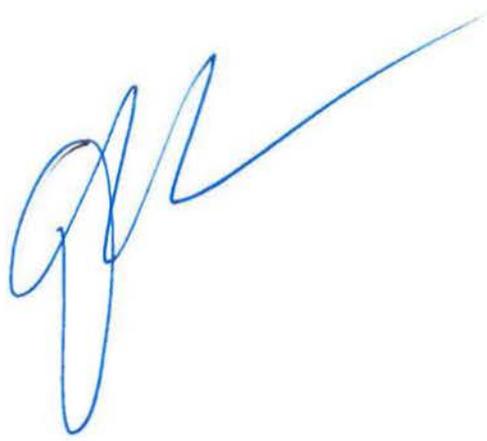


OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL
AREA DE ARCHIVO DIGITAL

MUNICIPIO DE CAYEY
AUDITORIA 2005-2006
30 DE JUNIO DE 2006

Out No 7-62
GENERAL DEL COMISIONADO
DE LOS MUNICIPIALES
2007 MAR 30 AM 11:10
UNIDAD DE CORREO

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2006



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2006

CONTENTS

	Page
<u>BASIC FINANCIAL STATEMENTS</u>	
Independent Auditors' Report	1-2
Required Supplementary Information (Part 1) Management's Discussion and Analysis	3-13
Government-Wide Financial Statements:	
Statement of Net Assets	14
Statement of Activities	15
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	16
Statement of Revenues, Expenditures and Changes in Fund Balances	17
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	18
Notes to Basic Financial Statements	19-47
<u>SUPPLEMENTARY INFORMATION</u>	
Required Supplementary Information (Part II):	
Budgetary Comparison Schedule-General Fund	48
Notes to Budgetary Comparison Schedule-General Fund	49
Schedule of expenditures of federal awards	50-52
Notes to the schedule of expenditures of federal awards	53
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u>	
Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	54-55

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2006

CONTENTS

Page

INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)

Report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133	56-58
-------------------------------------------------------------------------------------------------------------------------------------------------------	-------

FINDINGS AND QUESTIONED COSTS

Schedule of findings and questioned cost	59-76
Summary schedule of prior year audit findings	77-82



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
the Municipal Legislature
Municipality of Cayey
Cayey, 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 Cayey, Puerto Rico (Municipality)**, as of and for the year ended June 30, 2006, which collectively comprise the **Municipality's** basic financial statements as listed in the table of contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express opinions on these financial statements based on our audit.

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 7, 2006, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on page 48 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

López Vega, CPA, PSC.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 7, 2006

Stamp No. 2195993 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2006

This discussion and analysis of the Municipality of Cayey (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2006. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2005. This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2006 deserve special mention:

1. Total assets of the Municipality amounted to \$100,288,279 which represents an increase of 10% compared to prior fiscal year.
2. At the end of fiscal year 2006, total liabilities amounted to \$55,054,009. Out of said amount, \$45,965,585 corresponded to long-term liabilities of which \$34,995,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues.
3. Total net assets of the Municipality amounted to \$45,234,270 which represents an increase of 2% compared to prior fiscal year;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL HIGHLIGHTS (CONTINUED)

4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$36,187,736, derived from the following sources: \$3,118,976 charges for services; \$6,599,866 from operating grants and contributions; \$3,988,787 from capital grants and contributions obtained from other sources, and \$22,480,107 from general revenues available.
5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$35,343,420;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$844,316;
7. As of the close of the current fiscal year, the Municipality's Governmental Funds reported combined ending fund balances of \$29,886,298;
8. As the end of the current fiscal year, the Municipality's general fund balance amounted to \$2,972,935, compared to a fund balance of \$2,107,164 in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in a favorable balance of \$1,810,047.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2006. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds. This in turn will benefit the welfare of Cayey constituents.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of the Statements of Activities of the Municipality at June 30, 2006, shows total expenses incurred to afford the cost of all functions and programs amounted to \$35,343,420. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$13,707,629 was derived from the following sources: \$3,118,976 charges for services; \$6,599,866 from operating grants and contributions; and \$3,988,787 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$22,480,107. When such figure is added to the \$13,707,629 previously mentioned, total revenues available for the financing of activities amounted to \$36,187,736. There was an excess of revenues over expenses in the amount of \$844,316 which contributed with an increase to the figure of net assets attained at the end of the fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

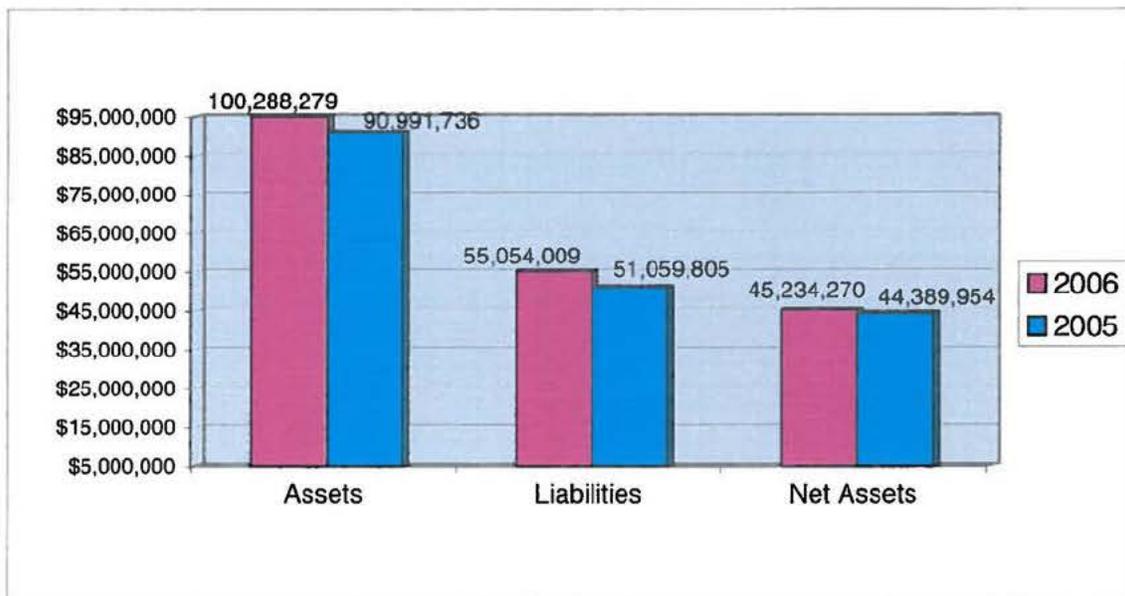
FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Cayey, primary government assets exceeded total liabilities by \$45,234,270 at the end of 2006, compared to \$44,389,954 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

Condensed Statement of Net Assets

	<u>2006</u>	<u>2005</u>	<u>Change</u>	<u>%</u>
Current assets	\$ 38,281,279	\$ 38,341,191	\$ (59,912)	-
Capital assets	62,007,000	52,650,545	9,356,455	18%
Total assets	<u>100,288,279</u>	<u>90,991,736</u>	<u>9,296,543</u>	10%
Current liabilities	9,088,424	7,147,095	1,941,329	27%
Noncurrent liabilities	45,965,585	43,912,710	2,052,875	5%
Total liabilities	<u>55,054,009</u>	<u>51,059,805</u>	<u>3,994,204</u>	8%
Invested in capital assets, net of related debt	27,012,000	22,682,545	4,329,455	19%
Restricted	26,913,363	29,108,765	(2,195,402)	(8%)
Unrestricted	(8,691,093)	(7,401,356)	(1,289,737)	17%
Total net assets	<u>\$ 45,234,270</u>	<u>\$ 44,389,954</u>	<u>\$ 844,316</u>	2%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Approximately 49 percent of the Municipality's total revenue came from taxes, while 38 percent resulted from grants and contributions, including federal aid. Charges for Services provide 9 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, health and welfare services, public works, public safety, culture and recreation, and community development. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

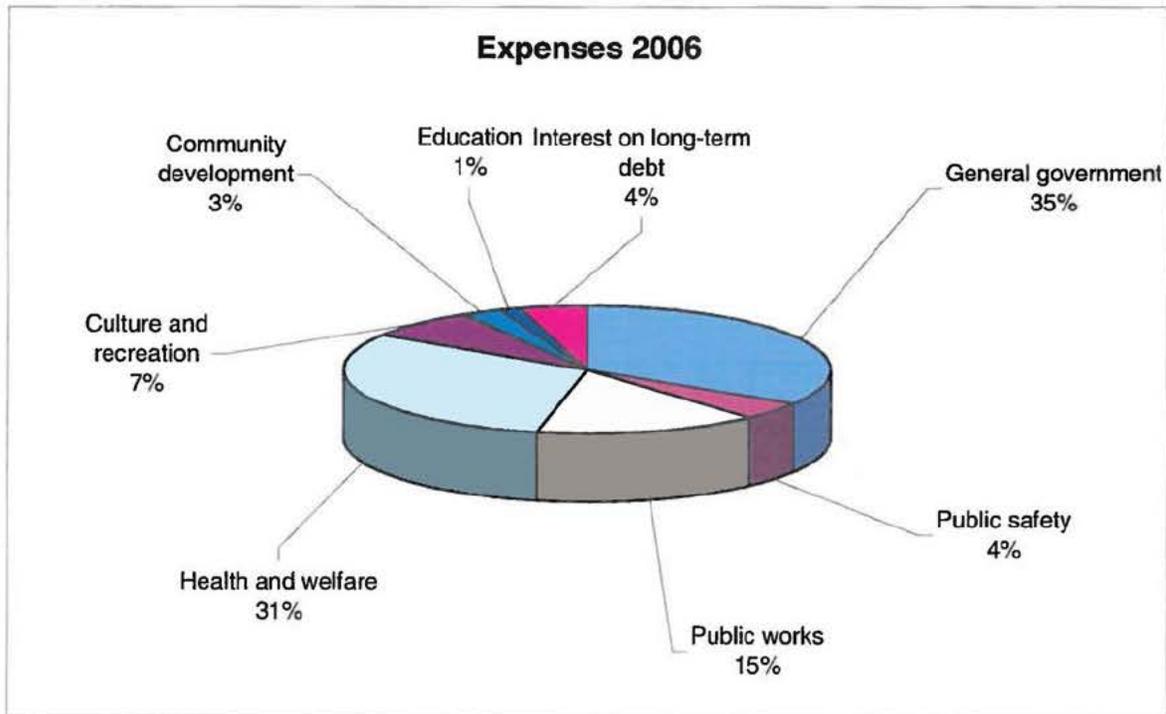
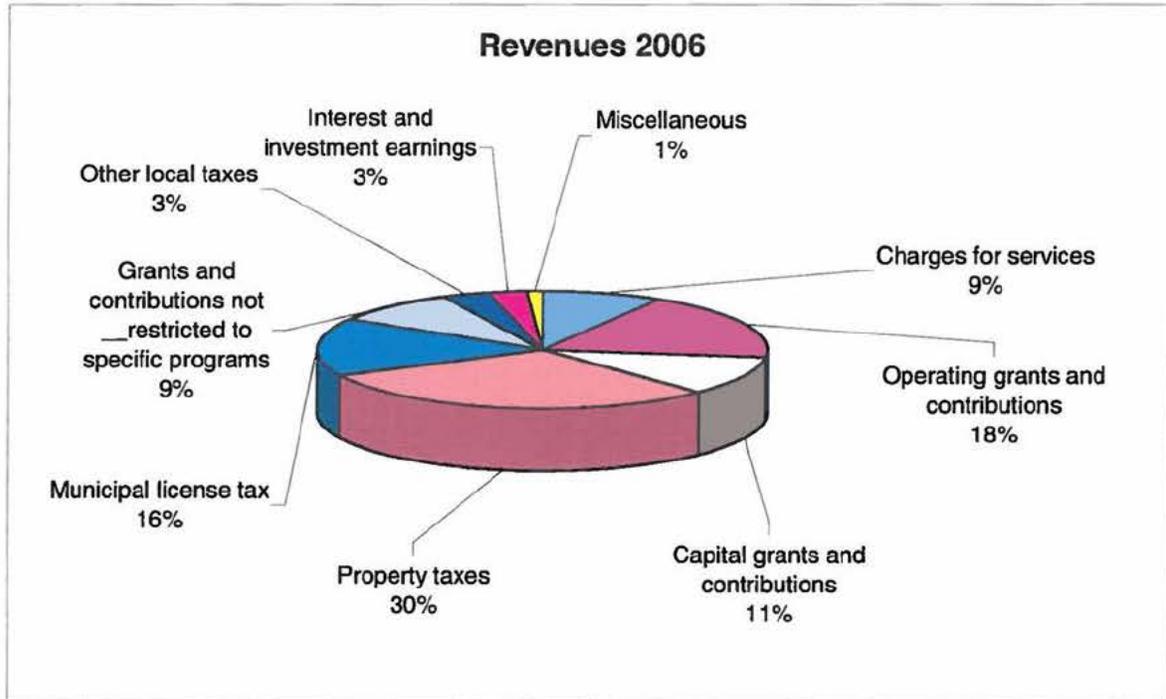
Condensed Statement of Activities	2006	2005	Change	%
Program revenues:				
Charges for services	\$ 3,118,976	\$ 4,541,709	\$ (1,422,733)	(31%)
Operating grants and contributions	6,599,866	7,210,320	(610,454)	(8%)
Capital grants and contributions	3,988,787	1,906,113	2,082,674	109%
General revenues:				
Property taxes	10,820,175	9,946,435	873,740	9%
Municipal license tax	5,729,814	5,437,385	292,429	5%
Grants and contributions not restricted to specific programs	3,276,919	2,604,555	672,364	26%
Other local taxes	1,197,117	2,382,513	(1,185,396)	(50%)
Interest and investment earnings	1,040,025	810,252	229,773	28%
Miscellaneous	416,057	492,322	(76,265)	(15%)
Total revenues	36,187,736	35,331,604	856,132	2%
Expenses:				
General government	11,965,442	10,602,698	1,362,744	13%
Public safety	1,558,077	1,737,863	(179,786)	(10%)
Public works	5,346,607	7,966,410	(2,619,803)	(33%)
Health and welfare	10,898,569	6,878,349	4,020,220	58%
Culture and recreation	2,574,705	769,334	1,805,371	235%
Economic development	23,137			
Community development	888,278	1,706,076	(817,798)	(48%)
Urban development	71,397	16,981	54,416	320%
Education	465,810	289,365	176,445	61%
Interest on long-term debt	1,551,398	1,128,025	423,373	38%
Total expenses	35,343,420	31,095,101	4,248,319	14%
Change in net assets	844,316	4,236,503	(3,392,187)	(80%)
Net assets, beginning as restated	44,389,954	40,153,451	4,236,503	11%
Net assets, end of year	\$45,234,270	\$44,389,954	\$ 844,316	2%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$29,886,298, a decrease of \$2,201,794 in comparison with the prior year. There are reservations of fund balance amounting to \$28,244,595. This is the fund balance that it is not available for new spending because it has already been committed 1) \$1,331,232 to liquidate contracts and purchase orders of the prior fiscal year, 2) \$4,692,543 to pay debt service, 3) \$18,099,777 to pay for capital projects, and 4) \$4,121,043 for other purposes.

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2006, the general fund has an undesignated fund balance of \$1,641,703.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The actual General Fund budgetary activities resulted in a favorable balance of \$1,810,047, caused mainly due to unexpected variances in revenue collections from miscellaneous sources.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2006, amounts to \$87,158,090, net of accumulated depreciation of \$25,151,090 (including depreciation charges for the year totaled \$2,055,123), leaving a net book value of \$62,007,000. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure, furnishing, computers and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2006, the Municipality has \$6,912,253 of unexpended proceeds mainly from bonds and notes issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a Municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a Municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2006-2007.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. It further contemplates to maintain or improve its current levels of Net Assets as indicative of a strong financial position which has been identified as one of the main short and long-term objectives of the Municipality.

During the fiscal year 2005-2006, the Municipality of Cayey obtained the administration of the Head Start Program, which was administrated by a local organization during the past years. The Program expended a total of \$4,358,979 during the fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer.

Commonwealth of Puerto Rico
Municipality of Cayey
Statement of Net Assets
June 30, 2006

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 19,117,746
Cash with fiscal agent	12,770,251
Accounts receivable:	
Municipal license tax	18,105
Intergovernmental	438,379
Interest	14,065
Federal grants	380,099
Other	17,184
Notes receivable	262,300
Other assets	5,263,150
Capital assets	
Land, improvements, and construction in progress	34,200,842
Other capital assets, net of depreciation	27,806,158
Total capital assets	<u>62,007,000</u>
Total assets	<u>100,288,279</u>
Liabilities	
Accounts payable and accrued liabilities	2,893,053
Due to other governmental entities	390,254
Deferred revenues:	
Municipal license tax	4,873,905
Federal grant revenues	931,212
Noncurrent liabilities:	
Due within one year	3,642,105
Due in more than one year	<u>42,323,480</u>
Total liabilities	<u>55,054,009</u>
Net Assets	
Invested in capital assets, net of related debt	27,012,000
Restricted for:	
Capital projects	18,099,777
Other purposes	4,121,043
Debt service	4,692,543
Unrestricted (deficit)	<u>(8,691,093)</u>
Total net assets	<u>\$ 45,234,270</u>

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

**Commonwealth of Puerto Rico
Municipality of Cayey
Statement of Activities
For the Year Ended June 30, 2006**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 11,965,442	\$ 73,243	\$ -	\$ -	\$ (11,892,199)
Public safety	1,558,077	47,880	51,982		(1,458,215)
Public works	5,346,607	398,684	28,896	427,704	(4,491,323)
Health and welfare	10,898,569	2,436,165	5,862,185	54,911	(2,545,308)
Culture and recreation	2,574,705	25,661	30,955	22,551	(2,495,538)
Economic development	23,137	137,343	478,887	800,236	1,393,329
Community development	888,278			2,636,332	1,748,054
Urban development	71,397			47,053	(24,344)
Education	465,810		146,961		(318,849)
Interest on long-term debt	1,551,398				(1,551,398)
Total governmental activities	\$ 35,343,420	\$ 3,118,976	\$ 6,599,866	\$ 3,988,787	(21,635,791)
General revenues:					
Property taxes					10,820,175
Municipal license tax					5,729,814
Other local taxes					1,197,117
Grants and contributions not restricted to specific programs					3,276,919
Interest and investment earnings					1,040,025
Miscellaneous					416,057
Total general revenues					22,480,107
Change in net assets					844,316
Net assets - beginning, as restated					44,389,954
Net assets - ending					\$ 45,234,270

**Commonwealth of Puerto Rico
Municipality of Cayey
Balance Sheet
Governmental Funds
June 30, 2006**

	General Fund	Special Revenue Fund State & Local Grants	Special Revenue Fund Head Start	Capital Projects Fund State & Local Grants	Capital Projects Fund Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets								
Cash and cash equivalents	\$8,723,725	\$ 2,915,439	\$ 46,830	\$ 6,753,885	\$ 529,781	\$ -	\$ 148,086	\$ 19,117,746
Cash with fiscal agent		1,278,893		6,070,638	841,615	4,579,105		12,770,251
Accounts receivable:								
Municipal license tax	18,105							18,105
Intergovernmental	266,925	31,685				139,769		438,379
Interest						14,065		14,065
Federal grants			67,870		9,843		302,386	380,099
Other	17,184							17,184
Due from other funds	314,797				181,336		2,507	498,640
Notes receivable					262,300			262,300
Other assets		38,150		5,225,000				5,263,150
Total assets	\$9,340,736	\$ 4,264,167	\$ 114,700	\$ 18,049,523	\$ 1,824,875	\$4,732,939	\$ 452,979	\$ 38,779,919
Liabilities and Fund Balances								
Liabilities :								
Accounts payable and accrued liabilities	\$ 704,812	\$ 111,439	\$ 108,028	\$ 790,943	\$ 140,560	\$ -	\$ 76,903	\$ 1,932,685
Due to other governmental entities	390,254							390,254
Due to other funds	131,905	31,685	6,672		3,914	40,396	284,068	498,640
Deferred revenues:								
Municipal license tax	4,873,905							4,873,905
Intergovernmental	266,925							266,925
Federal grant revenues					839,204		92,008	931,212
Total liabilities	6,367,801	143,124	114,700	790,943	983,678	40,396	452,979	8,893,621
Fund balances:								
Reserved for:								
Encumbrances	1,331,232							1,331,232
Capital projects				17,258,580	841,197			18,099,777
Other purposes		4,121,043						4,121,043
Debt service fund						4,692,543		4,692,543
Unreserved:								
Undesigned	1,641,703							1,641,703
Total fund balances	2,972,935	4,121,043		17,258,580	841,197	4,692,543		29,886,298
Total liabilities and fund balances	\$9,340,736	\$ 4,264,167	\$ 114,700	\$ 18,049,523	\$ 1,824,875	\$4,732,939	\$ 452,979	

Amounts reported for governmental activities in the statement of net assets are different because:

Accrual basis of accounting accounts receivable recognized in government-wide financial statements	266,925
Accrual basis of accounting accounts payable recognized in government-wide financial statements	(960,368)
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	62,007,000
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds	(45,965,585)
Net assets of governmental activities	\$ 45,234,270

Commonwealth of Puerto Rico
Municipality of Cayey
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2006

	General Fund	Special Revenue Fund State & Local Grants	Special Revenue Fund Head Start	Capital Projects Fund State & Local Grants	Capital Projects Fund Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues								
Property taxes	\$7,276,138	\$ -	\$ -	\$ -	\$ -	\$3,277,112	\$ -	\$ 10,553,250
Municipal license taxes	5,729,814							5,729,814
Licenses, permits and other local taxes	1,266,832							1,266,832
Charges for services	2,901,820							2,901,820
Intergovernmental	3,276,919	995,507		1,134,624	27,634			5,434,684
Rent of property	123,147							123,147
Fines and forfeitures	24,294							24,294
Interest	1,040,025							1,040,025
Federal grants			4,358,979		190,027		3,842,824	8,391,830
Miscellaneous	414,803	8,746		170			31,396	455,115
Total revenues	22,053,792	1,004,253	4,358,979	1,134,794	217,661	3,277,112	3,874,220	35,920,811
Expenditures								
Current:								
General government	10,950,575	184,766		5,948				11,141,289
Public safety	1,437,134	8,875					24,798	1,470,807
Public works	2,733,557	585,338		1,995,993	115,696		19,280	5,449,864
Health and welfare	4,423,168	77,332	4,358,979	1,201,460	154,906		1,520,751	11,736,596
Culture and recreation	965,183	37,071		6,425,023				7,427,277
Economic development		478,220		1,390,980	83,413			1,952,613
Community development	215,812	268,233			444,692		979,971	1,908,708
Education	299,841	293,071						592,912
Urban Development					47,141			47,141
Debt service:								
Principal						3,224,000		3,224,000
Interest						1,551,398		1,551,398
Total expenditures	21,025,270	1,932,906	4,358,979	11,019,404	845,848	4,775,398	2,544,800	46,502,605
Excess (deficiency) of revenues over (under) expenditures	1,028,522	(928,653)		(9,884,610)	(628,187)	(1,498,286)	1,329,420	(10,581,794)
Other financing sources (uses)								
Transfers in								
Transfers in						1,515,270		1,515,270
Transfers out	(162,751)						(1,352,519)	(1,515,270)
Long-term debt issued		125,000		8,255,000				8,380,000
Total other financing sources (uses)	(162,751)	125,000		8,255,000		1,515,270	(1,352,519)	8,380,000
Net change in fund balances	865,771	(803,653)		(1,629,610)	(628,187)	16,984	(23,099)	(2,201,794)
Fund balances, beginning as restated	2,107,164	4,924,696		18,888,190	1,469,384	4,675,559	23,099	32,088,092
Fund balances, ending	\$2,972,935	\$ 4,121,043	\$ -	\$ 17,258,580	\$ 841,197	\$4,692,543	\$ -	\$ 29,886,298

Handwritten signature and date:
 4/03/2007

Commonwealth of Puerto Rico
Municipality of Cayey
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2006

Net Change In Fund Balances - Total Governmental Funds \$ (2,201,794)

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 11,411,578

Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. (2,055,123)

Bonds and notes proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments. (5,027,000)

Repayment of long term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long-term property tax advance debt in the Government-Wide Statement of Net Assets. The following amount represent the change in long-term property tax advance debt from prior year. (314,697)

Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represent the change in long-term compensated absences from prior year. 167,660

Long-term claims and judgements are reported in the Governmental-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, claims and judgments are not reported as expenditures in Government Funds. The following amount represent the change in long-term claims and judgments from prior year. 40,100

Repayment of long term Land Information Management System (LIMS) is an expenditure in Governmental Funds, but the repayment reduces long term LIMS in the Government-Wide Statement of Net Assets. The following amount represent the change in long term LIMS debt from prior year. (482,965)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenue in the funds. The following amount represents the change in this revenues from prior year. 266,925

Expenses reported in the Government-Wide Statement of Activities and Change in Net Assets, but not reported as in the Governmental Funds because they do not require the use of current financial resources. The following amount represents the change in this expenses from prior year. (960,368)

Change in Net Assets of Governmental Activities \$ 844,316

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Cayey** (the Municipality) was founded on the year 1773. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a sixteen-member Municipal Legislature who are elected for four-year terms.

The Municipality provides public safety, public works, culture and recreation, health and welfare, urban development, education, economic development, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality implemented the capitalization of infrastructure since July 1, 2002.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by the GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units an amendment of GASB Statement 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component unit. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-typed activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

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

Special Revenue Fund - Head Start- is the accounting entity, in which revenues derived from head start and child and adult care food program grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

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

Capital Projects Fund - Federal Grants - is the accounting entity in which revenues derived from federal grants related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund- General Fund is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund – State & Local Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or state statutes.

Special Revenue Fund – Section 8 - Special Revenue Funds are used to account for revenues derived from section 8 choice voucher program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund – Head Start - Special Revenue Funds are used to account for revenues derived from head start and child and adult care food program funds. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

Special Revenue Fund – Other Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Fund – State & Local Grants - Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

Capital Projects Fund - Federal Grants – Capital Project Fund are used to account for revenues derived from federal grants related to capital projects. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

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

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America (“GAAP”) as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No.20.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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

E. Assets, liabilities and net assets

1. Cash, cash equivalents, and cash with fiscal agent- The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

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

Advances between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental and federal grant receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state founded programs. Intergovernmental in the debt service fund represent the distribution of property tax collected by the Municipal Revenue Collection Center (CRIM), which is restricted for the debt service.

3. Inventories- Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality, as well as the component unit, are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

5. **Long-term obligations-** The liabilities reported in the government-wide financial statements include the general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities and landfill closure and post closure care costs.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the general fund.

6. **Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay it is accrued when incurred in the government-wide financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

- 7. Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.
- 8. Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The municipality has the following reservations of fund balance:
- a. Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
 - b. Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
 - c. Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
 - d. Debt Service Fund-** Represents net assets available to finance future debt service payments.
- 9. Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:
- a. Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

10. Risk financing- The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2006 amounted to approximately \$ 529,671. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$ 420,212 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-Wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds", and that 'capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The detail of this reconciliation is as follows:

		<u>Total Net Assets</u> <u>Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 62,007,000	
Deduct:		
Bonds Payable	(28,545,000)	
Notes Payable	<u>(6,450,000)</u>	\$ 27,012,000
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		18,099,777
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balance		4,692,543
<u>Net assets restricted for other purposes</u>		
Special revenue fund - state & local grants- fund balance		4,121,043

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

<u>Net assets unrestricted (deficit)</u>	
General fund - total fund balance:	\$ 2,972,935
Add:	
Accrual basis accounts receivable	266,925
Deduct:	
Accrual basis accounts payable	(960,368)
Advances from CRIM	(5,064,490)
Compensated absences	(3,021,870)
Due to other governmental entity	(1,312,786)
Claims and judgments	(18,900)
LIMS repayment plan	(482,965)
Landfill obligation	<u>(1,069,574)</u>
	<u>(8,691,093)</u>
Total net assets - governmental activities	\$ <u>45,234,270</u>

2. DEPOSITS

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$ 8,723,725 in the general fund, \$ 2,915,439 in the special revenue fund - state & local grants, \$46,830 in the special revenue fund - head start, \$ 6,753,885 in the capital projects fund - state & local grants and \$ 529,781 in the capital projects fund - federal grants were fully collateralized at June 30, 2006. In the other governmental funds there were deposits with commercial banks of approximately \$ 148,086 that were fully collateralized.

The deposits at GDB of approximately \$ 1,278,893 in the special revenue fund - state & local grants, \$ 6,070,638 in the capital projects fund - state & local grants, \$841,615 in the capital projects fund - federal grants and the \$ 4,579,105 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

3. RECEIVABLES

a. **Municipal License Tax**- The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$ 1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2006, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2006, net of allowance for uncollectibles.

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

b. **Intergovernmental Receivables**- Intergovernmental receivable in the general fund represents the balance owned from the Municipal Revenue Collection Center (CRIM) at June 30, 2006, as described in Note 8. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ <u>266,925</u>
Total	\$ <u>266,925</u>

Intergovernmental receivable in special revenue fund – state & local grants represent expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Department of Labor and Human Resources- Law 52 Grant	\$ <u>31,685</u>
Total	\$ <u>31,685</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in the debt service fund represents property tax receivable at June 20, 2006. Following is a detail of the intergovernmental receivables:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM)	\$ <u>139,769</u>
Total	\$ <u>139,769</u>

- c. **Federal Grants Receivables**—Federal grants receivable in special revenue fund – head start represent expenditures incurred not yet reimbursed by the pass-through grantor. Following is a detail of the federal grants receivable:

<u>Program Description</u>	<u>Amount</u>
Head Start Program	\$ 22,842
Child and Adult Care Food Program	<u>45,028</u>
Total	\$ <u>67,870</u>

Federal grants receivable in capital projects fund – federal grants represent expenditures incurred not yet reimbursed by the pass-through grantor. Following is a detail of the federal grants receivable:

<u>Program Description</u>	<u>Amount</u>
Disaster Grants – Public Assistance	\$ <u>9,843</u>
Total	\$ <u>9,843</u>

Federal grants receivable in other governmental funds represent expenditures incurred not yet reimbursed by the Federal government or the pass-through grantors. Following is a detail of the federal grants receivable:

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Voucher	\$ 57,170
Community Development Block Grants – Entitlement Grants	187,118
Child Care and Development Block Grant	30,306
Other programs	<u>27,792</u>
Total	\$ <u>302,386</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

4. NOTES RECEIVABLE

At June 30, 2006, the notes receivable are composed of the following:

<u>Description</u>	<u>Amount</u>
Note receivable from "Cooperativa Agro-Comercial de P.R., La Marquetin", in the original amount of \$ 740,000, to be collected as follows:	
1. Monthly interest payments of \$ 1,850, at 3% annual interest rate, from the first through the end of the fifth year;	
2. Monthly installments of \$ 5,110, including interest at 3%, starting on the sixth year through year 2011.	<u>\$ 262,300</u>
Total	<u>\$ 262,300</u>

5. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2006, and interfund transfers during the fiscal year ended at June 30, 2006, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund - State & Local Grants	Payrolls, accruals, and other expenditures not reimbursed	\$ 31,685
General Fund	Special Revenue Fund - Head Start	Payrolls, accruals, and other expenditures not reimbursed	6,672
General Fund	Capital Projects Fund - Federal Grants	Payrolls, accruals, and other expenditures not reimbursed	3,914
General Fund	Debt Service Fund	Interest Revenue	40,396
General Fund	Other Governmental Funds	Payrolls, accruals, and other expenditures not reimbursed	232,130
Capital Projects Fund - Federal Grants	General Fund	Reimbursable Expenditures	129,407
Capital Projects Fund - Federal Grants	Other Governmental Funds	Reimbursable Expenditures	51,929
Other Governmental Funds	Other Governmental Funds	Reimbursable Expenditures	9
Other Governmental Funds	General Fund	Reimbursable Expenditures	<u>2,498</u>
Total			<u>\$ 498,640</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

5. INTERFUND TRANSACTIONS

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt Retirement	\$ 162,751
Other Governmental Funds	Debt Service Fund	Debt Retirement	<u>1,352,519</u>
Total			<u>\$ 1,515,270</u>

6. OTHER ASSETS

Other assets amounting to \$38,150 in the special revenue fund – state & local grants and \$5,225,000 in the capital projects fund – state & local grants represent amount consigned in the state court for the acquisition of real property by expropriation.

7. CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2006, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

7. CAPITAL ASSETS (CONTINUED)

Governmental Activities:	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2006</u>
Capital asset, not being depreciated:				
Land	\$ 18,786,650	\$ 1,008,564	\$ -	\$ 19,795,214
Construction in progress	<u>9,480,904</u>	<u>7,876,463</u>	<u>(2,951,739)</u>	<u>14,405,628</u>
Total capital assets not being depreciated	<u>\$ 28,267,554</u>	<u>8,885,027</u>	<u>(2,951,739)</u>	<u>\$ 34,200,842</u>
Capital assets, being depreciated:				
Buildings and buildings improvements	\$ 27,230,079	\$ 2,466,242		\$ 29,696,321
Equipment	3,263,392	129,373	(5,900)	3,386,865
Infrastructure and infrastructure improvements	8,973,675	2,737,760		11,711,435
Vehicles	<u>8,011,812</u>	<u>150,815</u>	<u>-</u>	<u>8,162,627</u>
Total capital assets being depreciated	<u>\$ 47,478,958</u>	<u>\$ 5,484,190</u>	<u>\$ (5,900)</u>	<u>\$ 52,957,248</u>
Less accumulated depreciation for:				
Buildings and buildings improvements	(12,362,337)	(498,487)		(12,860,824)
Equipment	(811,429)	(471,175)		(1,282,604)
Infrastructure and infrastructure improvements	(5,320,529)	(237,167)		(5,557,696)
Vehicles	<u>(4,601,672)</u>	<u>(848,294)</u>	<u>-</u>	<u>(5,449,966)</u>
Total accumulated depreciation	<u>\$(23,095,967)</u>	<u>\$(2,055,123)</u>	<u>\$ -</u>	<u>\$(25,151,090)</u>
Total capital assets being depreciated, net	<u>\$ 24,382,991</u>	<u>\$ 3,429,067</u>	<u>\$ (5,900)</u>	<u>\$ 27,806,158</u>
Governmental activities capital assets, net	<u>\$ 52,650,545</u>	<u>\$12,314,094</u>	<u>\$(2,957,639)</u>	<u>\$ 62,007,000</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

7. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 425,783
Public safety	160,555
Public works	684,377
Community development	107,315
Culture and recreation	285,116
Health and welfare	365,712
Urban Development	24,256
Economic Development	111
Education	<u>1,898</u>
Total depreciation expense-governmental activities	<u>\$ 2,055,123</u>

8. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the Municipal Revenue Collection Center (CRIM), a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Laws of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. The CRIM issued the preliminary liquidation noting that the collections exceeded advances by \$ 266,925. In the governmental funds, the entire receivable has been offset by deferred revenue since the excess was not available to pay liabilities of the current period. In the government-wide financial statements, the entire receivable is recognized as revenue.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. PROPERTY TAXES (CONTINUED)

The Statement of Net Assets includes an outstanding debt balance of \$92,065 corresponding to the 2005 CRIM final liquidation.

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years.

Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26, 1997, Public Law Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The Statement of Net Assets includes an outstanding debt balance of \$4,130,786 and \$841,639, respectively, related to Law 42 and Law 146.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. PROPERTY TAXES (CONTINUED)

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$ 15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$50,000 of the assessed value to retailers having annual net sales of less than \$150,000.

The annual tax rate is 9.33% for real property and 7.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 2.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund. The Commonwealth also contributes an annual tax rate of 0.2% of the property tax collected and such amount is accounted for similar to item (a) above.

9. DUE TO OTHER GOVERNMENTAL ENTITIES

The amounts due to other governmental entities in the general fund include the following:

<u>Governmental Entity</u>	<u>Amount</u>
Puerto Rico Aqueduct and Sewer Authority	\$ 281
General Services Administration	240
Puerto Rico Telephone Company	63,211
Department of Labor and Human Resources	9,126
Puerto Rico Electric Power Authority	<u>317,396</u>
Total	<u>\$ 390,254</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. DUE TO OTHER GOVERNMENTAL ENTITIES (CONTINUED)

During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System - LIMS, contracted by the CRIM. A total of \$777,289 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2006, the outstanding debt balance was \$ 482,965. This amount will be presented in the government wide statement of net assets.

10. DEFERRED REVENUES

- a. **Municipal License Tax**- The deferred revenues of approximately \$ 4,873,905 in the general fund relates to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.
- b. **Intergovernmental** - The deferred revenues of approximately \$ 266,925 in the general fund relates to the balance owned from the Municipal Revenue Collection Center (CRIM) at June 30, 2006, as described in Note 8.
- c. **Federal Grants**- The deferred revenues presented in capital projects fund - federal grants represent the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government or the pass-through grantors are as follows:

<u>Program Description</u>	<u>Amount</u>
Disaster Grants - Public Assistance	\$ 833,155
Other Programs	<u>6,049</u>
Total	<u>\$ 839,204</u>

The deferred revenues presented in other governmental funds represent the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government or the pass-through grantors are as follows:

<u>Program Description</u>	<u>Amount</u>
Special Program for the Aging-Title III, Part B-Grants for Supportive Services and Senior Centers	\$ 62,421
Other Programs	<u>29,587</u>
Total	<u>\$ 92,008</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2006, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$21,613,000	\$8,380,000	\$(1,448,000)	\$28,545,000	\$1,606,000
Notes Payable	8,355,000		(1,905,000)	6,450,000	1,485,000
Advances from CRIM	4,749,793	910,811	(596,114)	5,064,490	159,024
Compensated Absences	3,189,530	139,492	(307,152)	3,021,870	315,443
Due to Other					
Governmental Entity	1,312,786			1,312,786	
Claims and Judgments	59,000		(40,100)	18,900	
LIMS Repayment Plan		555,238	(72,273)	482,965	76,638
Landfill Obligation	<u>4,633,601</u>		<u>(3,564,027)</u>	<u>1,069,574</u>	
Total	<u>\$43,912,710</u>	<u>\$9,985,541</u>	<u>\$(7,932,666)</u>	<u>\$45,965,585</u>	<u>\$3,642,105</u>

- a. **Legal debt margin-**The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment if property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues if the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds payable, is paid with unrestricted funds.
- b. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition of equipment and construction of major capital facilities. During the current year, the Municipality issued bonds for approximately \$8,380,000. Bonds payable outstanding at June 30, 2006 are as follows:

<u>Type of bonds</u>	<u>Maturity date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2006</u>
1993 Series	7-1-07	\$ 2,440,000	4.2% to 6.4%	\$ 550,000
1994 Series	1-1-18	663,000	5.0%	436,000
1994 Series	1-1-18	465,000	5.0%	300,000
1998 Series	7-1-07	280,000	6.0% to 7.5%	75,000
1998 Series	7-1-22	1,015,000	4.9% to 6.7%	865,000
1998 Series	7-1-13	1,990,000	4.9% to 6.7%	1,275,000
1999 Series	7-1-13	355,000	4.9% to 6.7%	235,000
1999 Series	7-1-13	3,705,000	4.9% to 6.7%	2,460,000
1999 Series	7-1-12	725,000	2.7% to 7.3%	450,000
1999 Series	7-1-23	685,000	2.7% to 7.3%	595,000
2000 Series	7-1-19	355,000	2.7% to 7.8%	300,000
2000 Series	7-1-14	1,765,000	2.7% to 7.8%	1,275,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. LONG-TERM LIABILITIES (CONTINUED)

<u>Type of bonds</u>	<u>Maturity date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2006</u>
2001 Series	7-1-25	270,000	2.7% to 6.1%	245,000
2001 Series	7-1-25	1,010,000	2.7% to 6.1%	930,000
2002 Series	7-1-16	255,000	2.7% to 5.0%	215,000
2002 Series	7-1-16	1,120,000	2.7% to 5.0%	925,000
2002 Series	7-1-18	835,000	2.7% to 5.1%	720,000
2002 Series	7-1-16	125,000	2.7% to 5.0%	105,000
2002 Series	7-1-26	255,000	2.7% to 5.6%	235,000
2003 Series	7-1-17	235,000	4.2% to 5.0%	205,000
2003 Series	7-1-17	325,000	4.2% to 5.0%	280,000
2003 Series	7-1-17	85,000	4.2% to 5.0%	70,000
2003 Series	7-1-27	1,110,000	4.2% to 5.3%	1,055,000
2003 Series	7-1-27	1,415,000	4.2% to 5.3%	1,340,000
2003 Series	7-1-18	205,000	4.2% to 5.3%	190,000
2004 Series	7-1-13	120,000	4.2% to 5.0%	100,000
2004 Series	7-1-18	205,000	2.4% to 4.8%	185,000
2004 Series	7-1-28	140,000	2.4% to 5.3%	130,000
2004 Series	7-1-14	140,000	3.3% to 4.7%	130,000
2005 Series	7-1-29	160,000	3.3% to 5.3%	155,000
2005 Series	7-1-24	330,000	4.2% to 5.3%	320,000
2005 Series	7-1-29	1,210,000	4.2% to 5.3%	1,185,000
2005 Series	7-1-14	1,230,000	3.3% to 4.7%	1,135,000
2005 Series	7-1-14	1,698,000	3.2% to 5.0%	1,494,000
2006 Series	7-1-20	125,000	6.3% to 7.3%	125,000
2006 Series	7-1-30	135,000	4.2% to 5.3%	135,000
2006 Series	7-1-30	145,000	4.2% to 5.3%	145,000
2006 Series	7-1-30	305,000	4.2% to 5.3%	305,000
2006 Series	7-1-25	905,000	4.2% to 5.3%	905,000
2006 Series	7-1-20	1,010,000	4.2% to 4.8%	1,010,000
2006 Series	7-1-30	5,755,000	6.3% to 7.2%	<u>5,755,000</u>
Total general obligation bonds				<u>\$ 28,545,000</u>

These bonds, except the 2005 Series \$ 1,698,000 bond, are payable from the ad valorem property tax of 2.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. The 2005 Series \$ 1,698,000 bond is payable with General Fund resources.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. LONG-TERM LIABILITIES (CONTINUED)

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 1,606,000	\$ 1,433,395
2008	1,738,000	1,394,756
2009	1,502,000	1,314,752
2010	1,604,000	1,238,632
2011	1,706,000	1,155,551
2012-2016	8,317,000	4,385,118
2017-2021	5,062,000	2,693,063
2022-2026	4,060,000	1,474,437
2027-2031	<u>2,950,000</u>	<u>419,144</u>
Total	<u>\$ 28,545,000</u>	<u>\$ 15,508,848</u>

c. **Notes Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2006</u>
2002 Series	7-1-06	165,000	2.7% to 5.0%	\$ 40,000
2002 Series	7-1-08	325,000	2.7% to 5.0%	160,000
2002 Series	7-1-06	475,000	2.7% to 5.0%	110,000
2002 Series	7-1-06	260,000	2.7% to 5.0%	60,000
2002 Series	7-1-08	205,000	2.7% to 5.0%	100,000
2003 Series	7-1-07	55,000	4.2% to 5.0%	25,000
2003 Series	7-1-07	270,000	4.2% to 5.0%	120,000
2003 Series	7-1-09	1,030,000	4.2% to 5.0%	645,000
2003 Series	7-1-09	745,000	4.2% to 5.0%	465,000
2004 Series	7-1-10	180,000	4.2% to 5.0%	135,000
2004 Series	7-1-08	265,000	2.4% to 4.4%	170,000
2004 Series	7-1-08	605,000	4.2% to 5.0%	385,000
2005 Series	7-1-09	135,000	3.3% to 4.4%	110,000
Section 108 - 1996 Series	8-1-06	3,330,000	5.9% to 7.1%	280,000
Section 108 - 2000 Series	8-1-14	1,670,000	6.2% to 6.5%	1,010,000
Section 108 - 2000 Series	8-1-15	4,225,000	6.2% to 6.5%	<u>2,635,000</u>
Total notes payable				<u>\$ 6,450,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. LONG-TERM LIABILITIES (CONTINUED)

Except for the Section 108 notes, which are payable with Community Development Block Grant – Entitlement Program and General Fund sources of revenues, the notes are payable from the ad valorem property tax of 2.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 1,485,000	\$ 355,396
2008	1,045,000	288,850
2009	1,000,000	235,004
2010	745,000	186,783
2011	405,000	150,544
2012-2016	<u>1,770,000</u>	<u>324,529</u>
Total	<u>\$ 6,450,000</u>	<u>\$ 1,541,106</u>

- d. **Advances from CRIM-** This amount represents the balance owed to the CRIM at June 30, 2006 will be repaid through a financing obtained by the CRIM with GDB.
- e. **Compensated Absences-** The government-wide statement of net assets includes approximately \$1,338,892 of accrued sick leave benefits, and approximately \$1,682,978 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
- f. **Due to Other Governmental Entity-** This amount represents the balance owed to the Puerto Rico Electric Power Authority (PREPA) at June 30, 2006, resulting from prior year's excess of electricity consumption over in lieu of payment of taxes.
- g. **LIMS Repayment Plan-** This amount represents the balance owed to the CRIM at June 30, 2006, as described in Note 9.
- h. **Landfill Obligation-** State and federal laws and regulations require the Municipality to place a final cover on its landfill site, when it stopped accepting waste, and perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. LONG-TERM LIABILITIES (CONTINUED)

Based on this study, the Municipality has recognized \$ 1,069,574 as the Municipality's estimated current cost for landfill closure and post-closure costs as of June 30, 2006. The annual estimate of post closure costs has been assessed approximately to be \$15,500 for a period of approximately 30 years. Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. The balance of closure and post-closure costs are reported in the government-wide statement of net assets.

12. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

12. PENSION PLAN (CONTINUED)

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2006 recorded as pension expenditures were approximately \$ 483,576.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

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

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2006, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

13. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

14. COMMITMENTS AND CONTINGENCIES

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$ 18,900 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor or grantee. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

15. BEGINNING FUND BALANCES RESTATEMENT

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

Adjustments to fund balance of governmental funds in the fund financial statements:

General Fund

Interest due from Debt Service Fund	<u>\$ 21,833</u>
Total increase in fund balance	<u>21,833</u>

Capital Projects Fund - Federal Grants

Deferred revenue not previously recorded and revenues earned recorded as deferred	<u>325,417</u>
Total increase in fund balance	<u>325,417</u>

Debt Service Fund

Corrections to the property tax and interest receivables	568,579
Interest due to General Fund	<u>(21,833)</u>
Total increase in fund balance	<u>546,746</u>
Net increase in fund balance, governmental funds	<u>\$ 893,996</u>

Adjustments to net assets in the government-wide financial statement

Deferred revenue not previously recorded and revenues earned recorded as deferred	\$ 325,417
Corrections to the property tax and interest receivables	568,579
Change in estimate related to the landfill obligation	<u>3,564,027</u>
Total increase in net assets	<u>\$ 4,458,023</u>

16. SUBSEQUENT EVENTS

On May 25, 2006, the Municipal Legislature approved the Ordinance Number 125-2005-2006, which authorized the Mayor to impose a sales tax of 1.5%. This Ordinance was effective beginning on July 1, 2006.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

16. SUBSEQUENT EVENTS (CONTINUED)

On July 6, 2006, the Municipal Legislature authorized the Mayor to accept and apply the funds derived from the donation provided to the Municipality by the Commonwealth of Puerto Rico of the 2006, Series A, Public Improvement Bond Issuance of \$675,000,000. The Municipality of Cayey will receive approximately \$1,631,196 from the issuance, during the fiscal year 2006-2007. Those funds will be used to the construction of a baseball park, to the construction of an arts school, and to improvements of Municipality's properties.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2006

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u> (Budgetary Basis) (See Note 1)	<u>Variance with</u> <u>Final Budget</u> <u>Positive</u> <u>(Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 7,008,892	\$ 6,909,080	\$ 7,276,138	\$ 367,058
Municipal license tax	6,251,462	6,251,462	5,742,776	(508,686)
Licenses, permits and other local taxes	2,150,200	2,150,200	1,260,232	(889,968)
Intergovernmental	3,295,339	3,295,339	3,276,919	(18,420)
Charges for services	3,578,915	3,578,915	3,979,956	401,041
Fines and forfeitures	40,000	40,000	24,294	(15,706)
Interest	601,000	601,000	987,356	386,356
Rent of property	131,000	131,000	123,147	(7,853)
Miscellaneous	<u>255,000</u>	<u>255,000</u>	<u>414,803</u>	<u>159,803</u>
Total revenues	<u>23,311,808</u>	<u>23,211,996</u>	<u>23,085,621</u>	<u>(126,375)</u>
Budget carryover (1)		319,980	319,980	
Total revenues after carryover	<u>23,311,808</u>	<u>23,531,976</u>	<u>23,405,601</u>	<u>(126,375)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES				
Current:				
General government	11,741,093	11,939,073	11,165,995	773,078
Public safety	1,515,006	1,537,296	1,454,076	83,220
Public works	3,078,489	3,099,394	2,783,536	315,858
Culture and recreation	833,949	820,678	774,994	45,684
Health and welfare	4,923,311	4,900,417	4,493,600	406,817
Community development	508,454	534,232	449,695	84,537
Education	496,056	485,436	310,907	174,529
Operating transfer to other funds	<u>215,450</u>	<u>215,450</u>	<u>162,751</u>	<u>52,699</u>
Total expenditures and encumbrances	<u>23,311,808</u>	<u>23,531,976</u>	<u>21,595,554</u>	<u>1,936,422</u>
EXCESS OF REVENUES AND BUDGET CARRYOVER OVER EXPENDITURES AND ENCUMBRANCES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,810,047</u>	<u>\$ 1,810,047</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 23,405,601
Differences-budget to GAAP:				
Budget Carryover				(319,980)
GAAP adjustments to revenues				<u>(1,031,829)</u>
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 22,053,792</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 21,595,554
Differences-budget to GAAP:				
GAAP adjustment to expenditures				(242,595)
Prior year encumbrances recorded as current year expenditures for GAAP basis				519,578
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(684,516)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 21,188,021</u>

(1) Represents fund balance carried over from prior year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2006

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund. For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2006 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2006.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2006

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Direct Programs:			
Rural Housing Preservation Grant	10.433		\$ 96,439
Pass-through the Commonwealth of Puerto Rico - Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	<u>351,128</u>
Total U.S. Department of Agriculture			<u>447,567</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Programs:			
Community Development Block Grants - Entitlement Grants	14.218		2,334,293
Urban Development Action Grants	14.221		183,414
Emergency Shelter Grants Program	14.231		29,533
Community Development Block Grants - Section 108 Loan Guarantee	14.248		444,692
Section 8 Housing Choice Voucher	14.871		1,092,673
Pass-through the Commonwealth of Puerto Rico - Municipality of San Juan:			
Housing Opportunities for Persons with AIDS	14.241	Not Available	<u>6,854</u>
Total U.S. Department of Housing and Urban Development			<u>4,091,459</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF JUSTICE:			
Pass-through the Commonwealth of Puerto Rico – Department of Justice: Local Law Enforcement Block Grants Program	16.592	Not Available	<u>24,796</u>
Total U.S. Department of Justice			<u>24,796</u>
U.S. DEPARTMENT OF TRANSPORTATION:			
Direct Programs: Federal Transit – Formula Grants	20.507		<u>47,053</u>
Total U.S. Department of Transportation			<u>47,053</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico – Governors Office (Elderly Office): Special Program for the Aging – Title III, Part B – Grants for Supportive Services and Senior Centers	93.044	Not Available	84,938
Pass-through the Commonwealth of Puerto Rico – Family Department (ADFAN): Community Service Block Grant	93.569	Not Available	39,004
Pass-through the Commonwealth of Puerto Rico – Administration for Children and Families: Head Start Program	93.600	Not Available	4,021,646
Child Care and Development Block Grant	93.575	Not Available	<u>97,285</u>
Total U.S. Department of Health and Human Services			<u>4,242,873</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico – Governor Authorized Representative (GAR): Pre-disaster Mitigation Competitive Grants	97.017	Not Available	19,280
Disaster Grants – Public Assistance	97.036	1501-DRPR 1552-DRPR	<u>142,974</u>
Total U.S. Department of Homeland Security			<u>162,254</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 9,016,002</u>

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2006

A. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Cayey** and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the fund financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

B. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue and Capital Projects Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the funds financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

<u>Description</u>	<u>Special Revenue Fund Head Start</u>	<u>Capital Projects Fund Federal Grants</u>	<u>Debt Service Fund</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Per Schedule of Expenditures of Federal Awards	\$ 4,358,979	\$ 818,133	\$ 1,352,519	\$ 2,486,371	\$ 9,016,002
Non federal programs expenditures	-	27,715	3,422,879	58,429	3,509,023
Total expenditures in the fund financial statements	<u>\$ 4,358,979</u>	<u>\$ 845,848</u>	<u>\$ 4,775,398</u>	<u>\$ 2,544,800</u>	<u>\$ 12,525,025</u>



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Cayey, Puerto Rico**, as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated December 7, 2006, which was unqualified. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Cayey's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Cayey's** ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as item **06-01**.

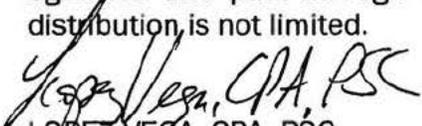
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, none are considered to be material weaknesses.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)**

Compliance and Other Matters

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

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 7, 2006

Stamp No. 2195994 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

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

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

Compliance

We have audited the compliance of the **Municipality of Cayey** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. The **Municipality of Cayey's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Cayey's** management. Our responsibility is to express an opinion on the **Municipality of Cayey'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 the *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Municipality of Cayey's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the **Municipality of Cayey's** compliance with those requirements.

In our opinion, the **Municipality of Cayey** 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, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, 06-02 through 06-10.

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

Internal Control Over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality of Cayey's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items **06-03** through **06-10**.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weakness. However, of the reportable conditions described above, we consider items **06-05** and **06-07** to be material weaknesses.

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Cayey** in a separate letter dated March 23, 2007.



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

This report is intended for the information of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

López-Vega, CPA, PSC.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 23, 2007

Stamp No. 2195995 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2006

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness identified?	Yes	No X
Reportable conditions identified not considered to be material weaknesses?	Yes X	None reported
Noncompliance material to financial statements noted?	Yes	No X

Federal awards

Internal Control over major programs:			
Material weakness identified?	Yes X	No	
Reportable conditions identified not considered to be material weaknesses?	Yes X	None reported	
Type of auditor’s report issued on compliance for major programs:	Unqualified		
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes X	No	

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
10.558	Child and Adult Care Food Program
14.218	Community Development Block Grants - Entitlement Grants
14.871	Section 8 Housing Choice Voucher Program
93.600	Head Start Program

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section II – Financial Statements Findings

Finding Reference	06-01
Requirement	Financial Reporting – Accounting Records
Statement of Condition	During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds.
Criteria	Chapter VIII, Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.
Cause of Condition	The Municipality's accounting data is not summarized in the form of a double-entry General Ledger record.
Effect of Condition	The Municipality's accounting system did not provide updated and complete financial information that presents the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.
Recommendation	We recommend to the Municipality's Management to implement internal control and procedures in order to maintain a double entry accounting system that contains accurate information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.
Questioned Costs	None
Management Response and Corrective Action	The Finance Director will contact staff members of the Office of the Commissioner of Municipal Affairs, to seek assistance related to their mechanized accounting system. Implementation Date: July 1, 2007 Responsible Person: Mr. Edwin Quiles Rosario Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-02
Program	Community Development Block Grant-Entitlement Program (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Cash Management
Statement of Condition	During our Cash Management test, we noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. In five (5) cases the disbursements were made from sixteen (16) to one hundred twenty three (123) days after receipt of funds.
Criteria	Code of Federal Regulations 24, Subpart I, Sec.570.489 (c) requires a cash management system in order to minimize the time elapsed between the transfer of funds from the pass-through grantor and disbursements made by the grantee.
Cause of Condition	The Municipality's disbursements procedures failed to assure that funds requested and received from the Pass-through Grantor be disbursed in compliance with the Code of Federal Regulations Requirements.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Sec.570.489 (c).
Recommendation	We recommend Management to strengthen its disbursement procedures to minimize the time elapsed between the transfer of funds from the pass-through grantor and the disbursements made by the Municipality.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **06-02 (Continued)**

**Management Response
and Corrective Action**

The Management instructed Program accounting staff in order to strength control and procedures to assure that the conditions observed by the auditors does not occur again. Cash will be requested to the Pass-through Grantor only when needed, and disbursed promptly.

Implementation Date: June 30, 2007

Responsible Person: Mr. Ramon Figueroa Cortés
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-03
Program	Community Development Block Grant-Entitlement Program (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Davis-Bacon Act
Statement of Condition	During our Davis-Bacon Act test we found the following exceptions: a) The Municipality did not monitor the classifications of the workers and wage rates paid in seven (7) of twenty two (22) weekly payrolls. b) One (1) weekly payroll was not submitted by the contractor during the fiscal year 2005-2006. c) The contract did not contain a provision for payment of prevailing wage rates as stated by the Davis Bacon Act.
Criteria	Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7)
Cause of Condition	The Municipality's controls and procedures failed to apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **06-03 (continued)**

Recommendation We recommend Management to follow monitoring system procedures developed, including informing contractors in the procurement process and prior to contractual agreement signature about the applicability of Davis Bacon Act, through field visits, realize contractors and subcontractors interviews, obtaining contractor's and subcontractor's weekly payrolls to be reviewed on a weekly basis to establish the degree of compliance and the nature and extend of violations, if any, and then, communicate contractors promptly about any failure in the payroll process.

Questioned Costs None

Management Response and Corrective Action We will contact the Pass-through Grantor to request a formal training to our Program staff in order to assure compliance with the Davis-Bacon Act requirements. The federal Program Director will monitor the duties of the labor standards officer on a project basis.

Implementation Date: June 30, 2007

Responsible Person: Mr. Ramon Figueroa Cortés
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-04
Program	Community Development Block Grant-Entitlement Program (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Procurement and Suspension and Debarment
Statement of Condition	<p>During our contract provision test, we examined one (1) construction contract, and one (1) professional service contract for the amounts of \$107,221 and \$7,000 respectively, and noted the following situations:</p> <ul style="list-style-type: none">a. One (1) contract did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours & Safety Standards Act.b. Two (2) contracts did not include a provision for granting access to GAO or other federal agency, to books and other documents.c. One (1) contract did not include a provision for compliance with the Clean Air and Water Act.d. One (1) contract did not include a provision for compliance with Energy Policy and Conservation Act.e. One (1) contract did not include a provision for compliance with the Copeland "Anti-Kickback" Act.f. Two (2) contracts did not include a provision for retention of all required records for three (3) years.g. One (1) contract did not include a provision for compliance of Executive Order 11246 "Equal Employment Opportunity".h. One (1) contract did not include a provision for Davis Bacon Act.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-04 (Continued)
Criteria	Code of Federal Regulations 24, Part 570.489 (g) requires that all purchase orders and contracts include any clauses required by Federal Statutes, executive orders and implementing regulations.
Cause of Condition	The Municipality did not maintain appropriate monitoring procedures to detect the exclusion of certain contract clauses.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Part 570.489 (g).
Recommendation	We recommend management to update contract model according with the federal requirements.
Questioned Costs	None
Management Response	The Director of the Municipal Office of Federal Programs will provide an additional copy of the laws and regulations that must be included as an attachment to construction contracts, financed in whole or in part with federal funds, to the Municipal Office of Legal Affairs. Implementation Date: April 1, 2007 Responsible Person: Ramón Figueroa Director of Municipal Office of Federal Programs

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-05
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Financial Administration–Standard for Financial Management System
Statement of Condition	During our audit, we noted that the set of accounting records maintained for the fiscal year 2005-2006 did not present properly the financial position and the results of operations of the program.
Criteria	<p>Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.</p> <p>The Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20, Financial Management, states the financial record keeping and management requirements with respect to Housing Assistance Payments Program Projects under annual contribution contracts.</p>
Cause of Condition	The Municipality maintained a cash basis accounting records for the Program. Also, the General Ledger did not contain the necessary accounts to properly post cash and modified accrual basis transactions.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart C, Part 85.20 (b) (2).
Recommendation	We recommended to management to instruct the program accountant to follow financial management and accounting procedures established in the Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20, Financial Management, and the policies and procedures established in the Low Rent Housing Accounting Guide (7510.1).
Questioned Cost	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-05 (Continued)

**Management Response
and Corrective Action**

The Finance Department Director will contact staff members of the Office of the Commissioner of Municipal Affairs, to seek assistance related to their mechanized accounting system.

Implementation Date: April 1, 2007

Responsible Person: Mr. Edwin Quiles
Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-06
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Eligibility of Individuals
Statement of Condition	During our test, we noted that the PHA did not use an updated Fair Market Rent Schedule to calculate Housing Assistance Payment. As result, the Program paid an incorrect HAP to the owner and it caused differences in the amount of Tenants Rent to the owner.
Criteria	Code of Federal Regulations 24, Subpart K, and Section 982.505 establish the procedures to be followed to calculate the Housing Assistance Payment. The Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6) and the PHA Administrative Plan establish procedures to be used as part of the HAP calculation.
Cause of Condition	The PHA controls and procedures failed to assure that all HAP's payments are duly computed by the program staff.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Subpart K, Section 982.505 and with the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6).
Recommendation	We recommend the PHA to strengthen its monitoring procedures to assure the HAP's are duly computed as required by the Federal Regulations. Also, we recommend that the PHA must verify the tenant files to determine which families required adjustments in their rents or utility reimbursements, and adjust the same retroactively to the date of the last reexamination, if need.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **06-06 (Continued)**

**Management Response
and Corrective Action**

The Fair Market Rent Schedule was updated by June 2006. In addition, we designed verification procedures that are essential to obtaining full and accurate information for the best use of the program funds and fair equitable treatment of all participants.

Implementation Date: April, 2007

Responsible Person: Mr. Ramon Figueroa Cortés
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-07
	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Selection from the Section 8 Waiting List
Statement of Condition	<p>In our Waiting List test, we noted the following situation:</p> <ul style="list-style-type: none">a) In fifteen (15) applicants included in the Waiting List, we observed that the PHA did not maintain the required information to assure that the selection of new tenants admitted to the program were in accordance with the administrative plan.b) The PHA did not have written policies in its administrative plan for selecting applicants from the waiting list.c) Also, the “Waiting List” record book was damaged during the year and a new book was created. We did not find evidence that demonstrated if the new book was created in the same order and with the same applicants included in the damaged book.
Criteria	<p>Code of Federal Regulations 24, Sections 982.54 (d) and 982.201 through 982.207 states the waiting list procedures and that the selection from the waiting list generally occurs when the PHA notifies a family, whose names reaches the top of the waiting list, to come in to verify eligibility for admission.</p> <p>The PHA’s administrative plan states that, except for special admissions, participant will be selected from the PHA waiting list. The PHA must select participants from the waiting list on a first-come, first-served basis, in accordance with this same plan, which includes equal opportunity. Also, the Municipality will maintain information that permits proper selection from the waiting list.</p>
Cause of Condition	<p>The Municipality controls and procedures failed to assure that the participants were selected from the top of the waiting list according with the PHA’s applicant selection policies.</p>
Effect of Condition	<p>The Municipality is not in compliance with Code of Federal Regulations 24, sections 982.54 (d), 982.201 through 982.207 and with the PHA’s administrative plan.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **06-07 (Continued)**

Recommendation We recommend management to improve monitoring procedures to assure that the participants are admitted to the program or are provided the opportunity to be admitted to the program according with the PHA administrative plan.

Questioned Costs None

**Management Response
and Correction Action** Selection from the approved “Waiting List” is based on first-come-first served basis, and/or under federal or local preferences as a result of a well-documented emergency situation, such as fire, natural disaster, etc. Nevertheless, as part of our corrective action plan, we will document all vouchers given by emergency situations.

Implementation Date: April, 2007

Responsible Person: Mr. Ramon Figueroa Cortés
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-08
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871); U.S. Department of Housing and Urban Development
Requirement	Special Test – Utility Allowance Schedule
Statement of Condition	The PHA did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2006. The PHA did not perform a review of the utility rates during the fiscal year to ascertain if there has been a change of ten (10) percent or more in the utility rate.
Criteria	Code of Federal Regulations 24, Subpart K, Section 982.517 states that the PHA must maintain an up-to-date utility allowance schedule. The PHA must review utility rate data for each utility category on a yearly basis and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category or fuel type since the last time utility allowance was revised.
Cause of Condition	The PHA did not follow the procedures established to review utility rate date each year.
Effect of Condition	The PHA is no in compliance with Code of Federal Regulations 24, Subpart K, and Section 982.517.
Recommendation	The PHA should evaluate utility allowance rate each year as established in the federal regulations.
Questioned Costs	None.
Management Response and Corrective Action	To correct the condition reported by the external auditors, we will review the utility rate data for each category in order to determine any adjustment necessary to the utility allowance in use. Implementation Date: April 1, 2007 Responsible Person: Mr. Ramon Figueroa Cortés Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-09
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Housing Quality Standards Inspections and HQS Enforcement
Statement of Condition	During our verification of nine (9) participant files, we noted the following exceptions: a. The Municipality did not perform the required Housing Quality Control re-inspections during the fiscal year 2005-2006.
Criteria	Code of Federal Regulations 24, Subpart I, 982.404 and Section 982.158 (d) and 982.405 (b) states that the PHA must inspect the unit leased to a family at least annually to determine if the unit meets Housing Quality Standards (HQS) and the PHA must conduct quality control re-inspections. Also the PHA must prepare a unit inspection report.
Cause of Condition	The Municipality did not maintain adequate monitoring procedures to assure that annual re-inspections Housing Quality Control re-inspections are properly performed.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Section 982.404 and 982.158 (d) and 982.405 (b).
Recommendation	We recommend management to implement internal control procedures to assure that annual inspections and quality control re-inspections are properly performed. The PHA supervisor or other qualified person must re-inspect a sample of units under contract during the last PHA fiscal year. Completed HQS inspections included in the sample must be no older than three months at the time of re-inspection. In addition, the quality control re-inspection should provide feedback on inspector's work, which can be used to determine if individual performance or general HQS training issues need to be addressed.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-09 (Continued)

Questioned Costs None

**Management Response
and Corrective Action** The Quality Control Re-inspections will be performed in accordance
with our Administrative Plan, revised on March 2007 .

Implementation Date: April 1, 2007

Responsible Person: Mr. Ramón Figueroa Cortés
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	06-10
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families
Requirement	Cash Management
Statement of Condition	We realized Cash Management Test and we found the following exceptions: a. The program did not maintain the proper documentation (Audit Trail) necessary to reconcile the funds received from the pass-through grantor with the disbursement of checks.
Criteria	CFR 45, Subpart C, Section 92.20 (b) (7), requires a cash management system in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursements made by the grantee.
Cause of Condition	The procedures established by ACUDEN in the agreement of delegation of funds do not provide a clause to comply with this requirement.
Effect of Condition	The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to require ACUDEN alternate methods to request cash in order to comply with this requirement.
Questioned Costs	None
Management Response And Corrective Action	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. Implementation Date: April 1, 2007 Responsible Person: Mrs. Idenisse Diaz Head Start Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-02	14.218	<p><u>During the contract provision test, the auditors examined three (3) to construction contracts with a cost of \$181,472.15, \$170,629.65 and \$15,300 respectively, and noted the following situations: (a) Two (2) contracts did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours & Safety Standards Act; (b) Three (3) contracts did not include a provision for granting access to GAO or other federal agency, to books and other documents; (c) Two (2) contracts did not include a provision for compliance with the Clean Air and Water Act; (d) Three (3) contracts did not include a provision for compliance with Energy Policy and Conservation Act; (e) Two (2) contracts did not include a provision for compliance with the Copeland "Anti-Kickback" Act; (f) Three (3) contracts did not include a provision for retention of all required records for three (3) years; (g) Two (2) contracts did not include a provision for Executive Order 11246 "Equal Employment Opportunity"; (h) Two (2) contracts did not include a provision for Davis Bacon Act.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-04.</p>
05-03	14.871	<p><u>During the examination, the auditors noted that the set of accounting records maintained for the fiscal year 2004-2005 did not present properly the financial position and the results of operations of the program.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-05.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-04	14.871	<p><u>The housing assistance payments expenditures reported in the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2005 included the housing assistance payments issued during the fiscal year 2004-2005 on behalf of portability participants administered by the Municipality. Also, the administrative fee income related to portability participants administered by the Municipality was not reported in the operating receipts section of the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2005. Also, the SEMAP Report was not available for our examination.</u></p> <p>Corrective action has been taken.</p>
05-05	14.871	<p><u>The auditors realized a Cash Management Test and after procedures, they found that the Municipality maintained during the current fiscal year an average cash balance in books of approximately \$166,117. At June 30, 2005, the cash balance in books was \$62,814; \$21,716 of these funds were from operating reserve at June 30, 2005, as determined in the preliminary year-end settlement; and the remaining \$41,098 was not identified by the auditors with respects to its origin. Also, portability accounts receivable and payable of \$ 18,609.90 and \$ 68,824.74 respectively, were not reported in the fiscal year 2004-05 preliminary year-end settlement. Also, during the twelve (12) month of the fiscal year 2004-2005, the PHA maintains a leasing ranging from 86% to 93%.</u></p> <p>Corrective action has been taken.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-06	14.871	<p><u>During the Waiting List Test, the auditors noted the following conditions: (a) The waiting list did not include the following information about each applicant: (1) qualifications for any local preferences; and (2) racial or ethnic designation of the head of household; (b) In the examination of eight (8) files of participants admitted to the program during the fiscal year 2004-2005, the auditors observed that those participants completed an application form according to the method required by the Municipality and were entered into the waiting list from June 1999 to February 2004. Also, the examination of such participant's files revealed that it does contain documents and information showing that the Municipality gave local preference for selection of such families. But, due to the fact that the waiting list did not include the qualifications for any local preferences, the auditors were unable to determine if applicants with the same local preferences were selected using the date and time of the application or use of a drawing or other random choice technique.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-07.</p>
05-07	14.871	<p><u>During the Utility Allowance Schedule Test, the auditors noted the following: (a) The Municipality updated the Utility Allowance Schedule as of March 2005, but was not applied in the Housing Assistance Payment calculation during the following months of April through June 2005.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-08.</p>
05-08	14.871	<p><u>During the verification of fifteen (15) participant files, the auditors noted that the Municipality did not perform the required Housing Quality Control re-inspections during the audit period.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-09.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-03	14.871	<p><u>The set of accounting records maintained by the Municipality for the fiscal year 2003-2004 did not present properly the financial position and the results of operations of the program</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-05.</p>
04-04	14.871	<p><u>The housing assistance payments expenditures reported in the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2004 included the housing assistance payments issued during the fiscal year 2003-2004 on behalf of portability participants administered by the Municipality. Also, the administrative fee income related to portability participants administered by the Municipality was not reported in the operating receipts section of the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2004.</u></p> <p>Corrective action has been taken.</p>
04-05	14.871	<p><u>The Municipality maintained during the current fiscal year an average cash balance in books of approximately \$376,146. At June 30, 2004, the cash balance in books was \$309,627; \$37,220 of these funds were from operating reserve at June 30, 2004, as determined in the preliminary year-end settlement; and the remaining \$272,407 was not identified by us with respects to its origin. Also, portability accounts receivable and payable of \$36,907 and \$6,341 respectively, and an underpayment of approximately \$40,411 were reported in the fiscal year 2003-04 preliminary year-end settlement. Also, during the twelve (12) month of the fiscal year 2003-2004, the PHA maintains a leasing ranging from 71% to 85%.</u></p> <p>Corrective action has been taken.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-06	14.871	<p><u>The waiting list did not include the following information about each applicant: (a) qualifications for any local preferences; and (b) racial or ethnic designation of the head of household. Also, in seven (7) files of families admitted to the program during the fiscal year 2003-2004, the participants completed an application form according to the method required by the Municipality and were entered into the waiting list from June 1999 to February 2003. Also, such participant's files revealed that it does contain documents and information showing that the Municipality gave local preference for selection of such families. But, due to the fact that the waiting list did not include the qualifications for any local preferences, the auditors were unable to determine if applicants with the same local preferences were selected using the date and time of the application or use of a drawing or other random choice technique.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-07.</p>
03-10	14.871	<p><u>At June 30, 2003, the cash balance in book was \$347,028; \$105,340 of these funds was from HUD overpayment during the fiscal year 2002-03 as determined in the year-end settlement; \$65,632 was from operating reserve at June 30, 2004, as determined in the year-end settlement; and the remaining \$176,056 was not identified by us with respects to its origin.</u></p> <p><u>We noted that during the twelve (12) month of the fiscal year 2003-2004, the PHA maintains a leasing rate under 95%, and maintains an average leasing rate of 86% for the fiscal year. The PHA did not submit to HUD a revised requisition (Form 52663) to reduce the monthly advance.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAYEY

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-12	14.871	<p><u>We were unable to determine if the report of Voucher for Payment of Annual Contributions and Operating Statement was made in accordance with the required accounting basis since the amounts in the report don't trace to the accounting records.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
03-16	14.871	<p><u>The Municipality did not maintain an up-to-date utility schedule for the audit period ending June 30, 2003. The last time the PHA reviewed its utility allowance schedule was in 1999.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
03-17	14.871	<p><u>The PHA does not select the families from the top of the waiting list according with the PHA applicant selection policies. Also, we noted that six (6) participants admitted for first time during the fiscal year 2002-03, did not appear in the Waiting List.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>