force* referred to above will continue operating after the Single Audit of the fiscal year ended June 30, 2008 since it is the intention of management to keep improving its current accounting, auditing, and financial reporting practices every year thereafter.

In addition, the Department of Finance is currently implementing a new accounting system in compliance with all applicable federal and local laws and regulations, including all the requirements established by generally accepted accounting principles. The new accounting system being implemented by the Municipality will provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements. The period of time required to annually carry out the Single Audit would be substantially reduced. The implementation is expected to be completed on or before December 31, 2008.

As part of the implementation of the new accounting system, the Department of Finance will establish and document new accounting policies and procedures. Accounting policies and procedures will be promulgated by an appropriate level of management to emphasize their importance and authority. The documentation of such accounting policies and procedures will be updated periodically according to a predetermined schedule. In addition, the Department of Finance will improve its fund accounting by evaluating, within the next two years, its fund structure to ensure that individual funds that have become superfluous, if any, are eliminated.

Furthermore, as of the date of this Plan, the Municipality and its consultants prepared a reconciliation of the balances reported in the Municipality's basic financial statements and those accounted for in UAS as of June 30, 2007. Accordingly, the Municipality determined the required adjusting entries needed to conform UAS to the basic financial statement figures.

Anticipated completion date:	The implementaton of the new accounting system is expected to be completed by December 31, 2008
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Contact person:	Mrs. Cathy Negrón, Director of Finance Telephone: (787) 788-0404 email: departamento de finanzas@yahoo.com
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Finding Control Number: 07-02

Inactive and Unnecessary Funds

The Municipality is maintaining an excessive number of funds that have been inactive for a long period. The accounting records include over 54 different funds (20 pertaining to the Special Revenue Funds and 34 pertaining to the Capital Projects Funds) which amounted to \$669,074, many of which have been inactive or had insignificant movement or operations during the year under audit.

This situation results from the need to analyze and close inactive funds when the fund's objective has been achieved or are no longer of significance. The internal control structure should provide for the accurate maintenance of the books, records, funds and accounts necessary to carry out the Municipality's operations.

Criteria:

Article 8.007(b) of the Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that funds without specific fiscal years should be closed when the fund's objectives have been completed.

Article 8.007(b) of the Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that funds without specific fiscal years should be closed when the fund's objectives have been completed.

NCGA Statement No. 1, paragraph 4, states that "governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established since unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration".

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In addition, the recommended practice on “*Improving the Effectiveness of Fund Accounting*” (2004), issued by the Government Finance Officers Association of the United States and Canada (GFOA), states that it is important in this regard to distinguish accounting from financial reporting. Whereas an accounting system must collect all of the data needed to ensure and demonstrate legal compliance, financial reporting is concerned with only those aspects of compliance that are of importance to users of general purpose external financial reports.

This situation occurred because the Municipality has not analyzed and closed inactive funds and bank accounts when the fund’s objectives have been met or are no longer relevant. The continued maintenance of these funds and accounts exposes the Municipality to the unauthorized use of funds from inactive accounts for activities not intended to be financed with these funds. The aforementioned conditions represent material weaknesses in the Municipality’s internal controls over financial reporting.

Questioned Costs: None

Independent Auditors’ Recommendation:

The Municipality should close all unnecessary and inactive funds or accounts. Budgetary balances or deficits remaining in those funds should be investigated and properly closed or established by law. The Municipality should determine whether the intended objectives of these funds were met. For all funds that have complied with the requirements, the Municipality should close them. Remaining balances in those funds should be disposed of in accordance with local and federal laws and regulations.

Response by Department of Finance – Finding Control Number 07-02:

We do not concur with this finding. The Municipality acknowledges that NCGA Statement No. 1, paragraph 4, states that “*governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established since unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration*”.

In addition, the Municipality understands and has followed the recommended practice on “*Improving the Effectiveness of Fund Accounting*” (2004), issued by the Government Finance Officers Association of the United States and Canada (GFOA), which states that it is important in this regard to distinguish *accounting* from *financial reporting*. Whereas an *accounting* system must collect all of the data needed to ensure and demonstrate legal compliance, *financial reporting* is concerned with only those aspects of compliance that are of importance to users of *general purpose external financial reports*. Consequently, not every “fund” used for internal accounting purposes should automatically be classified as a “fund” in general purpose financial reports.

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Taking in consideration the technical literature referred to above, the Municipality does not concur with this finding because, for accounting purposes, during the fiscal year ended June 30, 2007 the Municipality maintained only the minimum number of funds needed to ensure and demonstrate legal compliance and sound financial administration.

Although there were 54 funds with little or almost no activity during the fiscal year under audit, those funds were maintained in the accounting records of the Municipality due to the legal requirements imposed by state or federal grantors which do not allow to close those funds until the respective state or federal programs are closed or the resources in such funds are reprogrammed with the approval of grantors. These funds mostly consists of restricted operating and capital grants given by the Legislature of the Commonwealth of Puerto Rico and the U.S. Government. None of such funds are discretionary funds created by the management of the Company and, accordingly, none of them can be closed at the Municipality's will.

For financial statement purposes, the number of funds currently used by the Municipality are stated to the minimum possible since those funds were combined and reported in only two nonmajor funds for financial reporting purposes, a special revenue fund and a capital project fund. Therefore, the Municipality minimized the number of funds reported in the financial statements as of and for the fiscal year ended June 30, 2007 taking in consideration the legal constraints imposed by grantors.

However, the Department of Finance will continue, on a consistent yearly basis, improving its fund accounting by evaluating, its fund structure to ensure that individual funds that have become superfluous, if any, are eliminated, with the previous approval of grantors and regulators.

The circumstances described in the finding referred to above are not considered by the Municipality as reportable conditions in the internal controls over financial reporting nor a situation which could adversely affect the Municipality's ability to record, process, summarize, and report the federal programs transactions in the Municipality's financial statements in accordance with generally accepted accounting principles. This conclusion is evidenced by the following facts: (1) the Independent Auditors' Report on the Municipality's financial statements was unqualified for the fiscal year ended June 30, 2007 and (2) the Municipality was recently awarded by the Government Finance Officers Association with the Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007 and expects to be awarded again for its CAFR for the fiscal year ending June 30, 2008.

Anticipated completion date:	Not applicable.
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Contact person:	Mrs. Cathy Negrón, Director of Finance Telephone: (787) 788-0404 email: departamento_de_finanzas@yahoo.com
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Finding Control Number: 07-03:

Lack of Monitoring and Fraud Prevention Activities

As part of our evaluation of internal controls of the Municipality, we noted that the Municipality have not designed, documented nor placed in operations specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material inadequate financial reporting. In addition, does not keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality's core processes. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

Criteria:

Article 6.004 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states the Municipality shall perform interventions, audits and monitoring activities over all municipal operations financed with public funds, including: (1) the acquisition, use and disposition of capital assets, (2) transactions and operations of all administrative units (municipal departments), and (3) all accounts, records, books, contracts, budgets and any other financial activities.

These conditions arose by the lack of effective controls and procedures for the evaluation of significant risk factors in all municipal areas, the lack of proper planning of continued monitoring activities, and the lack of proper allocation of human resources and time schedules to perform the activities required by law.

Questioned Costs: None

Independent Auditors' Recommendation:

We recommend the Municipality to prepare a manual of policies and procedures specifically designed to prevent and detect fraud. The Municipality should also keep formal documentation of all fraud prevention and monitoring activities performed by management, including the identification and evaluation of all fraud risk factors. Fraud risk assessments should be reviewed periodically to consider changes in the operating policies of the Municipality and the control environment.

Response by Department of Internal Audit – Finding Control Number 07-03:

We do not concur with this finding. During 2007, the Municipality improved significantly its monitoring and control activities designed to prevent fraud and irregularities. As part of this initiative, the Municipality performed the following procedures: (1) an evaluation of the Municipality's internal controls for all municipal departments and agencies, including the

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Department of Finance, and (2) an evaluation of the operating and business risks of the Municipality. These two evaluations were submitted to and evaluated by the Office of the Comptroller of the Commonwealth of Puerto Rico and are compiled in a report titled in Spanish as “*Informe de las Evaluaciones del Sistema de Control Interno y los Riesgos del Municipio de Cataño*” (the Report). The Report is currently used by the Internal Audit Department of the Municipality to plan the nature, timing and extent of a risk-based audit emphasizing in the municipal departments and agencies with higher operating and financial risks. The Report is also being used by the management of the Municipality to design new internal controls and procedures to minimize fraud risks and to improve the operational efficiency of all departments. During the year 2008 and in subsequent years, the Municipality will perform annual evaluations of risks and controls as it did in 2007.

Also, during the fiscal year ended June 30, 2007, the Municipality’s Department of Finance carried out various monitoring activities among which are: (1) an evaluation of the costs incurred by the Municipality in telephone services and certain telecommunication projects, and (2) a monitoring project of selected deposits to its collection division. This is part of a continuous monitoring effort and constant procedures implemented by the Municipality to prevent errors and irregularities, as well as, to maximize financial resources.

In the other hand, during the fiscal year ended June 30, 2007, the Municipality followed all the controls and procedures promulgated by the Office of the Commissioner of Municipal Affairs (OCAM, by its Spanish acronyms), a governmental entity created by law to establish uniform standard control procedures and internal controls for the Municipalities of Puerto Rico in compliance with the Autonomous Municipalities Act of the Commonwealth of Puerto Rico. The standards established by OCAM are extremely restrictive in nature, therefore, are designed to minimize the risks of fraud, errors and irregularities in the Municipality’s revenues, collections, purchasing and disbursements and investing cycles, among others.

Furthermore, during the fiscal year ended June 30, 2007, the Internal Department of the Municipality performed certain audits over the internal controls and procedures of several departments of the Municipality. As an example, during the fiscal year 2006-2007, the Internal Audit Department issued its report titled “Intervention 07-01”, which evaluated the municipal controls and procedures as indicated before. These internal audits represent monitoring and control activities in place to prevent fraud and show the commitment by the management of the Municipality to continuously minimize risk factors.

Finally, as of June 30, 2007 there was no law or regulation requiring an anti-fraud plan to the Municipality. However, the management of the Municipality is strongly committed with the prevention of fraud and the establishment of appropriate measures to reduce risks factors associated with errors, irregularities and fraud. Accordingly, during the last three fiscal years the Municipality has adopted several internal controls and procedures to minimize the risks of fraudulent financial reporting and the misappropriation of assets. Among such internal controls and procedures are the following:

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1. As indicated in the response to Finding No. 1, a major goal of the Municipality's Department of Finance is to improve the quality of its current accounting, auditing, and financial reporting practices. During the last three fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the current accounting system used by the Municipality and reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The principal of the abovementioned internal control measures adopted by the Municipality was the establishment of a *Financial Reporting Task Force* composed of the management team of the Department of Finance and outside consultants. Such team works together throughout the year to prepare the Municipality's financial statements, including all of the accounting records and reports needed to support the balances and disclosures reported in the financial statements as of and for the fiscal year ended June 30, 2007. These control measures minimized the risks of possible errors, omissions or deviations from generally accepted accounting principles in the Municipality's basic financial statements (minimize the risk of fraudulent financial reporting). Also these measures minimize the risks of illegal acts and irregularities.

This conclusion is evidenced by the following facts: (1) the Independent Auditors' Report on the Municipality's financial statements was unqualified for the fiscal year ended June 30, 2007, (2) audit adjustments recorded in the financial statements were minimal and not material to the financial statements taken as a whole and, (3) the Municipality was recently awarded by the Government Finance Officers Association with the Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007 and expects to be awarded again for its CAFR for the fiscal year ending June 30, 2008. *The Financial Reporting Task Force* referred to above will continue operating after the Single Audit of the fiscal year ended June 30, 2007 since it is the intention of management to keep improving its current accounting, auditing, and financial reporting practices every year thereafter.

2. During the fiscal year ended June 30, 2007 the Internal Audit Department of the Municipality carried out extensive internal audits and monitoring activities over areas susceptible to fraud, such as: (a) cash, (b) collections, (c) disbursements, (d) inventories, etc. These audits and monitoring activities are supported by working papers kept by the Internal Audit Department, which are available for review by the independent auditors, grantors and regulators of the Municipality.
3. During the last two fiscal years, the Internal Audit Department prepared an anti-corruption plan and certain evaluations of the most significant risks factors from the point

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of view of the internal audit function. These plans and evaluations constitute the first phase of the preparation and implementation of a comprehensive fraud prevention plan that is expected to be completed during the calendar year 2008. In addition, these plans and evaluations were submitted to the Office of the Comptroller of the Commonwealth of Puerto Rico for their evaluation and review. The comprehensive fraud prevention plan to be implemented will include the design, the documentation and the adoption of specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material inadequate financial reporting. The Internal Audit Department will keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality's core processes.

4. The Municipality is currently implementing a new accounting system, which includes the re-engineering of several core processes, including all areas susceptible to fraud risks.

Anticipated completion date:	Not applicable.
Contact person:	Mrs. Cathy Negrón, Director of Finance Mrs. Maritza Ríos, Director of Internal Audit Mrs. Iris D. Caldera, Director of Federal Programs Telephone: (787) 788-0404

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Finding Control Number: 07-04:

Cash and Bank Accounts

The Municipality has not established sufficient controls in the handling of bank accounts to prevent errors and irregularities from being timely detected. The following control deficiencies were noted during our examination:

- a) The cash balance shown by the Municipality's Treasury Department for the Debt Service Fund as of June 30, 2007, did not agree with the notification of the Account Activity of the Municipal Revenues Collection Center, known by its Spanish acronym as CRIM. This is due to transactions for the fiscal year which were not recorded for in the Municipality's books. Although such information was received late from the CRIM, the Municipality had not closed the books at that date and such transactions could have been properly recorded.
- b) Reconciling items or differences have been outstanding for more than one year without adequate explanation. The bank reconciliations are the following:

<u>Bank Account Name</u>	<u>Reconciling Items Amount</u>
• Cuenta Corriente	\$5,078
• Aportación de Padres Municipal	44
• Reforma de Salud IPA	<u>2,232</u>
	<u>\$7,354</u>

- c) Per our audit work in the Cash and Bank Accounts Area, we noted that the reconciled balance of the "Cuenta Corriente" account reflected an incorrect balance at June 30, 2007. On June 29, 2007, the Municipality opened a certificate of deposit amounting to \$3,000,000 in another financial institution by issuing a check from its "Cuenta Corriente" account. Such check was not included as part of the list of outstanding checks at June 30, 2007. As a result of this error in recording the transaction the reconciled cash balance at year end was overstated by \$3,000,000. the aforementioned conditions represent material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation:

We recommend that transactions affecting funds held by the CRIM for the Municipality's Debt Service Fund should be recorded on a timely basis and balances reconciled periodically, especially at year end.

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Response by Department of Internal Audit – Finding Control Number 07-04:

We do not concur with this finding. As part of the preparation of the financial statements of the Municipality as of June 30, 2007, the Municipality established a Financial Reporting Task Force composed of the management team of the Department of Finance and outside certified public accountants and consultants. Such team prepared all of the accounting records and subsidiary reports that supported the cash balances and disclosures reported in the financial statements, including the analysis of the cash balances of the Debt Service Fund at June 30, 2007. The cash balances reported in the Debt Service Fund and all other governmental funds were accounted for by the Financial Reporting Task Force in the municipality's basic financial statements and were examined by the independent auditors, which concluded that no audit adjustments were needed at June 30, 2007 to conform them with generally accepted accounting principles. In addition the bank account reconciliation of the Debt Service Fund was prepared in a timely manner in each of the twelve months of fiscal year 2006-2007 and the related transactions were recorded in the corresponding accounting period in the Uniform Accounting System and in the manual books, therefore, no corrective action is needed for this finding.

The use of the *Financial Reporting Task Force* for these purposes reduced the risks of possible errors, omissions or deviations from generally accepted accounting principles in the Municipality's basic financial statements. Such internal control measures compensate all of the deficiencies in the current accounting system used by the Municipality and reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Furthermore, it is the Municipality's accounting policy currently in place, to prepare bank reconciliations on a monthly basis for all bank accounts, including the bank account of the debt service fund. Such reconciliations are also reviewed on a monthly basis. In each of the twelve months of the fiscal year ended June 30, 2007, the Department of Finance accurately prepared the bank account reconciliation of the Debt Service Fund's bank account and the related transactions were recorded in the corresponding accounting period. A copy of all of those reconciliations are kept filed in the Department of Finance and were submitted to the independent auditors for their audit.

The reconciling items referred to above in the finding that were outstanding in the bank account reconciliations for over one year amounted to only \$7,354 at June 30, 2007. Such amount is clearly immaterial to the financial statements taken as a whole and the total cash balances stated in those basic financial statement for \$46.4 million at June 30, 2007. Such difference of \$7,354 was adjusted and correctly accounted for in the basic financial statements and the governmental funds' trial balances prior to the audit performed by the independent auditors, therefore, no audit adjustment was proposed by the independent auditors on such balances.

Furthermore, the check of \$3,000,000 referred to above in the finding was also correctly accounted for as an outstanding check in the basic financial statements prior to the audit performed by the independent auditors, therefore, no audit adjustment was proposed by the

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independent auditors for such check. The effect of such check was zero in the financial statements since it was correctly accounted for as an outstanding check in the financial statements offsetted with an investment in certificates of deposit, both items for the same amount of \$3,000,000.

In relation to part “b” of this finding, we do not concur with the fact that certain reconciling items in the the aforementioned bank accounts have been outstanding without adequate explanation. Management understand that these items represent adequately documented reconciling items pending to be adjusted in the bank reconciliations and the manual accounting system of the Municipality. However, such reconciling items were properly adjusted and accounted for in the audited financial statements of the Municipality as of June 30, 2007. Furthermore, it is the Municipality’s accounting policy currently in place, to prepare bank reconciliations on a monthly basis for all bank accounts. Such reconciliations are also reviewed on a monthly basis and all reconclng items are properly identified and investigated.

Anticipated completion date:	Not applicable.
Contact person:	Mrs. Cathy Negrón, Director of Finance Telephone: (787) 788-0404

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
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Fiscal Year Ended June 30, 2007

Finding Control Number: 07-05:

Municipal License Tax

We selected 40 municipal license taxpayers' files for examination amounting to \$4,994,869. The following deficiencies were noted during our test:

- In 16 (40%) municipal license taxpayers files examined amounting to \$392,852, the municipal license issued were not present in file.
- In 3 (8%) municipal license taxpayer files amounting to \$95, the Modelo #5 – “Registro de Patente de Industria y Comercio” were not present in the file.
- In 1 (3%) municipal license taxpayer files amounting to \$41, the income section of the volume of business tax return did not agree with the volume of the business tax return.
- In 3 (8%) municipal license taxpayers files examined amounting to \$75, the income tax return was not present in file.
- In 1 (3%) municipal license taxpayer file amounting to \$244, the required audited financial statement for Volume of Business exceeding \$1,000,000 was not present in the file.
- In 1 (3%) municipal license taxpayer file amounting to \$161, the Volume of Business tax return was not sworn.

Questioned Costs: None

Independent Auditors' Recommendation:

According to Sec. 651i (a) (F) (i) Law No. 113 of July 10, 1974 as amended, for a volume of business less than \$1,000,000 the taxpayer must include a copy of the income section of the income tax return submitted to Puerto Rico Treasury Department. This document must be accompanied by a certification indicating that it is an exact copy of the documents submitted to the Treasury Department of the income tax return. All tax declarations without this certification will be considered not filed by the taxpayer.

The Municipality should improve the existing procedures related to the municipal license taxpayer files, to ascertain it completeness and accuracy. Also, the Municipality should implement a checklist to be used for each taxpayer to assure completeness of the required documentation.

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Response by Department of Finance – Finding Control Number 07-05:

We do not concur with this finding. The conditions described by the independent auditors in this finding do not include the required elements established by federal regulations in order for those conditions to be reported as a finding *on internal over financial reporting*. Although the conditions referred to above are related to certain internal control deviations, they do not have any effect over financial reporting since all municipal license revenues for 2006-2007 are supported by cash collections evidenced by collection receipts which were audited by the independent auditors and no exceptions on them were reported. Instead, the conditions reported in the finding above have only an operational effect, but not an effect over financial reporting. Accordingly, the conditions reported in this finding constitute matters that may be reported in a management letter but not as a finding. This can be corroborated by the fact that the 2003 Yellow Book, at Paragraphs 5.13 and 5.14, requires the independent auditors to prepare an audit report that discloses reportable conditions and material weaknesses in internal control based solely on the understanding obtained as part of the audit of the financial statements as defined in the standards established by the American Institute of Certified Public Accountants (AICPA). Paragraph 3.06 of the GAS/A-133 AICPA Audit Guide uses the term *internal control over financial reporting* to describe the controls *that relate to the financial statements and that are reported on in the internal control reporting required by the Yellow Book*.

In addition, the fifth bullet point of the finding is not correct as it has been written because it is not possible that for a volume of business of over \$1 million, the corresponding municipal license tax payment is only \$244. Therefore, it is more likely than not that the file examined by the independent auditors is not related to a taxpayer with a volume of business exceeding \$1 million. Consequently, we do not concur with this finding.

In addition, the alleged deficiencies referred in the finding, if considered true, would not be considered as a situation which could adversely affect the Municipality's ability to record, process, summarize, and report disbursements and the related liabilities in accordance with generally accepted accounting principles because during the last three fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the disbursements cycle referred to above, and reduce, to a relatively low level, the risk that misstatements in disbursement amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

This conclusion is evidenced by the following facts: (1) the Independent Auditors' Report on the Municipality's financial statements was unqualified for the fiscal year ended June 30, 2007, (2) the Municipality was recently awarded by the Government Finance Officers Association with the Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007 and expects to be awarded again for its CAFR for the fiscal year ending June 30, 2008, and (3) audit adjustments recorded in the financial statements were minimal and not material to the financial statements taken as a

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whole. *The Financial Reporting Task Force* referred to above will continue operating after the Single Audit of the fiscal year ended June 30, 2008 since it is the intention of management to keep improving its current accounting, auditing, and financial reporting practices every year thereafter.

Anticipated completion date:	Not applicable.
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Contact person:	Mrs. Cathy Negrón, Director of Finance Telephone: (787) 788-0404 email: departamento_de_finanzas@yahoo.com
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO**

**Exhibit A – Revised Corrective Action Plan of Financial Statements Findings
Fiscal Year Ended June 30, 2007**

Finding Control Number: 07-06:

Disbursement Test

As part of our test of cash disbursements during the year (amounting to approximately \$88 million), we selected 40 disbursement vouchers amounting to \$197,223. The following deficiencies were noted during our examination:

- In 22 (55%) disbursements vouchers amounting to \$167,955 we could not traced them to the General ledger since they were not posted.
- In 7 (18%) disbursements vouchers amounting to \$108,037 we could not traced them to the Orders and Contracts Book since they were not posted.

Criteria:

According to the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico, the pre-auditing unit or person in charge of pre-auditing the documents shall keep a record of the authorized signatures of the Municipality. He shall check against such record to ascertain that the officers certifying the documents are so authorized. He shall check the documents correctness in all of its parts and that the transactions in order to pursuant the correct legislation, ordinances, resolutions, contracts and regulations. Once everything is found to be in order, the document shall be certified as pre-audited and shall be sent for the approval of the Finance Director. In addition, of the aforementioned regulation, the vouchers, all canceled checks and any other document, that justifies a payment, shall be filed by the Finance Director to be audited by the Puerto Rico Comptroller's Office or any other agency as required by law.

Questioned Costs: None

Independent Auditors' Recommendation:

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the process of acquisition of materials and supplies, equipment, and construction and service contracts.

Response by Department of Finance – Finding Control Number 07-06:

We do not concur with this finding. The disbursement vouchers referred to above in this finding were adequately recorded in the Uniform Accounting System of the Municipality (UAS), and were also correctly recorded in the financial statements and the governmental funds' trial balances of the Municipality as of and for the fiscal year ended June 30, 2007. There were no audit adjustments proposed by the independent auditors for these disbursements as of June 30, 2007. Consequently, those disbursement vouchers were recorded in the proper accounting period through specific accounting and control procedures consistently applied by the

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Department of Finance over the disbursements cycle for the fiscal year ended June 30, 2007. These disbursements were recorded in the general ledger and the cash disbursements records during the fiscal year ended June 30, 2007, which agree with the basic financial statements and were given to the independent auditors for their audit. This can be evidenced by the fact that there were no audit adjustments nor questioned costs proposed by the independent auditors for these disbursements. Accordingly, all disbursements for the fiscal year then ended were made in strict compliance with the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico.

In addition to the above, management understands that the aforementioned disbursement items are clearly immaterial to the financial statements taken as a whole, which reported aggregate disbursements of approximately \$88 million for 2006-2007. Accordingly, the aforementioned items do not constitute reportable conditions in the internal control over financial reporting since are not material to the financial statements taken as a whole. In addition, the deficiencies referred in the finding, if considered true, would not be considered as a situation which could adversely affect the Municipality's ability to record, process, summarize, and report disbursements and the related liabilities in accordance with generally accepted accounting principles because during the last three fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the disbursements cycle referred to above, and reduce, to a relatively low level, the risk that misstatements in disbursement amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The principal of the abovementioned internal control measures adopted by the Municipality was the establishment of a *Financial Reporting Task Force* composed of the management team of the Department of Finance and outside certified public accountants and consultants specialized in governmental accounting and auditing. Such team worked together throughout the year to prepare the Municipality's financial statements, including all the necessary accounting entries needed to account for disbursements and liabilities reported in the financial statements as of and for the fiscal year ended June 30, 2007. These control measures minimized the risks of possible errors, omissions or deviations from generally accepted accounting principles in the Municipality's basic financial statements.

In addition, the alleged deficiencies referred in the finding, if considered true, would not be considered as a situation which could adversely affect the Municipality's ability to record, process, summarize, and report disbursements and the related liabilities in accordance with generally accepted accounting principles because during the last three fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the disbursements cycle referred to above, and reduce, to a relatively low level, the risk that misstatements in disbursement amounts that would

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be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

This conclusion is evidenced by the following facts: (1) the Independent Auditors' Report on the Municipality's financial statements was unqualified for the fiscal year ended June 30, 2007, (2) the Municipality was recently awarded by the Government Finance Officers Association with the Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007 and expects to be awarded again for its CAFR for the fiscal year ending June 30, 2008, and (3) audit adjustments recorded in the financial statements were minimal and not material to the financial statements taken as a whole. *The Financial Reporting Task Force* referred to above will continue operating after the Single Audit of the fiscal year ended June 30, 2008 since it is the intention of management to keep improving its current accounting, auditing, and financial reporting practices every year thereafter.

Anticipated completion date:	Not applicable.
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Contact person:	Mrs. Cathy Negrón, Director of Finance Telephone: (787) 788-0404 email: departamento_de_finanzas@yahoo.com
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MUNICIPALITY OF CATAÑO
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Finding Control Number: 07-07:

***Personnel Files and Related Payroll Procedures
Reportable Condition of Internal Control***

During our audit, we tested a sample of 40 employee files and noted that several files lacked documentation supporting the employee's salary, status or eligibility. The following exceptions were noted during our examination:

Health examinations	1 file	2%
Employee evaluations	18 files	45%
Eligibility verification form (Form I-9)	3 files	8%
Job Description OCAP-16	5 files	13%
Good Behavior certificate	5 files	13%
Regular or sick leave records	7 files	18%
Drug detection tests	1 file	2%
Child Support Form ASM-5	2 files	5%
PR Retirement System Documents	5 files	13%
Authorization for deductions	1 file	2%

Questioned Costs: None

Independent Auditors' Recommendation:

The Personnel Department should review each employee file and ascertain their completeness. Management could design a standard checklist where the file reviewer could determine if documents are missing from each file. Signed exemptions certificates and authorizations for non-statutory withholdings should always support the amounts withheld from employees.

Response by Department of Human Resources – Finding Control Number 07-07:

We partially concur with the major portion of this finding as explained as follows. The missing Child Support Forms ASM-5, the documents related to the Employees Retirement System of the Government of Puerto Rico and Its Instrumentalities and the authorization for deductions are related to internal controls and procedures with a direct effect over financial reporting, consequently, we concur with the finding only to the extent it relates to these three types of documents that were not present in the human resources files.

However, the other missing documents referred to above in the finding, do not include the necessary elements established by federal regulations in order to be reported as a finding *on internal over financial reporting*. Although these missing documents are related to certain internal control deviations, they do not have a direct effect over financial reporting. Instead, those conditions have only an operational effect, but not an effect over financial reporting. Accordingly, the conditions reported in this finding constitute matters that may be reported in a

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management letter but not as a finding of internal control over financial reporting. This can be corroborated by the fact that the 2003 Yellow Book, at Paragraphs 5.13 and 5.14, requires the independent auditors to prepare an audit report that discloses reportable conditions and material weaknesses in internal control based solely on the understanding obtained as part of the audit of the financial statements as defined in the standards established by the American Institute of Certified Public Accountants (AICPA). Paragraph 3.06 of the GAS/A-133 AICPA Audit Guide uses the term *internal control over financial reporting* to describe the controls ***that relate to the financial statements and that are reported on in the internal control reporting required by the Yellow Book.***

In addition, the alleged deficiencies referred in the finding, if considered true, would not be considered as a situation which could adversely affect the Municipality's ability to record, process, summarize, and report disbursements and the related liabilities in accordance with generally accepted accounting principles because during the last three fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the disbursements cycle referred to above, and reduce, to a relatively low level, the risk that misstatements in disbursement amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

This conclusion is evidenced by the following facts: (1) the Independent Auditors' Report on the Municipality's financial statements was unqualified for the fiscal year ended June 30, 2007, (2) the Municipality was recently awarded by the Government Finance Officers Association with the Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007 and expects to be awarded again for its CAFR for the fiscal year ending June 30, 2008, and (3) audit adjustments recorded in the financial statements were minimal and not material to the financial statements taken as a whole. *The Financial Reporting Task Force* referred to above will continue operating after the Single Audit of the fiscal year ended June 30, 2008 since it is the intention of management to keep improving its current accounting, auditing, and financial reporting practices every year thereafter.

However, during the fiscal year ended June 30, 2008, the Municipality's Department of Human Resources will review all employee files to ensure that all missing documents are identified and are filed appropriately. In addition, adequate internal controls and procedures will be placed in operations to avoid instances of missing documents in employee files.

Anticipated completion date:	June 30, 2008
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Contact person:	Mr. José Carrillo, Director of Human Resources Telephone: (787) 788-0404 email: departamento de finanzas@yahoo.com
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Finding Control Number: 07-08:

Cash Receipts Test

As part of our test of cash receipts during the year (amounting to approximately \$77 million), we selected 40 receipts amounting to \$488,532, representing .05% of the total receipts. The following deficiencies were noted during our examination:

- The Municipality could not provide us 7 validated deposit slips amounting to \$33,322, pertaining to cash receipts transactions for the fiscal year 2006-2007. Such validated deposit slips were not available for examination.
- In 33 (83%) cash receipts amounting to \$407,403, we could not traced them to the General Ledger.

According to Law 81, the books, documents and funds in the possession of the collectors must remain available for examination by Officers from the Office of the Comptroller, the Treasury Department, the Administration or any other duly authorized agency.

Criteria:

According to Law 81, the books, documents and funds in the possession of the collectors must remain available for examination by Officers from the Office of the Comptroller, the Treasury Department, the Administration or any other duly authorized agency.

Questioned Costs: None

Independent Auditors' Recommendation:

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the revenues and cash receipts cycle.

Response by Department of Finance – Finding Control Number 07-08:

We do not concur with this finding. The missing deposit slips referred to above in the finding do not include the required elements established by federal regulations in order to be reported as a finding *on internal over financial reporting*. Although these missing documents are related to certain internal control deviations, they do not have a direct effect over financial reporting and the determination of the financial position and the results of operations of the Municipality since the basic financial statements of the Municipality included all cash receipts evidenced by a reconciliation of all bank accounts at June 30, 2007 and for each of the twelve months of the year then ended.

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All cash collections were correctly recorded in the general ledger audited by the independent auditors and the financial statements of the Municipality as of and for the fiscal year ended June 30, 2007. There were no audit adjustments proposed by the independent auditors for any unrecorded collections for the fiscal year ended June 30, 2007. Consequently, those collections were recorded in the proper accounting period through specific accounting and control procedures consistently applied by the Department of Finance over the cash receipts cycle for the fiscal year ended June 30, 2007.

Instead, those conditions referred in the first bullet point of the above finding, have only an operational effect, but not an effect over financial reporting because the cash balances reported in the audited financial statements of the Municipality were accurately reported and were supported by monthly bank account reconciliations. Furthermore, it is the Municipality's accounting policy currently in place, to prepare bank reconciliations on a monthly basis for all bank accounts. Such reconciliations are also reviewed on a monthly basis and all reconciled items are investigated and resolved in a timely manner.

Accordingly, the conditions reported in this finding constitute matters that may be reported in a management letter but not as a finding of internal control over financial reporting. This can be corroborated by the fact that the 2003 Yellow Book, at Paragraphs 5.13 and 5.14, requires the independent auditors to prepare an audit report that discloses reportable conditions and material weaknesses in internal control based solely on the understanding obtained as part of the audit of the financial statements as defined in the standards established by the American Institute of Certified Public Accountants (AICPA). Paragraph 3.06 of the GAS/A-133 AICPA Audit Guide uses the term *internal control over financial reporting* to describe the controls ***that relate to the financial statements and that are reported on in the internal control reporting required by the Yellow Book.***

In addition, the alleged deficiencies referred in the finding, if considered true, would not be considered as a situation which could adversely affect the Municipality's ability to record, process, summarize, and report disbursements and the related liabilities in accordance with generally accepted accounting principles because during the last three fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the disbursements cycle referred to above, and reduce, to a relatively low level, the risk that misstatements in disbursement amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

This conclusion is evidenced by the following facts: (1) the Independent Auditors' Report on the Municipality's financial statements was unqualified for the fiscal year ended June 30, 2007, (2) the Municipality was recently awarded by the Government Finance Officers Association with the Certificate of Achievement for Excellence in Financial Reporting for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007 and expects to be awarded again for its CAFR for the fiscal year ending June 30, 2008, and (3) audit adjustments recorded

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in the financial statements were minimal and not material to the financial statements taken as a whole. *The Financial Reporting Task Force* referred to above will continue operating after the Single Audit of the fiscal year ended June 30, 2008 since it is the intention of management to keep improving its current accounting, auditing, and financial reporting practices every year thereafter.

However, during the fiscal year ending June 30, 2008, the Department of Finance will review the documentation of all cash receipts made during the fiscal year and will prepare and adopt additional specific written accounting and control policies over the cash receipts cycle of the Municipality to ascertain that all documents are adequately safeguarded and all cash receipts are made in strict compliance with the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico.

It important to mention that management understands that the aforementioned conditions constitute isolated cases that do not represent the actual status of the remaining population of cash receipts not examined by the independent auditors. During the fiscal year ended June 30, 2006, the Municipality had cash receipts amounting to over \$77 million, of which only \$488,532 (0.5% of total cash receipts) were examined by the independent auditors as part of the Single Audit.

Anticipated completion date:	June 30, 2008
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Contact person:	Mrs. Cathy Negrón, Director of Finance Telephone: (787) 788-0404 email: departamento_de_financeas@yahoo.com
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
 Exhibit A – Revised Corrective Action Plan of Federal Award Findings
 Fiscal Year Ended June 30, 2007

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
All Federal Programs	07-09 Federal Financial Reports	

The accounting records maintained by the Federal Programs Office are not reconciled with the accounting records maintained by the Municipality's central accounting department records. The Municipality has not established procedures for the reconciliation of the transactions recorded in the Program's accounting records with those recorded in the Municipality's central accounting department records. As a result, this condition may lead to inaccurate reporting of programs supported activities.

NONE

Criteria:

OMB Circular A-102, 20 (b) (2) requires recipient of federal funds to have a financial management system that provides for the maintenance of accurate, current and complete records of the financial results of federally assisted activities in accordance with the financial reporting requirements of the Federal Program. The Municipality should prepare federal financial reports based on the Programs underlying accounting records.

Response by Department of Federal Programs – Finding Control Number 07-09

We concur with this finding. For the fiscal year ended June 30, 2008 the Department of Federal Programs will prepare a reconciliation of the official accounting records of the Municipality (kept by the Department of Finance) and the accounting records of each federal program. In such reconciliation, the cash receipts and cash disbursements of both accounting records will be compared and the differences will be identified and will be properly accounted for in the Municipality's basic financial statements as of and for the fiscal year ending June 30, 2008. The reconciliation referred to above will be performed by program year for each federal grant through June 30, 2008. Accordingly, the federal financial reports will be prepared with financial data from the Municipality's official accounting records, which will agree with the accounting records of federal programs.

Anticipated completion date:	June 30, 2008
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Exhibit A – Revised Corrective Action Plan of Federal Award Findings
Fiscal Year Ended June 30, 2007

Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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Exhibit A – Revised Corrective Action Plan of Federal Award Findings
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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All Federal Programs **07-10 Procurement, Suspension and Debarment**

Statement of Condition:

The Municipality has not established effective procurement procedures to verify in the acquisition of goods and services that the supplier was not suspended or debarred or otherwise excluded. The Municipality did not performed any step to ascertain that supplier is not included in the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), obtaining a certification from the entity or adding a written clause or condition to the covered transaction with that entity.

NONE

Criteria:

2 CFR, Part 180 and 70 FR 51863 state that contractors receiving individual awards for \$25,000 or more and all sub recipients must certify that the organization and its principals are not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), collecting a certification from the entity or adding a clause or condition to the covered transaction with the entity.

Independent Auditors' Recommendation:

We recommend the Municipality to obtain the EPLS in printed or electronic format in order to use it as part of the procurement cycle. The printed version is published on a monthly basis. Copies can be obtained by purchasing a yearly subscription to the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by calling the Government Printing Office Inquiry and Order Desk at (202) 783-3238. The electronic version can be obtained on the Internet (<http://epls.amet.gov>). The Municipality should

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enforce strict compliance with the prescribed
federal requirement.

Response by Department of Federal Programs – Finding Control Number 07-10

We concur with this finding. For the fiscal year ended June 30, 2008, the Department of Federal Programs will obtain the EPLS in printed or electronic format and will used in the evaluation of all future purchases of goods or services in order to ascertain that suppliers are not suspended or debarred. The Department of Federal Programs will ascertain that the EPLS used for these purposes is the updated printed version published on a monthly basis by the U.S. Government Printing Office. In the case the electronic format is used, the EPLS will be obtained on the Internet (<http://epls.arnet.gov>).

However, based on an evaluation performed by the Department of Federal Programs subsequently to the Single Audit, the Municipality concluded that all goods and services purchased with federal funds were acquired from suppliers that were not suspended nor debarred parties during the fiscal year ended June 30, 2007. This can be evidenced by the fact that the independent auditors did not find disbursements made to any suspended or debarred supplier of goods or services during the fiscal year ended June 30, 2007. In addition, it is a policy of the Municipality to include a clause in every contract with suppliers or goods or services where the supplier confirms that has not been convicted of any crime and has no legal situations or cases limiting it from performing their services to the Municipality.

Anticipated completion date:	June 30, 2008
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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All Federal Programs **07-11 Equipment and Real Property Management**

Statement of Condition:

The Municipality has not complied with the property management requirements. There were no physical inventories performed during the fiscal year ended June 30, 2007.

NONE

The Federal Programs has not prepared a subsidiary ledger of equipment acquired with federal funds. Such subsidiary ledger to comply with federal requirements should: (1) have information needed to calculate the federal share of the cost of the equipment, (2) have information about the identification number of the asset, such as the manufacturer's serial numbers, (3) identify the grant under which the program acquired the equipment, (4) have information about the location, use and condition of the equipment and the date the information was obtained, and (5) have all pertinent information on the ultimate transfer, replacement, or disposal of the equipment (6) have information about acquisition date and unit acquisition cost.

Furthermore, there is no evidence that the total amount of capital expenditures and the composition of capital assets incurred by Federal Programs have been reconciled with the general ledger or other control account to enhance the controls to prevent unauthorized disposition of assets.

Criteria:

29 CFR 97.32 (d) (2) established that the Municipality should take the physical inventory and reconcile the results with the property records. In addition, section (d) (3) establishes that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property.

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Federal regulations also require that, every two years, at a minimum, a physical inventory shall be conducted and the results shall be reconciled with property records to verify the existence, current utilization, and continued need for the equipment. Any discrepancies between quantities determined by the physical inspection with those shown in the accounting records shall be investigated to determine the causes of the differences. Property records shall be accurate. Property records shall include the following for each item:

- A description of the equipment including manufacturer's serial numbers.
- Identification number, as the manufacturer's serial numbers.
- Identification of the grant under which the recipient acquired the equipment.
- The information needed to calculate the federal share of the cost of the equipment.
- Acquisition date and unit acquisition cost.
- Location, use and condition of the equipment and the date the information was obtained.

- All pertinent information on the ultimate transfer, replacement or disposal of the equipment.

Independent Auditors' Recommendation:

A physical inventory of the Federal Programs capital assets should be taken as soon as possible. Physical inventory amounts should be reconciled with the property recorded on the subsidiary ledgers. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions. Dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance Director.

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Response by Department of Federal Programs – Finding Control Number 07-11

We partially concur with this finding. During the fiscal year ended June 30, 2007, the Municipality performed a physical inventory of personal property in all agencies and municipal departments. Currently, the Municipal Property Administrator is in the process of reconciling the physical counts with the respective personal property units recorded in the Uniform Accounting System and is in the process of writing-down assets lost or damaged. However, these assets are generally immaterial to the financial statements taken as a whole since most of them are either fully or substantially depreciated at June 30, 2007 due to their short useful lives ranging from five to ten years.

For financial reporting purposes, currently the accounting and administration of capital asset is kept in electronic worksheets, in compliance with GASB Statement No. 34. For fiscal and managerial, day-to-day purposes, the capital assets of the Municipality are accounted for in the Uniform Accounting System (refer to audit finding number 07-01). The capital asset records kept in the electronic worksheets were reconciled and agreed with the Municipality's audited financial statements and trial balances at June 30, 2007 and include the historical cost, the accumulated depreciation, the location, acquisition date and the depreciation expense for each asset with a unit cost of \$500 or more. The accounting of these assets is made pursuant to a formal capital assets policy adopted by the Municipality in 2003. The Municipality will continue to update the subsidiary of capital assets during the fiscal year 2007-2008 to account for additions, retirements, impairments and certain missing information of capital assets.

During the fiscal year ended June 30, 2008, the Municipal Property Administrator will expand the information kept for each capital asset purchased with federal funds to ensure that for each asset, the subsidiary includes information for each asset such as: (1) information needed to calculate the federal share of the cost of the equipment, (2) information about the identification number of the asset, such as the manufacturer's serial numbers, (3) grant under which the program acquired the equipment, (4) the location, use and condition of the equipment and the date the information was obtained, and (5) all pertinent information on the ultimate transfer, replacement, or disposal of the equipment.

During the fiscal year 2007-2008, the In-Charge of Property will complete the reconciliation of the physical inventory taken in 2007 with the property records kept in the Uniform Accounting System (UAS). In the case of real property and general infrastructure assets, the Municipality will perform a physical inspection of them during 2007-2008 to ascertain compliance with GASB Statement No. 42.

During the fiscal year ended June 30, 2007, the Municipality prepared a detail of all capital expenditures incurred and the source of funds used to pay for them. Such capital outlays were reconciled in all of the governmental funds of the Municipality and were properly accounted for in the Municipality's basic financial statements and the trial balance of each governmental fund for the fiscal year ended June 30, 2007. The list of capital outlays was provided to the

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independent auditors and no audit adjustments or questioned costs were proposed by them as of and for the fiscal year 2006-2007.

Anticipated completion date:	June 30, 2008
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Contact person:	Mr. Benito Maldonado, Municipal Property Administrator Telephone: (787) 788-0404 email: departamento_de_finanzas@yahoo.com
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
CSBG Program CFDA No. 93.569	07-12 Cash Management System <u>Statement of Condition:</u> The Municipality has not established effective cash management procedures. The Program had an average cash balance of approximately \$16,232, during the fiscal year. There were months which reported balances as high as \$16,529, at the end of the month. <u>Criteria:</u> Federal Regulation requires that grantees shall conform to the standards applicable to advances from federal agencies. Amounts requested should be limited to the Program's immediate cash needs. <u>Independent Auditors' Recommendation:</u> In accordance with Federal Regulations, the Municipality should estimate drawdown of federal funds as closely as possible to the actual disbursements.	NONE

Response by Department of Federal Programs– Finding Control Number 07-12:

We concur with this finding. The Department of Federal Programs acknowledge that the cash management compliance requirements apply to most federal programs, except for federal awards that operate on a cost-reimbursement basis with no cash being advanced. The CSBG Program of the Municipality operated on a cost-reimbursement basis during the fiscal year ended June 30, 2007.

However, the outstanding cash balance of the CSBG Program related to the aforementioned finding represents funds carried over from prior fiscal years that remained undisbursed at June 30, 2007. Such undisbursed balance decreased significantly in comparison with the prior fiscal year, therefore, the effect of the cash management noncompliance referred to above in the finding was minimized during the current fiscal year.

As an immediate corrective action, on September 2007, the Municipality performed a detailed analysis of the unspent cash balances of the CSBG Program and concluded that there was a surplus of \$16,186.85 as of June 30, 2007, carried over from program years 1995-1996 and 1998

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through 2002. Consequently on September 18, 2007, the Municipality reimbursed \$16,186.85 to the grantor through the Puerto Rico Secretary of the Treasury (check numer 0588; payment voucher CSB60588; lot 7673) related to such surpluses of CSBG funds from program years 1995-1996 (\$1,545.52), and 1998 through 2002 (\$14,641.33). Accordingly, as of the date of this corrective action plan, the finding has been already totally corrected.

Anticipated completion date:	Corrective action already completed.
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
Emergency Shelter Program CFDA No. 14.231	07-13 Cash Management System	

Statement of Condition:

The Municipality has not established effective cash management procedures. The Program had an average cash balance of approximately \$13,377, during the fiscal year. There were months which reported balances as high as \$71,249, at the end of the month.

NONE

Criteria:

Federal Regulation requires that grantees shall conform to the standards applicable to advances from federal agencies. Amounts requested should be limited to the Program's immediate cash needs.

Independent Auditors' Recommendation:

In accordance with Federal Regulations, the Municipality should estimate drawdown of federal funds as closely as possible to the actual disbursements.

Response by Department of Federal Programs– Finding Control Number 07-13:

We concur with this finding. The Department of Federal Programs acknowledge that the cash management compliance requirements apply to most federal programs, except for federal awards that operate on a cost-reimbursement basis with no cash being advanced. The ESG Program of the Municipality operated on a cost-reimbursement basis during the fiscal year ended June 30, 2007.

However, the outstanding cash balance of the ESG Program related to the aforementioned finding represents funds carried over from prior fiscal years that remained undisbursed at June 30, 2007. Such undisbursed balance decreased significantly in comparison with the prior fiscal year, therefore, the effect of the cash management noncompliance referred to above in the finding was minimized during the current fiscal year.

As an immediate corrective action, on August 2007, the Municipality performed a detailed analysis of the unspent cash balances of the ESG Program and concluded that there was a surplus

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of \$23,414.50 as of June 30, 2007, carried over from program year 2005-2006. Consequently on August 31, 2007, the Municipality reimbursed \$23,414.50 to the grantor through the Puerto Rico Secretary of the Treasury (check 204, dated August 31, 2007) related to such surpluses of ESG funds from program year 2005-2006. Accordingly, as of the date of this corrective action plan, the finding has been already totally corrected.

Anticipated completion date:	Corrective action already completed.
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
Child Care Program CFDA No. 93.575	07-14 Cash Management System	

Statement of Condition:

The Municipality has not established effective cash management procedures. The Program had an average cash balance of approximately \$17,439, during the fiscal year. There were months which reported balances as high as \$36,978, at the end of the month.

NONE

Criteria:

Federal Regulation requires that grantees shall conform to the standards applicable to advances from federal agencies. Amounts requested should be limited to the Program's immediate cash needs.

Independent Auditors' Recommendation:

In accordance with Federal Regulations, the Municipality should estimate drawdown of federal funds as closely as possible to the actual disbursements.

Response by Department of Federal Programs– Finding Control Number 07-14:

We concur with this finding. The Department of Federal Programs acknowledge that the cash management compliance requirements apply to most federal programs, except for federal awards that operate on a cost-reimbursement basis with no cash being advanced. The Child Care Program of the Municipality operated on a cost-reimbursement basis during the fiscal year ended June 30, 2007, and for such program year, the Municipality complied with the cash management requirements.

The remaining undisbursed amount kept by the program at June 30, 2007 will be analyzed and, if considered necessary, will be reimbursed to the U.S. Department of Health and Human Services on or before June 30, 2008. As an immediate corrective action, the Municipality will establish the necessary policies and procedures to estimate drawdowns of federal funds as closely as possible to the actual disbursement date. In addition, the Municipality will minimize the drawdowns made after the 25th day of each month to minimize the ending monthly cash balances

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resulting from drawdowns. Any excess cash balances will be reimbursed to the federal government immediately as are identified.

Anticipated completion date:	June 30, 2008
Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net

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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP Program CFDA No. 14.219	07-15 Cash Management System <u>Statement of Condition:</u> The Municipality has not established effective cash management procedures. The Program had an average cash balance of approximately \$12,029, during the fiscal year. There were months which reported balances as high as \$31,254, at the end of the month. <u>Criteria:</u> Federal Regulation requires that grantees shall conform to the standards applicable to advances from federal agencies. Amounts requested should be limited to the Program's immediate cash needs. <u>Independent Auditors' Recommendation:</u> In accordance with Federal Regulations, the Municipality should estimate drawdown of federal funds as closely as possible to the actual disbursements.	NONE

Response by Department of Federal Programs– Finding Control Number 07-15:

We concur with this finding. The Department of Federal Programs acknowledge that the cash management compliance requirements apply to most federal programs, except for federal awards that operate on a cost-reimbursement basis with no cash being advanced. The remaining undisbursed amount kept by the program at June 30, 2007 will be analyzed and, if considered necessary, will be reimbursed to the U.S. Department of Housing and Urban Development on or before June 30, 2008.

As an immediate corrective action, the Municipality will establish the necessary policies and procedures to estimate drawdowns of federal funds as closely as possible to the actual disbursement date. In addition, the Municipality will minimize the drawdowns made after the 25th day of each month to minimize the ending monthly cash balances resulting from drawdowns. Any excess cash balances will be reimbursed to the federal government immediately as are identified.

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Anticipated completion date:	June 30, 2008
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Contact person:	Mrs. Iris D. Caldera Rodriguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP Program CFDA No. 14.219	07-16 Financial Reporting	

Statement of Condition:

Our review of the quarterly financial reports submitted to Oficina del Comisionado de Asuntos Municipales (OCAM), disclosed that the information presented in the financial reports did not agree with the information recorded in the Program General Ledger. Several discrepancies were noted in the following accounts.

NONE

<u>Account Number</u>	<u>Account Name</u>	<u>Quarter</u>	<u>Report</u>	<u>General Ledger</u>
9101	Administrative salaries	1 st quarter	\$57,540	\$47,701
9456	Reembolso de intereses	2 nd quarter	\$67,929	\$67,996

Criteria:

Federal regulations require that the financial management system must meet some requirements, including the financial reporting. It states that accurate, current and complete disclosure of the financial results of the financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.

Independent Auditors' Recommendation:

The Municipality should prepare financial reports based on the Program's underlying accounting records. Any difference should be investigated and reconciled, accordingly.

Response by Department of Federal Programs– Finding Control Number 07-16:

We concur with this finding. The Department of Federal Programs will ascertain that all accounting transactions of the SBGP Program, which are recorded in the program's manual general ledger, are properly accounted for and reported in the corresponding program financial reports for the fiscal year ending June 30, 2008. In addition, to ensure accurate financial

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reporting of the program's activities, a reconciliation process between the Uniform Accounting System (UAS) and the manual accounting records of the SBGP Program will be made and documented for the fiscal year ending June 30, 2008. Differences between both accounting systems will be identified and adjusted prior to the preparation of the financial reports submitted to the Office of the Commissioner of Municipal Affairs (OCAM, by its Spanish Acronyms).

Anticipated completion date:	June 30, 2008
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP Program CFDA No. 14.219	07-17 Inadequate Documentation of Participant Files	

Statement of Condition:

As part of our test to determine whether the grantee assure that the rehabilitation work is properly completed, we selected a sample of 39 participants. The following documents were not available for examination:

1. Inspection of the rehabilitation work upon completion	35 Files	88%
2. Pre-rehabilitation inspection describing deficiencies	1 File	3%
3. Contract not signed.	1 File	3%
4. Family income not below low income table	3 Files	8%
5. Deficiencies to be corrected not incorporated to contract	3 Files	8%
6. Evidence of construction material return	1 File	3%

Criteria:

According to 24 CFR, 570.506 the grantee must assure that the work is properly completed. For each residential rehabilitation activity the following records are needed:

- a) Re-habilitation contract describing the deficiencies in each structure to be corrected.
- b) An inspection of the rehabilitation work upon completion to assure that it was carried out in accordance with contract specifications.

Independent Auditors' Recommendation:

The Municipality must inspect the rehabilitation work upon completion to assure that it is carried out in accordance with the contract specifications.

Response by Department of Federal Programs– Finding Control Number 07-17:

We concur with this finding. Regarding the pending inspections of thirty-five (35) rehabilitation projects, the Department of Federal Programs concur with the finding and,

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accordingly, will ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of housing rehabilitation standards of 24 CFR 570.506, 508 and 609. In addition, during the fiscal year ending on June 30, 2008, the Department of Federal Programs will review all participant files and will perform all pending inspections and will obtain the missing documents referred to above for the applicable housing rehabilitation projects.

Anticipated completion date:	June 30, 2008
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP Program CFDA No. 14.219	07-18 Earmarking Requirement	

Statement of Condition:

As of June 30, 2007, the Municipality expended less than 70 percent of the funds over a period of up to three years, for activities that benefit low-and moderate-income persons as required by the federal regulation.

NONE

Criteria:

According to 24 CFR, 570.506 the grantee must assure that not less than 70 percent of the funds must be used over a period of up to three years, as specified by the grantee in its certification, for activities that benefit low-and moderate-income persons.

Independent Auditors' Recommendation:

The Municipality should establish procedures to ascertain that comply with the earmarking requirement in accordance with 24 CFR sections 570.420 and 570.430.

Response by Department of Federal Programs– Finding Control Number 07-18:

We concur with this finding and we will adopt the recommendations of the independent auditors. The Department of Federal Programs acknowledges that earmarking includes requirements that specify the minimum and/or maximum amount or percentage of the program's funding that must/may be used for specified activities, including funds provided to subrecipients. During the fiscal year 2007-2008, the Department of Federal Programs will review the internal controls in place designed to comply with the earmarking requirements and will adopt the necessary modifications to such controls to ensure the compliance of this requirement in the future, including expending at least seventy percent (70%) of funds as soon as possible.

The Department of Federal Programs will identify all applicable percentage of dollar requirements for earmarking and will develop new control procedures to verify that the amounts recorded in the financial records meet the requirement (e.g. the minimum required amount to be spent for a specified type of cost).

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Anticipated completion date:	June 30, 2008
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
Even Start Program CFDA No. 84.213	07-19 Matching, Level of Effort and Earmarking	

Statement of Condition:

The Even Start Program has not complied with the matching requirements established by Subpart 3, Part B of Title I, William F. Goodling Even Start Family Literacy Programs and Title IX of the Elementary and Secondary Educational Act of 1965, as amended, OMB Circular A-87, OMB Circular A-102 as applicable. The Even Start Program did not have adequate internal controls and procedures to ensure compliance with the required level of matching contributions and the adequate documentation of it. Based on our examination of the annual In-Kind Contributions Certifications submitted by the Even Start Program to the Department of Education for the fiscal year ended June 30, 2007, we noted the following in-kind matching contributions for which no adequate documentation was available to support their allowability:

\$340,283

Type of In-Kind Contribution	Contribution Amount
Salaries Regular Employees	\$57,993
Utilities Expenses	6,000
Rent	244,500
Print and binding	1,500
Shipping	300
Transportation	1,000
Traveling within Puerto Rico	500
Professional and consulting services	500
Food	200
Cleaning Supplies	3,000
Office supplies	200
Educative equipment	1,000
Printing equipment	2,000
Social Security contribution	4,590

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State Insurance Fund	1,019
Christmas bonus	1,000
Payroll taxes	2,016
Total unsupported in-kind contributions	<u>\$328,318</u>

Criteria:

Section 1234 of Subpart 3, Part B of Title I, William F. Goodling Even Start Family Literacy Programs and Title IX of the Elementary and Secondary Educational Act of 1965, states that grantees are required to contribute at least sixty five percent (65%) of the costs of the program through cash or in-kind contributions. 45 CFR 74.23 states that to be accepted, all cost sharing or matching contributions, including cash and third party in-kind, shall meet all of the following criteria:

- Are verifiable from the recipient's records.
- Are not included as contributions for any other federally-assisted project or program.
- Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
- Are allowable under the applicable cost principles.
- Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.
- Are provided for in the approved budget.
- Unrecovered indirect costs may be included as part of cost sharing or matching.
- Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles. If the awarding agency authorizes recipients to

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donate buildings or land for construction/facilities acquisition projects or long-term use, the value of the donated property for cost sharing or matching shall be the lesser of: (1) the certified value of the remaining life of the property recorded in the recipient's accounting records at the time of donation; or (2) the current fair market value.

- Volunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program. Rates for volunteer services shall be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient's organization, rates shall be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved. In either case, fringe benefits consistent with those paid that are reasonable, allowable, and allocable may be included in the valuation.
- When an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overhead costs), provided these services are in the same skill for which the employee is normally paid.
- Donated supplies may include such items as expendable property, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation.

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- Volunteer services shall be documented and, to the extent feasible, supported by the same methods used by the recipient for its own employees, including time records.
- The basis for determining the valuation for personal service, material, equipment, buildings and land shall be documented.

Independent Auditors' Recommendation:

We recommend the Even Start Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of matching requirements of 45 CFR 74.23. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements, including adopting the necessary procedures to ensure adequate documentation of the in-kind contributions made to this federal financially assisted program.

Response by Department of Federal Programs– Finding Control Number 07-19:

We do not concur with this finding nor the questioned cost. The Municipality has properly documented in-kind matching contributions made to the Even Start Program in the amount of \$968,587, consisting of direct costs amounting to \$116,644 and indirect costs amounting to \$851,943 for the fiscal year ended June 30, 2007. Such in-kind contributions exceeded significantly the minimum matching contributions required to the Municipality by the grant agreement for the fiscal year 2006-2007. Matching contributions consisting of indirect costs were made based on the approval from the Puerto Rico Department of Education, the pass-through entity, which approved indirect costs as allowable matching contributions for 2006-2007. The following are the in-kind contributions actually made and properly documented by the Municipality for the fiscal year ended June 30, 2007:

Type of In-Kind Contribution	Contribution Amount
Salaries and wages	\$19,614
Payroll taxes and fringe benefits	3,780
Materials and supplies	17,411
Equipment	1,758
Food and meals for participants	2,619

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Rent	33,144
Transportation	3,597
Depreciation – Maria G. Vaello Building	5,244
Utilities – water and sewer	1,069
Repairs and maintenance	2,760
Allocated federal programs department’s costs	25,648
Indirect costs allocated	851,943
Total unsupported in-kind contributions	\$968,587

The above in-kind contributions are properly supported by value opinions from independent appraisers, contracts, checks, invoices and other supporting documents that were made available to the independent auditors for their review. The Municipality prepared a report detailing the composition and documenting its in-kind contributions of the Even Start Program for the fiscal year ended June 30, 2007. Such report is available for the review of the federal grantor and the pass-through entity upon request.

Regarding the questioned cost of \$340,283, we do not concur with it because it is significantly overstated and was erroneously computed by the independent auditors. Based on a computation performed by Mrs. Mary Roldán, Fiscal Officer of the Puerto Rico Department of Education (pass-through entity) on March 27, 2008, the amount of required in-kind contributions not contributed by the Municipality during the fiscal year ended June 30, 2007 was only \$21,171.08. Therefore, the questioned cost of \$340,283 was incorrectly reported in the Single Audit Report for the fiscal year then ended.

Furthermore, on September 19, 2007, the Puerto Rico Department of Education approved a waiver for the matching contribution requirements that must be met by the Municipality of Cataño for the fiscal year 2007-2008. The written waiver was given pursuant to Section 1234(b)(2), Subpart 3, Part B, Title I, “*William F. Gooding Even Start Family Literacy Program*”, to avoid any possibility of eliminating or reducing services to the families of Cataño under this program.

Anticipated completion date:	Not applicable.
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
Even Start Program CFDA No. 84.213	<p data-bbox="472 384 829 415">07-20 Financial Reporting</p> <p data-bbox="483 457 854 489"><u>A) Statement of Condition:</u></p> <p data-bbox="483 531 1154 741">During our tests of the quarterly financial reports submitted to the Puerto Rico Department of Education, we could not examine the Quarterly Disbursement Report pertaining to the first, second and fourth quarter since they were not available for examination.</p> <p data-bbox="475 789 597 821"><u>Criteria:</u></p> <p data-bbox="480 863 1154 999">According to contract with the State Department of Education, quarterly financial reports must be submitted at least 15 days after the close of each quarter.</p> <p data-bbox="475 1047 1044 1079"><u>Independent Auditors' Recommendation:</u></p> <p data-bbox="480 1121 1154 1440">The Municipality should improve existing procedures to ensure the timely submission of the Annual Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.</p> <p data-bbox="475 1488 846 1520"><u>B) Statement of Condition:</u></p> <p data-bbox="472 1562 1154 1692">Our review of the final financial reports submitted to the Puerto Rico Department of Education, disclosed that they were submitted after the required submission date, as detailed below.</p>	NONE
		NONE

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<u>Program Year</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>Past Due Days</u>
2006-2007	July 30, 2007	Oct. 30, 2007	30 days

Criteria:

According to contract with the Puerto Rico Department of Education annual fiscal reports, must be submitted at least 30 days after the close of each annual contract.

Independent Auditors' Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Annual Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

C) Statement of Condition:

Our review of the quarterly financial reports submitted to Department of Education, disclosed that the information presented in the financial reports did not agree with the information recorded in the Program General Ledger, since it is recorded on a cash basis. Quarterly reports were prepared using the Order and Contract Register.

NONE

Criteria:

Federal regulations require that the financial management system must meet some requirements, including the financial reporting. It states that accurate, current and complete disclosure of the financial results of the financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.

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Independent Auditors' Recommendation:

The Municipality should prepare financial reports based on the Program's underlying accounting records. Any difference should be investigated and reconciled, accordingly.

D) Statement of Condition:

Our review of the financial reports submitted to the Department of Education for program year 2005-2006, we could not determine the timely submission of report, since there is no evidence of submission date.

NONE

Criteria:

According to contract with the Department of Education annual fiscal reports, must be submitted at least 30 days after the close of each annual contract.

Independent Auditors' Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Annual Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

Responses by Department of Federal Programs– Finding Control Number 07-20:

Finding 07-20(A) – We do not concur with this finding. The quarterly financial reports for each of the four quarters of fiscal year 2006-2007 have been available for the review of the grantor, the pass-through entity and the independent auditors. This finding contradicts Finding 07-20(C) because in 07-20(C) the independent auditors reported that they examined these reports and concluded that these reports did not agree with the information recorded in the Program General Ledger. Consequently, they examined the reports and, accordingly, the reports could not be missing.

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Finding 07-20(B) – We concur with this finding. As a corrective action, the Department of Federal Programs will instruct its employees about the deadlines established by the federal regulations for financial reporting and will implement a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report.

Finding 07-20(C) – We do not concur with this finding. This finding contradicts Finding 07-20(A) because in 07-20(A) the independent auditors reported that they could not examine the reports for three quarters, therefore, it is not possible that they have concludes that the reports for such missing quarters did not did not agree with the information recorded in the Program General Ledger.

Finding 07-20(D) – We do not concur with this finding. The conditions referred to in the finding correspond to fiscal year 2005-2006, which is beyond the scope of the single Audit for the fiscal year ended June 30, 2007.

Anticipated completion date:	June 30, 2007
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Contact person:	Mrs. Iris D. Caldera Rodriguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
Even Start CFDA No. 84.213	07-21 Inadequate Documentation of Participant Files <u>Statement of Condition:</u> As part of our eligibility test for participant, we selected 12 participants files. The following deficiency was noted during our examination. <ul style="list-style-type: none">- In one (8%) participant file the birth certificate was not present on file.- In one (8%) participant file the social security card was not present on file.- In 3 (25%) participants files the utilities invoices were not present on file.- In 2 (16%) participants files the school transcript was not present on file.- In one (8%) participant file the school withdrawal letter was not present on file.- In 2 (16%) participants files the immunization certificate was not present on file.- In 2 (16%) participants files the participant son/daughter immunization certificate was not present on file. <u>Criteria:</u> According to program requirements the program application must be submitted with the following documentation: <ul style="list-style-type: none">a- Birth certificate (adult and child)b- Social security (adult and child)c- Utilities invoiced- School transcript or school certificatione- School withdrawal letterf- Immunization certificate (adult and child)	

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g- Income evidence

Independent Auditors' Recommendation:

The Municipality should implement procedures to assure that all required information is present on file at time of admittance to the program.

Response by Department of Federal Programs– Finding Control Number 07-21:

We do not concur with this finding. The missing documents referred to in the finding are not documents specifically required by the federal regulations applicable to the Even Start Program. In the other hand, the Municipality has complied with all the eligibility and other requirements of the Even Start Program Grant. The participant files include all the necessary information from participants needed to ascertain their eligibility, status, etc. In addition, the Municipality has adopted and complied with all of the following general eligibility requirements for each of its participants during the fiscal year ended June 30, 2007:

- Parents/Caregivers who lack the level of skills expected of a high school graduate or whose lack of mastery of basic skills results in an inability to speak, read, or write the English language are eligible.
- If parents/caregivers have a high school diploma but lack the basic skills of a high school graduate, they may be eligible for the program. However, they should not represent the majority of adults in the program.
- The local school district must provide or ensure the availability of the basic education component for teen parents who are within the state's compulsory school attendance age range.
- A child or children birth to age seven are eligible.
- If Title I contributes to the cost of the program, children eight years of age or older are eligible as long as the focus of the program continues to remain on families with young children.
- Participation in the program may continue until **all** members of the family are ineligible:
 1. in the case of a family in which ineligibility was due to the child or children of a family attaining the age of eight, ineligibility shall be in two years or when the parent or parents become ineligible due to educational advancement, whichever occurs first; and
 2. in the case of a family in which ineligibility was due to the educational advancement of the parent or parents of such family, ineligibility shall be when **all** children in the family attain the age of eight.

Anticipated completion date:	Not applicable.
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Even Start
 CFDA No. 84.213

07-22 Programmatic Reports

Statement of Condition:

During our tests of the monthly programmatic reports submitted to the Department of Education, we could not determine the timely submission of reports pertaining to the months of July 2006 through June 2007, since there is no evidence of submission date.

Criteria:

According to contract with the Department of Education, monthly programmatic reports must be submitted with quarterly financial reports within 15 days of start of each quarter.

Independent Auditors' Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Annual Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

Response by Department of Federal Programs– Finding Control Number 07-22:

We do not concur with this finding. The conditions referred to in this finding are already included and answered in Finding No. 07-20.

Anticipated completion date:	Not applicable.
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Contact person:	Mrs. Iris D. Caldera Rodríguez, Director of Federal Programs Telephone: (787) 788-0404 email: icaldera@coqui.net
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