OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE JUANA DIAZ

AUDITORIA 2005-2006

30 DE JUNIO DE 2006

MUNICIPALITY OF JUANA DÍAZ, COMMONWEALTH OF PUERTO RICO

SINGLE AUDIT REPORT

For the Fiscal Year Ended June 30, 2006
(With Independent Auditors' Reports Thereon)

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RMS-CPA & Company, PSC is a member firm of the American Institute of Certified Public Accountants and is enrolled in the AICPA Peer Review Program sponsored by the Puerto Rico Society of Certified Public Accountants.

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Single Audit Report
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Fiscal Year Ended June 30, 2006

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INDEPENDENT AUDITORS' REPORT

The Honorable Mayor, Members
of the Municipal Legislature and
People of the Municipality of
Juana Díaz, Commonwealth of Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major governmental fund, and the aggregate remaining fund information of the Municipality of Juana Díaz, Commonwealth of Puerto Rico (the Municipality), as of and for the fiscal year ended June 30, 2006. 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 did not audit the financial statements of Villas del Parque (FmHA Project No. 63-033-0690660049) (Villas del Parque), a business-type activity (proprietary fund) of the Municipality which single audit report reflect total assets, liabilities, net assets, revenues and expenses of $1,742,043, $1,408,670, $333,373, $347,926 and $493,446, respectively, as of and for the fiscal year ended June 30, 2006. The accompanying statement of net assets – proprietary fund and the statement of revenues, expenses and changes in fund net assets – proprietary fund are financial statements of Villas del Parque, which were audited by other auditors whose report, dated August 24, 2006, has been furnished to us, and our opinion, insofar as it relates to Villas del Parque, is based solely on the report of the other auditors. The accompanying statement of cash flows – proprietary fund is a financial statement of the Villas del Parque, which we did not audit nor has been audited by the other auditors. These financial statements collectively comprise the Municipality's basic financial statements as listed in the table of contents.

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

As more fully described in Note 7, the Municipality did not have complete, updated and accurate accounting records of capital assets of governmental activities at June 30, 2006 which are recorded in the accompanying statement of net assets for $39,679,353, net of accumulated depreciation of $17,022,957. In addition, during the fiscal year ended June 30, 2006, the

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INDEPENDENT AUDITORS' REPORT (CONTINUED)

the Municipality did not adopt the provisions of Statement No. 42, *Accounting and Financial Reporting of Impairments of Capital Assets and for Insurance Recoveries*, issued by the Governmental Accounting Standards Board, which required the Municipality to evaluate prominent events or changes in circumstances affecting capital assets to determine whether an impairment of a capital asset has occurred. Because of this departure from accounting principles generally accepted in the United States of America for capital assets, the assets and net assets reported in the accompanying statement of net assets are materially misstated for significant amounts that could not be determined at June 30, 2006. In addition, the expenses and the net result of operations reported in the accompanying statement of activities are also misstated for amounts that could not be determined for the fiscal year ended June 30, 2006.

As more fully described in Note 11, the Municipality did not comply with the requirements established by Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, issued by the Governmental Accounting Standards Board and the regulations set forth by the U.S. Environment Protection Agency in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991. At June 30, 2006, the accompanying statement of net assets does not include the required liability for closure and postclosure care costs of the Municipality's solid waste landfill using current costs allocated based on the actual landfill capacity used at June 30, 2006. Because of this departure from accounting principles generally accepted in the United States of America, the liabilities and net assets reported in the accompanying statement of net assets are understated and overstated, respectively, for significant amounts that could not be determined at June 30, 2006. In addition, the expenses and the net result of operations reported in the accompanying statement of activities are also understated and overstated, respectively, for amounts that could not be determined for the fiscal year ended June 30, 2006.

As discussed in Note 9(h), the Municipality did not comply with the requirements established by Statement No. 16, *Accounting for Compensated Absences*, issued by the Governmental Accounting Standards Board. In addition, the Municipality did not have complete, accurate and updated records of compensated absences at June 30, 2006. In addition, the liability for compensated absences, recorded in the accompanying statement of net assets for $2,159,803, does not include the accumulated sick leave of a significant number of employees and the accumulated compensatory time of all employees of the Municipality. Furthermore, the accompanying statement of net assets and the statement of net assets – proprietary fund do not include a liability for compensated absences related to Villas del Parque (FmHA Project No. 63-033-0690660049). Because of this departure from accounting principles generally accepted in the United States of America, the liabilities and net assets in the accompanying statement of net assets and the statement of net assets – proprietary fund are understated and overstated, respectively, in both statements, for significant amounts that could not be determined at June 30, 2006. In addition, the expenses and the net result of operations in the accompanying statement of activities and the statement of revenues, expenses and changes in fund net assets – proprietary

INDEPENDENT AUDITORS' REPORT (CONTINUED)

fund are also understated and overstated, respectively, in both statements, for amounts that could not be determined for the fiscal year ended June 30, 2006.

As more fully described in Note 9(b), the accompanying statement of net assets does not include accrued interests on bonds payable amounting to $43,745. Because of this departure from accounting principles generally accepted in the United States of America, the liabilities and net assets reported in the accompanying statement of net assets are understated and overstated, respectively, for $43,745 at June 30, 2006.

We were unable to obtain sufficient and competent evidential matter to support the balances of the notes payable to the Municipal Revenue Collection Center stated at $577,404 in the accompanying statement of net assets, nor were we able to satisfy ourselves as to the carrying value and the accrued interests balance of such notes payable detailed in Note 9(e), by other auditing procedures.

As more fully described in Note 6, the general fund of the Municipality reported advances due from other governmental funds amounting to $1,090,987 at June 30, 2006 of which $994,075 represent inter-fund loans that have been outstanding for a period of time significantly longer than one fiscal year without being collected. In addition, the Municipality did not have complete and accurate accounting records of inter-fund balances. These conditions raise substantial doubts about the existence and valuation of a portion of the general fund's uncollected inter-fund advances amounting to $994,075 at June 30, 2006. The ultimate outcome of the existence, valuation and collectibility of the aforementioned inter-fund advances cannot presently be determined.

As more fully described in Note 5, the other governmental funds (nonmajor funds) of the Municipality reported intergovernmental receivables from grants and contributions amounting to $1,319,171 at June 30, 2006, of which $522,926 represent balances that have been outstanding for a period of time significantly longer than one fiscal year without being collected. In addition, the Municipality did not have complete and accurate accounting records of intergovernmental receivables at June 30, 2006. These conditions raise substantial doubts about the existence and valuation of a portion of the other governmental (nonmajor) funds' intergovernmental receivables amounting to $522,926 at June 30, 2006. The ultimate outcome of the existence, valuation and collectibility of the aforementioned receivables cannot presently be determined.

As shown in Notes 9(d) and 9(e), the accompanying basic financial statements do not disclose the debt service maturities of the notes payable to the Puerto Rico Health Services Administrations and the Municipal Revenue Collection Center (LIMS), which had outstanding balances of $356,882 and $339,092, respectively, at June 30, 2006. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

As shown in Note 10, the accompanying basic financial statements do not disclose, separately, the employers and employee contributions to the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities and System 2000 for the last three fiscal years. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

Because we were not engaged to audit the basic financial statements of the Municipality as of and for the fiscal year ended June 30, 2005 (the preceding fiscal year), we were unable to satisfy ourselves, by means of other audit procedures, regarding the balances of assets, liabilities, net assets (liabilities) and fund balances (deficits) of the governmental activities reported in the statement of net assets and the balance sheet - governmental funds at June 30, 2005. The amounts of assets, liabilities, net assets (liabilities) and fund balances (deficits) at June 30, 2005 materially affect the determination of the results of operations and cash flows for the fiscal year ended June 30, 2006.

In our opinion, because of the matters discussed in the preceding paragraphs, the financial statements referred to above do not present fairly, in all material respects, the financial position of the governmental activities of the Municipality of Juana Díaz, Commonwealth of Puerto Rico, as of June 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, except for the matters discussed in the preceding paragraphs, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major governmental fund and aggregate remaining fund information of the Municipality of Juana Díaz, Commonwealth of Puerto Rico, as of June 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, based on the report of the other auditors, except for the matters discussed in the preceding paragraphs, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and the proprietary fund of the Municipality of Juana Díaz, Commonwealth of Puerto Rico, as of June 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the changes in financial position of the business-type activities of the Municipality of Juana Díaz, Commonwealth of Puerto Rico, as of June 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

Because of the matters discussed in the preceding paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the changes in financial

INDEPENDENT AUDITORS' REPORT (CONTINUED)

position of the governmental activities, each major governmental fund, and the aggregate remaining fund information of the Municipality of Juana Díaz, Commonwealth of Puerto Rico.

The accompanying statement of cash flows – proprietary fund were not audited by us nor has been audited by the other auditors, accordingly, we do not express an opinion on it.

As more fully described in Note 12, the Municipality's general fund has an accumulated deficit of $1,394,006 at June 30, 2006 and the Municipality is currently facing significant liquidity and cash flows deficiencies. Management is currently evaluating alternatives for the permanent financing of the operations of the general fund and the Municipality, of which some of them are described in Note 12. The success of management's plans and strategies to reduce the general fund's accumulated deficit, to improve the cash flows and liquidity of the Municipality and to achieve excess revenues over expenditures in the general fund of the Municipality cannot be assured, as it is significantly dependent upon events and circumstances which outcome cannot presently be determined. However, management is committed to undertake whatever actions may be necessary to prevent operating deficiencies in the future. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2006, on our consideration of the Municipality of Juana Díaz, Commonwealth of Puerto Rico's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis and the budgetary comparison schedule - general fund are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. Management decided to exclude from the accompanying management's discussion and analysis the comparative data related to the fiscal year ended June 30, 2005 due to the lack of comparability between the current year basic financial statements with those of the prior fiscal year that arose from various prior-period adjustments and fund reclassifications that were accounted for in the accompanying basic financial statements as of and for the fiscal year ended June 30, 2006. 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.

INDEPENDENT AUDITORS' REPORT (CONCLUDED)

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Juana Díaz, Commonwealth of Puerto Rico'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 also not a required part of the basic financial statements the Municipality of Juana Díaz, Commonwealth of Puerto Rico's. These schedules and note have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

RMS-CPA & Company, PSC

Bayamón, Puerto Rico
December 22, 2006

Stamp No. 2122886 of the
Puerto Rico Society of Certified
Public Accountants was affixed
to the original report

As management of the Municipality of Juana Díaz (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements as of and for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the accompanying financial statements, which follow this narrative.

We decided to exclude from this management's discussion and analysis the comparative data related to the fiscal year ended June 30, 2005 due to the lack of comparability between the current year basic financial statements and those of the prior fiscal year. During the current fiscal year, the Municipality revised the classifications of its governmental funds, which resulted in reclassifications of various funds and the correction of various accounting errors and omissions reported in the prior year's governmental funds. These errors consist principally in the effect of not adopting adequately the provisions of GASB No. 33, *Accounting and Financial Reporting for Non-exchange Transactions,* prior to June 30, 2005, as required by GAAP, and the effect of various unrecorded accounts receivables, accounts payable, deferred revenues, inter-fund transactions, deferred charges, long-term liabilities (principally certain notes payable and obligations under capital leases) and certain capital asset transactions at June 30, 2005.

In addition, as more fully described in Note 1, On July 1, 2005, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). Based on the criteria established by GASB No. 39, the Municipality's management concluded that there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2006. Villas del Parque (FmHA Project No. 63-033-0690660049) was erroneously reported as a blended component as part of the special revenue funds (under the modified accrual basis of accounting) on the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2005. Accordingly, after adopting GASB No. 39, on July 1, 2005, the Municipality recorded a fund reclassification to properly account for the financial position, the results of operations and the cash flows of Villas del Parque as a business-type activity (proprietary fund under the accrual basis of accounting) instead of as a blended component unit as of and for the fiscal year ended June 30, 2006. The effect of the fund reclassification and the change in basis of accounting were reported as prior-period adjustments to the respective fund balances and fund net assets as of July 1, 2005 in the amount of $429,441.

The significant required changes in content and structure referred to above make the accompanying basic financial statements not easily comparable with the prior fiscal year's basic financial statements. However, in the basic financial statements for the fiscal year ended June 30, 2007, the comparative analysis will be more meaningful and will go further in explaining the Municipality's financial position and results of operations.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's total assets amounted to $55,459,284 at June 30, 2006, of which $41,340,456 (74%) consist of capital assets (net of accumulated depreciation and amortization of $19,153,588), $8,972,430 (16%) consist of cash and cash equivalents (of which $8,970,163 are restricted for specific purposes), $5,032,218 (9%) consist of accounts receivable (net of reserve for doubtful accounts of $11,822,094), $84,998 (0.1%) consist of deferred charges (net of accumulated amortization of $48,980), and $29,182 (0.05%) consist of other assets.

- The Municipality's total liabilities amounted to $30,187,790 at June 30, 2006, of which $19,738,895 (65%) consist of bonds and notes payable, $5,574,332 (18%) consist of accounts payable and accrued liabilities, $2,159,803 (7%) consist of accrued compensated absences, $2,410,782 (7%) consist of unearned revenues, $162,187 (.05%) consist of accrued legal claims and judgments, and $141,791 (.04%) consist of obligations under capital leases.

- The Municipality's total assets exceeded its liabilities (net assets) by $25,271,494 at June 30, 2006.

- The Municipality's total revenues amounted to $28,140,311 for the fiscal year ended June 30, 2006, of which $7,291,639 (25%) arose from taxes, $19,471,370 (69%) arose from intergovernmental grants and contributions, $276,257 (.09%) arose from interests on deposits, and $1,582,813 (5%) arose from charges from services, miscellaneous revenues and special items.

- The Municipality's total expenses amounted to $25,552,220 for the fiscal year ended June 30, 2006, of which $20,189,158 (79%) where incurred in providing direct services and benefits to citizens in relation to urban and economic development, health and sanitation, public safety, public housing and welfare, culture, recreation and education. In addition, the Municipality incurred in $1,335,424 (5%) of its total expenses, in interests related to its long-term obligations, and $4,027,638 (15%) in general government activities to support the Municipality's functions and programs. The Municipality's total expenses include depreciation and amortization of capital assets in the amount of $1,781,769 for the fiscal year ended June 30, 2006.

- The Municipality's total net assets increased by $3,251,036 during the fiscal year ended June 30, 2006.

Governmental Funds' Highlights:

- The total fund balances of governmental funds amounted to $4,102,780 at June 30, 2006, of which $6,872,439 are reserved for capital projects, debt service, encumbrances and other specific purposes, while $2,769,659 are presented as unreserved fund deficit.

- The fund balances of governmental funds decreased by $4,366,529 during the fiscal year ended June 30, 2006.

Proprietary Fund Highlights:

- The total restricted fund net assets of the proprietary fund amounted to $333,373, of which $283,540 are invested in capital assets, net of related debt, while $49,833 are restricted for the operations of federally funded programs.

- The total restricted fund net assets of the proprietary fund decreased by $96,068 during the fiscal year ended June 30, 2006

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2006. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

The Municipality's basic financial statements include three components: (1) government-wide financial statements (GWFS), (2) fund financial statements (FFS), and (3) notes to the basic financial statements (NBFS). This report also contains additional required information in addition to the basic financial statements themselves. These components are described below.

The basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental and proprietary funds. Both perspectives allow the users to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

a) Government-Wide Financial Statements

The GWFS are composed of: (1) the statements of net assets (SNA) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2006. The GWFS are prepared using methods that are similar to those used by most private businesses.

Both of the government-wide financial statements distinguish functions of the Municipality that are principally supported by taxes and intergovernmental activities (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities)*.

1. Statement of Net Assets

The purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality. On the other hand, the Municipality reports liabilities, such as claims and judgments, bonds and notes payable, obligations under capital leases, compensated absences and certain accounts payable and accrued liabilities, even though these liabilities might not be paid until several fiscal years into the future.

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

2. Statement of Activities

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2006, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

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

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

This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

GWFS and FFS present all of the Municipality's governmental and business-type activities, which are supported mostly by taxes, intergovernmental revenues (such as federal and state grants and contributions), and charge for services. All services normally associated with the Municipality fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; public housing and welfare; and economic and urban development.

b) Fund Financial Statements

The Municipality's FFS consist of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances – governmental funds, (3) the statement of net assets – proprietary fund, (4) the statement of revenues, expenses and changes in fund net assets - proprietary fund, and (5) the statement of cash flows – proprietary fund. These financial statements report the financial position, the results of operations and cash flows of the Municipality's governmental and proprietary funds, with an emphasis on the Municipality's major governmental and proprietary funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions. All of the funds of the Municipality can be divided into two categories: governmental funds and proprietary funds.

1. Governmental funds

Governmental funds are used to account for most of the services provided by the Municipality. These funds are used to account for essentially the same functions reported as governmental activities in the GWFS. Unlike GWFS, the focus of governmental funds in the FFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, governmental funds in FFS report the Municipality's operations in more detail than the GWFS.

Governmental funds in FFS provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) general fund, (2) debt service fund, (3) special revenue funds, (4) capital projects funds and (5) permanent funds.

Governmental funds FFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. In general, governmental funds FFS focus on near-term inflows and outflows of expendable financial resources, consequently, they measure and account for cash and other assets that can easily be converted to cash. For example, amounts reported on the balance sheet include capital assets within a very short period of time, but do not include capital assets such as land and buildings. Governmental fund liabilities generally include amounts that normally are going to be paid within a short period after the end of the fiscal year. The difference between a fund's total assets and total liabilities is reported as the fund balance or deficit, and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for governmental funds reports only those revenues and expenditures that were collected in cash or paid with cash, respectively, during the current fiscal year or very shortly after the end of the fiscal year.

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

The Municipality has five major governmental funds. Each major fund is presented in a separate column in the balance sheet – governmental funds and the statement of revenues, expenditures and changes in fund balances – governmental funds. The five major governmental funds are: (1) general fund, (2) debt service fund, (3) head start fund, (4) legislative joint resolutions fund, and (5) Section 108 loan guarantee fund.

2. Proprietary fund

The proprietary fund is a fund used to report the financial position, results of operation and cash flows of Villas del Parque (FmHA Project No. 63-033-0690660049), is a housing development consisting of eighty-four (84) dwelling units located in Juana Díaz. The project is owned by the Municipality, but its operations are carried out by a private management agent unrelated to the Municipality. The housing development project of Villas del Parque has been designed to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The project operates under financing through the Section 8 New Construction and Substantial Rehabilitation Program of the U.S. Department of Housing and Urban Development and the Section 515 Rural Rental Housing Loans Program of the U.S. Department of Agriculture. The purpose of Villas del Parque is to provide adequate housing to low-income residents of the Municipality.

The activities of Villas del Parque have been reported as a proprietary fund in the accompanying basic financial statements since GAAP permits the use of enterprise funds to report any activity for which a fee is charged to external users of goods or services, regardless of whether the government intends to fully recover the cost of the goods or services provided. Thus, it is common to use proprietary fund reporting to account for services where the government intends to recover only a portion of its costs through fees or user charges.

Proprietary funds provide the same type of information as the GWFS, but in more detail.

c) Notes to Basic Financial Statements

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

d) Other Supplementary Information

The basic financial statements are followed by a section of other supplementary information consisting of: (1) budgetary comparison schedule – general fund and (2) the schedule of expenditures of federal awards.

FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Municipality's overall financial position and operations at June 30, 2006 are summarized as follows, based on the information included in the accompanying statement of net assets:

	Governmental activities	Business-type activities	Total
Assets:			
Current assets	$ 13,952,890	80,940	$ 14,033,830
Non-current assets:			
Capital assets, net	39,679,353	1,661,103	41,340,456
Other non-current assets	84,998	-	84,998
Total assets	53,717,241	1,742,043	55,459,284
Liabilities:			
Current liabilities, excluding long-term obligations	7,954,007	31,107	7,985,114
Long-term obligations:			
Due within one year	2,037,801	23,006	2,060,807
Due after one year	18,787,312	1,354,557	20,141,869
Total liabilities	28,779,120	1,408,670	30,187,790
Net assets (deficit):			
Invested in capital assets, net of related debt	27,220,696	283,540	27,504,236
Restricted	1,690,311	49,833	1,740,144
Unrestricted	(3,972,886)	-	(3,972,886)
Total net assets	$ 24,938,121	333,373	$ 25,271,494

At June 30, 2006, the Municipality's current assets, amounting to $14,033,830 are mainly composed of restricted cash and cash equivalents ($8,972,430), property taxes receivable, net of reserve for doubtful accounts ($1,406,922), restricted and unrestricted intergovernmental grants and contributions receivable ($3,014,475), and other receivables ($610,821).

The restricted cash represents resources legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded grant programs. Restricted cash also consists of unspent proceeds of bonds issued for acquisition, construction and improvement of major capital assets. Restricted property taxes receivable represent resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's non-current assets, amounting to $41,425,454 at June 30, 2006, are substantially composed of capital assets, with a cost basis of $60,494,044, which are reported net of accumulated depreciation and amortization of $19,153,588.

At June 30, 2006, the Municipality's current liabilities amounting to $10,045,921 are mainly composed of unearned revenues ($2,410,782), accounts payable and accrued liabilities ($5,574,332), and the portions due within one year of compensated absences ($800,000), bonds and notes payable ($1,056,846) and legal claims and judgments ($162,187). Unearned revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded grant programs.

The Municipality's non-current liabilities, amounting to $20,141,869 at June 30, 2006, are mainly composed of portions due after one year of bonds and noted payable ($18,682,049) and compensated absences ($1,359,803).

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. The assets of the Municipality exceeded liabilities by $25,271,494 at June 30, 2006. The most significant portion of net assets ($27,504,236) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, furniture, fixtures, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since capital assets cannot be used to liquidate these liabilities.

Another significant portions of net assets ($1,690,311) at June 30, 2006, represents resources that are restricted for debt service payments and to finance the operations of federal and state funded programs.

The remaining component of total net assets consists of unrestricted net liabilities amounting to ($3,972,886) at June 30, 2006. These unrestricted net liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds and notes payable, compensated absences, claims and judgments, certain obligations under capital leases, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

During April and May 2006, the government of the Commonwealth of Puerto Rico shut down its operations for approximately two weeks due to a publicly announced temporary cash flows and budgetary financial crisis. As a result of that situation, the monthly property tax advances received by the municipalities from the Municipal Revenue Collection Center (CRIM) for the month of May 2006 was postponed and the Government Development Bank for Puerto Rico (GDB) temporarily canceled all available short-term and long-term financing options for the municipalities of Puerto Rico until the financial crisis was resolved. In addition, all grants and contributions assigned by the government of the Commonwealth of Puerto Rico were also postponed until the financial crisis was resolved.

Since the Municipality is significantly dependent on the intergovernmental grants and contributions received from the government of the Commonwealth of Puerto Rico and from property tax advances received from CRIM, the municipality suffered a significant financial burden for certain scheduled intergovernmental revenues not collected for the aforementioned reasons and, accordingly, also shut down operations until the financial crisis of the central government was resolved.

In addition, during the prior fiscal years, the Municipality suffered recurring operating losses significant liquidity and cash flows shortfalls during the fiscal year then ended. In addition, substantially all of the Municipality's cash balances are restricted for specific purposes and cannot be used for general operating purposes. Furthermore, at June 30, 2006, the Municipality has an excess of checks drawn over bank balances of $220,379 recorded within accounts payable and accrued liabilities.

Going forward, if the Municipality continues to have expenditures in excess of revenues before other financing sources, a financial risk will continue to exist regarding the dependability on financing from GDB and advances in excess of actual property tax collections from CRIM.

Management is currently evaluating alternatives for the permanent financing of the operations of the Municipality. Among the actions currently taken by the management of the Municipality in relation to these matters are: (1) the implementation of a cost reduction plan and related activities, (2) the implementation of a sales and use tax effective July 1, 2006 (see note 15), (3) the implementation of increased collection efforts over accounts receivable and inter-fund balances, and (4) the evaluation of different alternatives through possible long-term financing agreements with GDB.

The total net assets of the Municipality increased by $3,251,036 for the fiscal year ended June 30, 2006. Such increase is due to the excess of total revenues ($28,803,256), including special and extraordinary items over expenses ($25,552,220), including depreciation and amortization of capital assets of ($1,781,769) for the fiscal year ended June 30, 2006.

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The following is a condensed presentation of the Municipality's results of operations as reported in the statement of activities for the fiscal year ended June 30, 2006:

	Governmental activities	Business-type activities	Total
Program revenues:			
Program-specific operating grants and contributions	$ 8,175,079	$ 347,926	$ 8,523,005
Program-specific capital grants and contributions	5,351,030	-	5,351,030
Charges for services	481,884	31,764	513,648
Total program revenues	$ 14,007,993	$ 379,690	$ 14,387,683
General revenues:			
Property taxes	4,267,331	-	4,267,331
Municipal license taxes	1,451,861	-	1,451,861
Construction excise taxes	1,572,447	-	1,572,447
Unrestricted grants and contributions	5,597,335	-	5,597,335
Other general revenues (various sources)	845,966	17,688	863,654
Total general revenues	13,734,940	17,688	13,752,628
Special item - legal judgment and settlement with Puerto Rico Electric Power Authority	481,768	-	481,768
Extraordinary item – proceed from bond issuance surplus distributed by GDB	181,177	-	181,177
Total revenues	28,405,878	397,378	28,803,256
Program expenses:			
General government	$ 4,027,638	-	$ 4,027,638
Urban and economic development	4,631,057	-	4,631,057
Health and sanitation	1,688,560	-	1,688,560
Public safety	3,100,284	-	3,100,284
Public housing and welfare	1,386,730	493,446	1,880,176
Culture, recreation and education	8,889,081	-	8,889,081
Interest on long-term obligations	1,335,424	-	1,335,424
Total expenses	25,058,774	493,446	25,552,220
Net increase (decrease) in net assets	3,347,104	(96,068)	3,251,036
Net assets, at beginning of fiscal year, as restated	21,591,017	429,441	22,020,458
Net assets, at end of fiscal year	$ 24,938,121	$ 333,373	$ 25,271,494

As previously mentioned, the Municipality's total net assets increased by $3,251,036 (14%) during the current fiscal year. Approximately 25% ($7,291,639) of the Municipality's total revenues for the current fiscal year came from property, municipal license and construction excise taxes, while 68% ($19,471,370) resulted from restricted and unrestricted capital and operating grants and contributions. Charges for services and other revenues, amounting to $1,377,302, provided 6% of the total revenues for the current fiscal year.

The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2006 were related to: (1) general administrative and operating costs ($4,027,638), which were classified as "general government" and accounted for 15% of total expenses, (2) public housing and welfare ($1,880,176), which accounted for 7% percent of total expenses, (3) health and sanitation ($1,688,560), which accounted for 6% of total expenses, (4) urban and economic development ($4,631,057), which accounted for 18% of total expenses, (5) public safety ($3,100,284), which accounted for 12% of total expenses, (6) culture, recreation and education ($8,889,081), which accounted for 34% of total expenses, and (7) interest on long-term obligations ($1,335,424), which accounted for 5% of total expenses. These expenses include depreciation of capital assets and deferred charges in the amount of $1,876,177, for the fiscal year ended June 30, 2006.

FINANCIAL ANALYSIS OF GOVERNMENTAL ACTIVITIES

Analysis of Financial Position of Governmental Funds

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

At June 30, 2006, the total assets of governmental funds amounted to $16,418,401, which consisted principally of: (1) cash and cash equivalents of $8,895,260 (54%), (2) tax receivables, net of reserve for doubtful accounts, of $1,931,315 (11%), and (3) intergovernmental, accrued interests and other receivables of $3,039,837 (18%). Such assets include cash, cash equivalents and receivables in the amount of $13,925,673 (56%) that are principally used for debt service, capital projects, encumbrances and other specific purposes.

At June 30, 2006, the total liabilities of governmental funds amounted to $12,315,621, which consisted principally of: (1) deferred revenues of $3,902,654 (31%), (2) accounts payable and accrued liabilities of $4,895,936 (39%) and matured bonds and interests due and payable of $1,051,520 (8%).

The total fund balances of governmental funds amounted to $4,102,780 at June 30, 2006, of which $6,872,439 are reserved for capital projects, debt service, encumbrances and other specific purposes, while $2,769,659 represent unreserved fund deficit. The fund balances of governmental funds decreased by $4,366,529 during the fiscal year ended June 30, 2006.

The following table presents the condensed financial position of governmental funds at June 30, 2006:

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Assets:	
Total assets - major governmental funds	$ 11,047,822
Total assets - other governmental funds	5,370,579
Combined total assets	16,418,401
Liabilities:	
Total liabilities - major governmental funds	8,736,476
Total liabilities - other governmental funds	3,579,145
Combined total liabilities	12,315,621
Fund balances (deficits):	
Reserved - major governmental funds	5,081,005
Reserved - other governmental funds	1,791,434
Unreserved - major governmental funds	(2,769,659)
Combined total fund balances	4,102,780
Total liabilities and fund balances	$ 16,418,401

Major Governmental Funds

General fund (GF) – The GF is the principal operating fund of the Municipality. The GF's total assets amounted to $3,324,412 at June 30, 2006. Such assets consist principally of: (1) property, municipal license and construction excise tax receivables ($1,542,566), and (3) short-term and long-term amounts due from other funds ($1,543,808).

The GF's total liabilities amounted to $4,718,418 at June 30, 2006. Such liabilities are composed mainly of: (1) deferred revenues ($2,575,728), and (2) accounts payable and accrued liabilities, including amounts due to other governments ($1,299,736), which include checks drawn over bank balance in general fund in the amount of $220,379.

At the end of the current fiscal year, unreserved fund deficit of the GF amounted to $2,714,322, while total fund deficit reached $1,394,006.

The general fund of the Municipality reported as part of its assets, the advances due from other governmental funds amounting to $1,090,987 at June 30, 2006 of which $994,075 represent inter-fund loans that have been outstanding over one year without being collected. The Municipality did not have complete and accurate accounting records of inter-fund balances, including a subsidiary record documenting the collection procedures made by management and the repayment and other terms and conditions of inter-fund loans, transfers and reimbursements among governmental funds. These conditions raise substantial doubts about the existence and valuation of a portion of the general fund's uncollected inter-fund advances amounting to $994,075 at June 30, 2006. The ultimate outcome of the existence, valuation and collectibility of the aforementioned inter-fund advances cannot presently be determined.

Debt service fund (DSF)- The DSF's total assets amounted to $2,710,087 at June 30, 2006, which consist mainly of restricted cash in fiscal agent ($1,969,495) and restricted property taxes receivable, net of reserve for doubtful accounts ($388,749). The DSF's total liabilities amounted to $1,440,240 at June 30, 2006, which are mainly composed of: (1) matured bonds due and payable ($785,000), and (2) matured interest due and payable ($266,520). At the end of the current fiscal year, DSF's total and reserved fund balance reached $1,269,847.

Head start fund (HSF)- The HSF's total assets amounted to $52,921 at June 30, 2006, which consist mainly of restricted cash in commercial banks ($13,251), and advance from general fund ($39,670). The HSF's total liabilities amounted to $52,921 at June 30, 2006, which are composed of: (1) amounts due to other governmental fund ($10,000), and (2) accounts payable and accrued liabilities ($42,921). At the end of the current fiscal year, the HSF had no total or reserved fund balances.

Legislative joint resolutions fund (LJRF)- The LJRF's total assets amounted to $1,705,739 at June 30, 2006, which consist of restricted cash in commercial banks ($166,216), and receivables from intergovernmental grants and contributions ($1,519,154). The LJRF's total liabilities amounted to $1,701,037 at June 30, 2006, which are composed mainly of accounts payable and accrued liabilities ($1,701,037). At the end of the current fiscal year, the LJRF had total fund balances amounted to $4,702.

Section 108 loan guarantee fund (S108F)- The S108F's total assets amounted to $3,254,663 at June 30, 2006, which consist of restricted cash and cash equivalents in commercial banks ($3,212,389). The S108F's total liabilities amounted to $823,860 at June 30, 2006, which are composed mainly of accounts payable and accrued liabilities ($823,860). At the end of the current fiscal year, the S108F had total reserved fund balances amounted to $2,430,803.

Other governmental funds (OGF)- The OGF's total assets amounted to $5,370,579 at June 30, 2006, which consist mainly of restricted cash and cash equivalents ($1,953,893), restricted cash in fiscal agent (1,577,749), and receivables from intergovernmental grants and contributions ($1,319,171). The OGF's total liabilities amounted to $3,579,145 at June 30, 2006, which are mainly composed of deferred revenues ($955,435), accounts payable and accrued liabilities ($1,028,382) and short-term and long-term amounts due to other funds ($1,595,328). At the end of the current fiscal year, OGF's total reserved fund balance reached $1,791,434.

Analysis of Operating Results of Governmental Funds

Major Governmental Funds

General fund – The total fund deficit of the GF decreased by $11,432 (.08%) during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to $12,629,247, $11,685,094, and $932,721, respectively, for the fiscal year ended June 30, 2006.

Approximately 47% ($6,049,469) of the GF's total revenues for the current fiscal year came from property, municipal license and construction excise taxes, while 43% ($5,543,389) resulted from intergovernmental grants and contributions. Interest revenues, charges for services and miscellaneous revenues, amounting to $1,036,389, provided 8% of the total revenues for the current fiscal year.

The largest expenses of the GF for the fiscal year ended June 30, 2006 were related to: (1) general administrative and operating costs ($4,093,716), which were classified as "general government" and accounted for 35% of total expenses, (2) public housing and welfare ($248,372), which accounted for 12% percent of total expenses, (3) health and sanitation ($1,382,077), which accounted for 11% of total expenses, (4) urban and economic development ($1,481,117), which accounted for 12% of total expenses, (5) public safety ($2,754,042), which accounted for 23% of total expenses, (6) culture, recreation and education ($1,327,534), which accounted for 11% of total expenses, and (7) principal and interest on long-term obligations ($293,974), which accounted for 2% of total expenses.

Debt service fund (DSF) – The total fund balance of the DSF increased by $170,375 (15%) during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to $1,372,088, $1,519,391 and $317,678, respectively, for the fiscal year ended June 30, 2006.

Approximately 95% ($1,317,135) of DSF's total revenues for the current fiscal year came from restricted property taxes. DSF's total expenditures for the current fiscal year came from principal and interests on bonds payable ($1,519,391).

Head start fund (HSF)- Total revenues, expenditures and other financing sources (net) amounted to $5,715,808, $6,637,386 and $921,578, respectively, for the fiscal year ended June 30, 2006.

HSF's total revenues for the current fiscal year came from federal grants ($5,715,808). HSF's total expenditures for the current fiscal year came from program activities, while other financing sources (net) arose principally from the transfers from general fund during fiscal year 2005-2006 ($921,578).

Legislative joint resolutions fund (LJRF)- The total fund balance of the LJRF increased by $1,567 (49%) during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to $3,223,885, $3,176,131 and $46,187, respectively, for the fiscal year ended June 30, 2006.

Approximately 99% ($3,222,318) of LJRF's total revenues for the current fiscal year came from restricted grants from the Central government. LJRF's total expenditures for the current fiscal year came from capital outlays, while other financing sources (net) arose principally from transfers among funds.

Section 108 loan guarantee fund (S108F)- The total fund balance of the S108F decreased by $2,862,612 (54%) during current fiscal year. Total expenditures and other financing sources (net) amounted to $3,600,832 and $650,637, respectively, for the fiscal year ended June 30, 2006.

S108F's total expenditures for the current fiscal year came from capital outlays ($2,977,052) and interests on note payable ($623,780), while other financing sources (net) arose principally from transfers among funds.

Other governmental funds (OGF) – The total fund balance of the OGF decreased by $1,687,291 (48%) during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to $4,735,341, $6,496,134 and $589,443, respectively, for the fiscal year ended June 30, 2006. Approximately 96% ($4,587,983) of OGF's total revenues for the current fiscal year came from intergovernmental grants.

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FINANCIAL ANALYSIS OF BUSINESS-TYPE ACTIVITIES

Analysis of Financial Position of Proprietary Fund

At June 30, 2006, the total assets of proprietary fund amounted to $1,742,043, which consisted principally of: (1) restricted cash in commercial banks of $77,170 (4%), and (2) capital assets net of accumulated depreciation ($1,661,103).

At June 30, 2006, the total liabilities of the proprietary fund amounted to $1,408,670, which consisted principally of: (1) mortgage notes payable of $1,377,563, and (2) accounts payable and accrued liabilities of $31,107.

The total restricted net assets of proprietary fund amounted to $333,373 at June 30, 2006, of which $283,540 are invested in capital assets, and $49,833 are reserved for program activities. The following table presents a summary of the financial position of the proprietary fund (PF) at June 30, 2006:

Assets:	
Total current assets	$ 80,940
Total non-current assets	1,661,103
Total assets	1,742,043
Liabilities:	
Total current liabilities	54,113
Total non-current liabilities	1,354,557
Total liabilities	1,408,670
Net assets:	
Invested in capital assets, net of related debt	283,540
Restricted for federal funded program	49,833
Total restricted net assets	$ 333,373

The PF's total assets amounted to $1,742,043 at June 30, 2006. Such assets consist principally of: (1) capital assets, net of related depreciation ($1,661,103).

The total restricted fund net assets of the PF decreased by $96,068 (22%) during current fiscal year. Total operating revenues, operating expenses and non-operating income amounted to $396,132, $493,446, and $1,246, respectively, for the fiscal year ended June 30, 2006.

Approximately 87% ($347,926) of the PF's total revenues for the current fiscal year came from intergovernmental grant and contributions – tenant payment assistance, while 8% ($31,764) came from charge for services – rent income.

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BUDGETARY HIGHLIGHTS

a) General Fund

The original and the final budget of the general fund for the fiscal year ended June 30, 2006 amounted to $13,265,428 and $13,575,446, respectively. Over the course of the fiscal year, the Municipality revised the GF's budget in order to include increases and decreases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. The laws and regulations of the Commonwealth mandate a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were $12,687,594, which is 6% ($887,852) less than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were $12,691,987, which is 6% ($883,459), lower than the budgeted expenditures.

The most significant fluctuation in actual revenues occurred in construction excise taxes which had actual revenues that were $1,139,002 less than budgeted, which reflects the actual condition and negative growth of the construction industry in the Commonwealth of Puerto Rico.

The most significant fluctuation in actual expenditures occurred in general government expenditures which had actual amounts that were $412,747 less than budgeted. This reduction is mainly due to certain cost reduction activities performed by management during the current fiscal year as a result of the reduction in actual revenues.

CAPITAL ASSETS AND DEBT ADMINISTRATION

a) Capital Assets

The Municipality has invested $56,702,310 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of $17,022,957 at June 30, 2006. The net capital assets of governmental activities increased during the current fiscal year due to the current fiscal year's capital additions ($8,231,300), which were partially offset by the depreciation and amortization expense ($1,781,769) for the same period.

The capital additions made to capital assets during the fiscal year ended June 30, 2006 were the following:

Buildings, structures and improvements	$ 6,142,241
Infrastructure	1,198,218
Machinery, equipment, furniture and fixtures	401,277
Office equipment under capital leases	30,214
Licensed vehicles	549,350
Other capital additions for the fiscal year ended June 30, 2006	$ 8,321,300

b) Debt Administration

The Municipality finances a significant portion of its construction activities through bond and note issuances, and through state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

At June 30, 2006, the Municipality's total bonded debt amounted to $11,274,000, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. The following is a summary of the debt activity for the fiscal year ended June 30, 2006:

- Bonds payable decreased by 6% ($745,000) by the total principal payments on bonds ($745,000) made during the current fiscal year.

- The Municipality has also certain outstanding notes payable due to Puerto Rico Treasury Department ($653,047). During the year, notes payable to the Treasury Department increased by 64% ($291,328) due to the issuance of one new note payable amounting to $291,328, which increased the debt. However, such increase was partially reduced by the total principal payments on notes ($123,618) made during the current fiscal year. The proceed of the new note issuance was used to pay claims and judgments.

- The Municipality has also certain outstanding notes payable due to CRIM ($577,404). Such notes payable decreased by $81,504 during the current fiscal year mainly due to the principal payments made during the same period.

- Furthermore, the Municipality has notes payable to the U.S. Department of Housing and Urban Development, amounting to $5,500,000, which proceeds are being used in the construction of the Fine Arts Center of the Municipality.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Municipality of Juana Díaz, Department of Finance.

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Statement of Net Assets
June 30, 2006

Assets	Governmental activities	Business-type activities	Total
Current assets:			
Cash in commercial banks	$ 2,267	-	$ 2,267
Accounts receivable, net of allowance for doubtful accounts of $8,638,767:			
Taxes:			
Property taxes	1,018,173	-	1,018,173
Municipal license taxes	83,744	-	83,744
Construction excise taxes	440,649	-	440,649
Intergovernmental grants and contributions	176,150	-	176,150
Other	59,621	-	59,621
Restricted assets:			
Cash and cash equivalents:			
Cash in commercial banks	3,845,749	77,170	3,922,919
Cash in fiscal agent	3,547,244	-	3,547,244
Cash equivalents in commercial banks	1,500,000	-	1,500,000
Accounts receivable:			
Property taxes receivable, net of allowance for doubtful accounts of $3,183,327	388,749	-	388,749
Accrued interest on deposits	25,362	-	25,362
Intergovernmental grants and contributions	2,838,325	-	2,838,325
Other receivables		1,445	1,445
Other current assets	26,857	2,325	29,182
Total current assets	13,952,890	80,940	14,033,830
Non-current assets:			
Capital assets:			
Depreciable capital assets, net of accumulated depreciation of $17,022,957 and $ 2,130,631 for governmental and business-type activities, respectively.	29,388,814	1,564,874	30,953,688
Non-depreciable capital assets	10,290,539	96,229	10,386,768
Deferred charges, net of accumulated amortization of $48,980	84,998	-	84,998
Total non-current assets	39,764,351	1,661,103	41,425,454
Total assets	$ 53,717,241	1,742,043	$ 55,459,284

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Statement of Net Assets (concluded)
June 30, 2006

Liabilities and net assets (liabilities)	Governmental activities	Business-type activities	Total
Current liabilities (due within one year):			
Accounts payable:			
Trade payables, including excess of checks drawn over bank balance of $220,379	$ 4,514,554	23,871	$ 4,538,425
Intergovernmental payables	381,382	-	381,382
Accrued liabilities:			
Accrued interests on bonds and notes payable	268,038	7,236	275,274
Accrued christmas bonuses of employees	379,251	-	379,251
Unearned revenues	2,410,782	-	2,410,782
Current portion of long-term obligations:			
Bonds payable	785,000	-	785,000
Notes payable	248,840	23,006	271,846
Obligation under capital leases	41,774	-	41,774
Compensated absences	800,000	-	800,000
Claims and judgments	162,187	-	162,187
Total current liabilities	9,991,808	54,113	10,045,921
Non-current liabilities, excluding current portion (due in more than one year) :			
Bonds payable	10,489,000	-	10,489,000
Notes payable	6,838,492	1,354,557	8,193,049
Obligation under capital leases	100,017	-	100,017
Compensated absences	1,359,803	-	1,359,803
Total non-current liabilities	18,787,312	1,354,557	20,141,869
Total liabilities	28,779,120	1,408,670	30,187,790
Net assets (liabilities):			
Invested in capital assets, net of related debt	27,220,696	283,540	27,504,236
Restricted for:			
Debt service	1,592,045	-	1,592,045
Federal and state funded programs	98,266	49,833	148,099
Unrestricted net liabilities	(3,972,886)	-	(3,972,886)
Total net assets	$ 24,938,121	333,373	$ 25,271,494

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Statement of Activities
Fiscal Year Ended June 30, 2006

		Program Revenues			Net (Expense) Revenue and Changes In Net Assets		
Activities and Functions	**Expenses, including depreciation/ amortization expenses**	**Charges for services**	**Program - specific operating grants and contributions**	**Program - specific capital grants and contributions**	**Governmental activities**	**Business-type activities**	**Total**
Governmental activities:							
General government	$ 4,027,638	-	-	-	(4,027,638)	-	$ (4,027,638)
Urban and economic development	4,631,057	400,116	792,009	2,127,695	(1,311,237)	-	(1,311,237)
Health and sanitation	1,688,560	3,700	262,617	-	(1,422,243)	-	(1,422,243)
Public safety	3,100,284	18,125	208,418	-	(2,873,741)	-	(2,873,741)
Public housing and welfare	1,386,730	-	684,003	-	(702,727)	-	(702,727)
Culture and recreation	8,889,081	59,943	6,228,032	3,223,335	622,229	-	622,229
Interest on long-term obligations	1,335,424	-	-	-	(1,335,424)	-	(1,335,424)
Total governmental activities	25,058,774	481,884	8,175,079	5,351,030	(11,050,781)	-	(11,050,781)
Business-type activities:							
Public housing and welfare, including interests on long-term obligations of $101,041	493,446	31,764	347,926	-	-	(113,756)	(113,756)
Total business-type activities	$ 493,446	31,764	347,926	-	-	(113,756)	(113,756)
General revenues:							
Taxes:							
Property taxes					$ 4,267,331	-	$ 4,267,331
Municipal license taxes					1,451,861	-	1,451,861
Construction excise taxes					1,572,447	-	1,572,447
Total tax revenues					7,291,639	-	7,291,639
Intergovernmental grants and contributions, not restricted to specific programs					5,597,335	-	5,597,335
Interest on deposits					275,011	1,246	276,257
Miscellaneous					570,955	16,442	587,397
Total general revenues					13,734,940	17,688	13,752,628
Special item - proceeds from legal judgment and settlement with Puerto Rico Electric Power Authority					481,768	-	481,768
Extraordinary item - proceed from bond issuance surplus distributed by the Government Development Bank for Puerto Rico					181,177	-	181,177
Net change in net assets					3,347,104	(96,068)	3,251,036
Net assets at beginning of fiscal year, as restated					21,591,017	429,441	22,020,458
Net assets at end of fiscal year					$ 24,938,121	333,373	$ 25,271,494

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

MUNICIPALITY OF JUANA DÍAZ, COMMONWEALTH OF PUERTO RICO
Balance Sheet – Governmental Funds
June 30, 2006

	Major governmental funds						
	General fund	Debt service fund	Head start fund	Legislative joint resolutions fund	Section 108 loan guarantee fund	Other governmental funds	Total governmental funds
Assets							
Cash in commercial banks	$ 2,267	-	-	-	-	-	$ 2,267
Accounts receivable, net of allowance for doubtful accounts of $8,638,767							
Taxes:							
Property taxes	1,018,173	-	-	-	-	-	1,018,173
Municipal license taxes	83,744	-	-	-	-	-	83,744
Construction excise taxes	440,649	-	-	-	-	-	440,649
Intergovernmental grants and contributions	176,150	-	-	-	-	-	176,150
Due from other governmental funds	452,821	-	-	-	-	-	452,821
Advances from other governmental funds	1,090,987	-	-	-	-	-	1,090,987
Other	59,621	-	-	-	-	-	59,621
Restricted assets:							
Cash and cash equivalents:							
Cash in commercial banks	-	-	13,251	166,216	1,712,389	1,953,893	3,845,749
Cash in fiscal agent	-	1,969,495	-	-	-	1,577,749	3,547,244
Cash equivalents in commercial banks	-	-	-	-	1,500,000	-	1,500,000
Accounts receivable:							
Taxes:							
Property taxes, net of allowance for doubtful accounts of $3,183,327	-	388,749	-	-	-	-	388,749
Accrued interest on deposits	-	5,105	-	-	15,417	4,840	25,362
Intergovernmental grants and contributions	-	-	-	1,519,154	-	1,319,171	2,838,325
Due from other governmental funds	-	346,738	-	-	-	514,926	861,664
Advances from other governmental funds	-	-	39,670	20,369	-	-	60,039
Other restricted assets	-	-	-	-	26,857	-	26,857
Total assets	$ 3,324,412	2,710,087	52,921	1,705,739	3,254,663	5,370,579	$ 16,418,401
Liabilities							
Accounts payable and accrued liabilities:							
Trade payables, including excess of checks drawn over bank balance in general fund of $220,379	$ 918,354	-	42,921	1,701,037	823,860	1,028,382	$ 4,514,554
Intergovernmental payables	381,382	-	-	-	-	-	381,382
Due to other governmental funds	782,915	17,229	10,000	-	-	504,341	1,314,485
Advances to other governmental funds	60,039	-	-	-	-	1,090,987	1,151,026
Deferred revenues:							
Unearned revenues	1,406,054	49,293	-	-	-	955,435	2,410,782
Earned and unavailable revenues	1,169,674	322,198	-	-	-	-	1,491,872
Matured bonds due and payable	-	785,000	-	-	-	-	785,000
Matured interest due and payable	-	266,520	-	-	-	-	266,520
Total liabilities	4,718,418	1,440,240	52,921	1,701,037	823,860	3,579,145	12,315,621
Fund balances (deficits)							
Reserved for:							
Encumbrances	229,329	-	-	-	-	-	229,329
Other restricted assets	-	-	-	-	26,857	-	26,857
Debt service	-	1,269,847	-	-	-	-	1,269,847
Capital projects	-	-	-	-	2,403,946	1,724,727	4,128,673
Advances from other governmental funds	1,090,987	-	39,670	20,369	-	-	1,151,026
Federal and state funded programs	-	-	-	-	-	66,707	66,707
Unreserved	(2,714,322)	-	(39,670)	(15,667)	-	-	(2,769,659)
Total fund balances (deficits)	(1,394,006)	1,269,847	-	4,702	2,430,803	1,791,434	4,102,780
Total liabilities and fund balances (deficits)	$ 3,324,412	2,710,087	52,921	1,705,739	3,254,663	5,370,579	$ 16,418,401

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Statement of Revenues, Expenditures and Changes in Fund Balances (Deficits) – Governmental Funds
Fiscal Year Ended June 30, 2006

	Major governmental funds						
	General fund	**Debt service fund**	**Head start fund**	**Legislature joint resolutions fund**	**Section 108 loan guarantee fund**	**Other governmental funds**	**Total governmental funds**
Revenues:							
Taxes:							
Property taxes	$ 3,025,161	1,317,135	-	-	-	-	$ 4,342,296
Municipal license taxes	1,451,861	-	-	-	-	-	1,451,861
Construction excise taxes	1,572,447	-	-	-	-	-	1,572,447
Total tax revenues	6,049,469	1,317,135	-	-	-	-	7,366,604
Intergovernmental grants and contributions	5,543,389	-	5,715,808	3,222,318	-	4,587,983	19,069,498
Interest on deposits	47,193	54,953		1,567	87,583	83,715	275,011
Charges for services	418,241	-	-	-	-	63,643	481,884
Miscellaneous	570,955	-	-	-	-	-	570,955
Total revenues	12,629,247	1,372,088	5,715,808	3,223,885	87,583	4,735,341	27,763,952
Expenditures:							
Current:							
General government	4,083,716	-	-	-	-	292,888	4,376,604
Urban and economic development	1,481,117	-	-	-	-	2,385,106	3,866,223
Health and sanitation	1,382,077	-	-	-	-	266,692	1,648,769
Public safety	2,754,042	-	-	-	-	201,714	2,955,756
Public housing and welfare	248,372	-	-	-	-	1,121,796	1,370,168
Culture, recreation and education	1,327,534	-	6,637,386	-	-	170,308	8,135,228
Debt service:							
Principal	215,533	895,000	-	-	-	24,983	1,135,516
Interest	78,441	624,391	-	-	623,780	9,006	1,335,618
Capital outlays	114,262	-	-	3,176,131	2,977,052	2,023,641	8,291,086
Total expenditures	11,685,094	1,519,391	6,637,386	3,176,131	3,600,832	6,496,134	33,114,968
Revenues over (under) expenditures	944,153	(147,303)	(921,578)	47,754	(3,513,249)	(1,760,793)	(5,351,016)
Other financing sources (uses):							
Transfers from other governmental funds	517,403	372,874	921,578		650,637	246,527	2,709,019
Transfers to other governmental funds	(1,480,338)	(55,196)	-	(46,187)	-	(1,127,298)	(2,709,019)
Capital leases	30,214	-	-	-	-	-	30,214
Proceeds from issuance of long-term debt	-	-	-	-	-	291,328	291,328
Total other financing sources (uses), net	(932,721)	317,678	921,578	(46,187)	650,637	(589,443)	321,542
Net increase (decrease) in fund balances (deficits) before special and extraordinary items	11,432	170,375	-	1,567	(2,862,612)	(2,350,236)	(5,029,474)
Special items - proceeds from legal judgment settlement with Puerto Rico Electric Power Authority	-	-	-	-	-	481,768	481,768
Extraordinary items - proceeds from bond issuance surplus distributed by the Government Development Bank for Puerto Rico	-	-	-	-	-	181,177	181,177
Net increase (decrease) in fund balances (deficit)	11,432	170,375	-	1,567	(2,862,612)	(1,687,291)	(4,366,529)
Fund balance (deficit) at beginning of fiscal year, as restated	(1,405,438)	1,099,472	-	3,135	5,293,415	3,478,725	8,469,309
Fund balance (deficit) at end of fiscal year	$ (1,394,006)	1,269,847	-	4,702	2,430,803	1,791,434	$ 4,102,780

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Reconciliation of the Balance Sheet – Governmental Funds and the Statement of Net Assets – Proprietary Fund to the Statement of Net Assets
June 30, 2006

	Governmental activities	Business-type activities	Total
The amounts of governmental and business-type activities reported in the statement of net assets are different to the amounts reported in the balance sheet – governmental funds and the statement of net assets – proprietary fund, respectively, for the following reasons:			
Total fund balances and fund net assets reported in the balance sheet – governmental funds and the statement of net assets – proprietary fund, respectively.	$ 4,102,780	333,373	$ 4,436,153
Add (Deduct):			
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds. This is the carrying amount of capital assets, net of accumulated depreciation and amortization of $17,022,957 at June 30, 2006.	39,679,353	-	39,679,353
Certain deferred revenues in the governmental funds are recognized as revenues in the statement of activities. This is the deferred revenues (earned and unavailable revenues) for revenue streams that are measurable but not available at June 30, 2006 (municipal licenses, intergovernmental grants and contributions and charges for services, excise taxes and property taxes).	1,491,872	-	1,491,872
Debt issued by the Municipality has associated costs (deferred charges) that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets and reported net of accumulated amortization of $48,980 at June 30, 2006.	84,998	-	84,998
The following liabilities are not due (mature) in the current fiscal year, therefore, are not reported in the governmental funds at June 30, 2006:			
Bonds payable	(10,489,000)	-	(10,489,000)
Notes payable	(7,087,332)	-	(7,087,332)
Obligations under capital leases	(141,791)	-	(141,791)
Compensated absences	(2,159,803)	-	(2,159,803)
Claims and judgments	(162,187)	-	(162,187)
Accrued christmas bonuses and accrued interests of $379,251 and $1,518, respectively	(380,769)	-	(380,769)
Net assets – governmental and business-type activities, as reported in the statement of net assets	$ 24,938,121	333,373	$ 25,271,494

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances (Deficits) – Governmental Funds and the Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Fund to the Statement of Activities
Fiscal Year Ended June 30, 2006

	Governmental activities	Business-type activities	Total
The amounts of governmental and business-type activities reported in the statement of activities are different to the amounts reported in statement of revenues, expenditures and changes in fund balances (deficits) – governmental funds and the statement of revenues, expenses and changes in fund net assets – proprietary fund, respectively, for the following reasons:			
Total net decrease in fund balances and total net decrease fund net assets reported in the statement of revenues, expenditures and changes in fund balances – governmental funds and the statement of revenues, expenses and changes in fund net assets – proprietary fund	$(4,366,529)	(96,068)	$(4,462,597)
Add (Deduct):			
Certain revenue streams recorded in the statement of activities do not necessarily provide current financial resources, therefore, sometimes are deferred in the governmental funds. This is the net change in deferred revenues of the revenue items,that are measurable but not available at fiscal year end:	(21,020)	-	(21,020)
Governmental funds report capital outlays as expenditures. However in the statement of activities the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expense. This is the amount by which capital outlays expenditures ($8,291,086) exceeded depreciation and amortization expense ($1,781,769) for the fiscal year ended June 30, 2006.	6,509,317	-	6,509,317
Repayment of principal of long-term obligations is reported as an expenditure in the governmental funds; however, the repayment reduces long-term liabilities in the statement of net assets.	1,135,516	-	1,135,516
Repayment of claims and judgments is reported as an expenditure in the governmental funds; however, the repayment reduces long-term liabilities in the statement of net assets.	223,936	-	223,936
Repayment of property tax advances is reported as an expenditure in the governmental funds; however, the repayment reduces long-term liabilities in the statement of net assets.	133,432	-	133,432
Certain accrued interest expense reported in the statement of activities do not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	195	-	195
Amortization of deferred charges reported in the statement of activities does not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	(7,799)	-	(7,799)
Some expenses reported in the statement of activities do not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	31,384	-	31,384
Proceeds from issuance of long term debt provide current financial resources to governmental funds, but issuing such debt increases long-term liabilities in the statement of net assets.	(291,328)	-	(291,328)
Net increase (decrease) in net assets, as reported in the statement of activities	$3,347,104	(96,068)	$ 3,251,036

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Statement of Net Assets - Proprietary Fund
June 30, 2006

Restricted Assets		Business-Type Activities - Enterprise Fund Villas del Parque FmHA Project No. 63-033-0690660049
Current assets:		
Restricted assets:		
Cash in commercial banks	$	77,170
Tenants accounts receivable		1,445
Other assets		2,325
Total current assets		80,940
Non-current assets:		
Depreciable capital assets, net of accumulated depreciation of $2,130,631		1,564,874
Non-depreciable capital assets		96,229
Total non-current assets		1,661,103
Total assets	$	1,742,043
Liabilities and fund net assets		
Current liabilities (due within one year):		
Accounts payables and accrued liabilities, including accrued interests of $7,236	$	31,107
Current portion of mortgage notes payable		23,006
Total current liabilities		54,113
Non-current liabilities, excluding current portion		
Mortgage notes payable – due in more than one year		1,354,557
Total liabilities		1,408,670
Fund net assets:		
Invested in capital assets, net of related debt		283,540
Restricted for federal funded program		49,833
Total restricted net assets	$	333,373

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Statement of Revenues, Expenses and Changes in Fund Net Assets
Proprietary Fund
Fiscal year ended June 30, 2006

	Business-Type Activities - Enterprise Fund Villas del Parque FmHA Project No. 63-033-0690660049
Operating revenues:	
Intergovernmental grants and contributions – tenants assistance payments from U.S. Department of Housing and Urban Development	$ 347,926
Charge for services – rental income from tenants	31,764
Miscellaneous	16,442
Total operating revenues	396,132
Operating expenses:	
General and administrative	130,653
Utilities	16,803
Maintenance	122,219
Insurance	28,322
Interest on mortgage notes payable	101,041
Depreciation of capital assets	94,408
Total operating expenses	493,446
Operating loss	(97,314)
Non-operating income – interest on deposits	1,246
Net decrease in restricted fund net assets	(96,068)
Restricted fund net assets at beginning of fiscal year, as restated	429,441
Restricted fund net assets at end of fiscal year	$ 333,373

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

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Statement of Cash Flows
Proprietary Fund
Year Ended June 30, 2006

	(Unaudited) Business-Type Activities - Enterprise Fund Villas del Parque FmHA Project No. 63-033-0690660049
Cash flows from operating activities:	
Rent and other charges collected from tenants	$ 31,633
Collections from other operating activities	16,442
Payment to suppliers and employees	(312,933)
Net cash used by operating activities	(264,858)
Cash flows provided by non-capital financing activities – federal grants and contributions collected	347,926
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(110,915)
Principal paid on mortgage notes payable	(18,658)
Interest paid on mortgage notes payable	(101,041)
Net cash used in capital and related financing activities	(230,614)
Cash flows provided by investing activities – interest collected on deposits	1,246
Net decrease in restricted cash in commercial banks	(146,300)
Restricted cash in commercial banks at beginning of fiscal year	223,470
Restricted cash in commercial banks at end of fiscal year	$ 77,170
Reconciliation of net decrease in fund net assets to net cash used in operating activities:	
Net decrease in fund net assets	$ (96,068)
Adjustments to reconcile the net decrease in net assets to net cash used in operating activities:	
Depreciation expense of capital assets	94,408
Changes in operating assets and liabilities:	
Net decrease in accounts receivable from tenants	(131)
Net decrease in accounts payable and accrued liabilities	(263,067)
Total adjustments	(168,790)
Net cash used in operating activities	$ (264,858)

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

1. Summary of Significant Accounting Policies

The Municipality of Juana Díaz, Commonwealth of Puerto Rico (the Municipality), is a local municipal government constituted in 1798 in the Commonwealth of Puerto Rico. The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Law No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipal governments legally separated from the state government of the Commonwealth of Puerto Rico (the Commonwealth).

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

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

a) Financial Reporting Model

The accompanying basic financial statements present the financial position of the governmental activities, the business-type activities, each major governmental and proprietary funds, and the aggregate remaining fund information of the Municipality at June 30, 2006, in conformity with Accounting Principles Generally Accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). In addition, the accompanying basic financial statements present the changes in the financial position (results of operations) of the governmental activities, the business-type activities, each major governmental and proprietary funds, and the aggregate remaining fund information for the fiscal year ended June 30, 2006, in conformity with GAAP. Furthermore, the basic financial statements referred to above present the cash flows of the business-type activities (proprietary fund) for the fiscal year ended June 30, 2006 in conformity with GAAP.

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

RSI consists of: (1) a Management's Discussion and Analysis (MD&A) and (2) a budgetary comparison schedule – general fund. RSI is unaudited supplementary information required by GAAP presented along with, but separate from, the Municipality's basic financial statements.

MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2006, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

In addition to the required financial reporting requirements referred to above, the accompanying basic financial statements are accompanied by additional supplementary information consisting of a budgetary comparison schedule – debt service fund and the notes to the budgetary comparison schedule – debt service fund, which have been subjected to the auditing procedures applied in the audit of the accompanying basic financial statements as of and for the fiscal year ended June 30, 2006.

b) Financial Reporting Entity

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

The accompanying basic financial statements include the financial statements of Villas del Parque (FmHA Project No. 63-033-0690660049), an operational unit and a business-type activity (proprietary fund) of the Municipality which single audit report reflect total assets, liabilities, net assets, revenues and expenses of $1,742,043, $1,408,670, $333,373, $347,926 and $493,446, respectively, as of and for the fiscal year ended June 30, 2006. The financial position, results of operations and cash flows of Villas del Parque as of and for the fiscal year ended June 30, 2006 are reported in the accompanying statement of net assets – proprietary fund, the statement of revenues, expenses and changes in fund net assets – proprietary fund, and the statement of cash flows – proprietary fund, respectively.

Villas del Parque is a housing development project consisting of eighty-four (84) dwelling units located in Juana Díaz. The project is owned by the Municipality, but its operations are carried out by a private management agent unrelated to the Municipality. The housing development project of Villas del Parque has been designed to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The project operates under financing through the Section 8 New Construction and Substantial Rehabilitation Program of the U.S. Department of Housing and Urban Development and the Section 515 Rural Rental Housing Loans Program of the U.S. Department of Agriculture. The purpose of Villas del Parque is to provide adequate housing to low-income residents of the Municipality. Separate audited financial statements of Villas del Parque can be obtained directly from the management agent's offices at Professional Center Building, Suite 302, San Juan, Puerto Rico 00927.

On July 1, 2005, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

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

- The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.

- The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.

- The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14. The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2006.

Villas del Parque was erroneously reported as a blended component as part of the special revenue funds (under the modified accrual basis of accounting) on the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2005. Accordingly, after adopting GASB No. 39, on July 1, 2005, the Municipality recorded a fund reclassification to properly account for the financial position, the results of operations and the cash flows of Villas del Parque as a business-type activity (proprietary fund under the accrual basis of accounting) instead of as a blended component unit as of and for the fiscal year ended June 30, 2006. The effect of the fund reclassification and the change in basis of accounting were reported as prior-period adjustments to the respective fund balances as of July 1, 2005 in the amount of $429,441.

c) *Government-Wide Financial Statements*

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

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

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

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

- **Invested in capital assets, net of related debt** – This net asset category consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.

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

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

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

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

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

(1) **Debt service** – Represent net resources available to cover future debt service payments of bonds and notes payable.

(2) **Federal and state funded programs** – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs.

- **Unrestricted net liabilities** – This category consists of the excess of liabilities over related assets (accumulated deficit) that are neither externally nor legally restricted, neither invested in capital assets. However, assets reported within unrestricted net liabilities often are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints that are imposed by management but can be removed or modified. When both restricted and unrestricted resources are available for use, it is the Municipality's policy to generally use restricted resources first, and then unrestricted resources as they are needed.

The accompanying statement of activities presents the Municipality's results of operations by showing, how the Municipality's net assets or liabilities changed during the fiscal year ended June 30, 2006, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

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

General government:
Municipal legislature
Mayor's office
Department of finance

Department of human resources
Department of municipal secretary
Department of internal audit
Office of communications
Office of administrative services

Urban and economic development:
Department of public works
Department of planning and development

Public safety:
Department of emergency management – civil defense
Department of municipal police
Department of sanitation

Health and sanitation:
Department of recycling services
Municipal enterprises
Department of health

Culture, recreation and education:
Department of sports and recreation
Department of art, culture and tourism

Public housing and welfare:
Department of citizen affairs

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in three broad categories: (1) program revenues, (2) general revenues and (3) special items.

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

- **Charges for services** – These revenues generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, rent, charges for licenses and permits, and fines and forfeitures, among others.

- **Program-specific operating and capital grants and contributions** – These revenues consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Capital grants and contributions consist of revenues or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

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

Special items consist of revenues arising from significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence.

Extraordinary items consist of revenues arising from significant transactions or other events that are both unusual in nature and infrequent in occurrence.

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

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

The Municipality classifies the most significant portion of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the FFS. On the other hand, the operations of Villas del Parque are reported as business-type activities in the accompanying GWFS. These activities are primarily financed from grants and contributions and charges for services. These business-type activities are also reported in the FFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements.

The Municipality has operations and activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is financed primarily through user charges; and where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

d) Fund Financial Statements

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

The accompanying FFS are composed of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances (deficits) – governmental funds, (3) the statement of net assets – proprietary fund, (4) the statement of revenues, expenses and changes in fund net assets – proprietary fund, and (5) the statement of cash flows – proprietary fund.

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

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

- ***General fund*** – The general fund is the Municipality's main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.

- ***Debt service fund*** – The debt service fund is a major governmental fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. During the fiscal year ended June 30, 2006, the financial activity accounted for in the debt service fund was specifically related to bonds payable.

  The outstanding balance of general long-term obligations for which debt service payments do not involve the advance accumulation of resources (such as notes payable and obligations under capital leases) are only accounted for in the accompanying statement of net assets. The debt service payments of such debts, as applicable, are generally accounted for as debt service – principal and debt service – interest expenditures in the general fund, except for certain notes payable to HUD, which are accounted for in the Section 108 loan guarantee fund and other debt which are accounted for within other governmental funds.

- ***Special revenue funds*** – The special revenue funds are major and non-major governmental funds, as defined below, used by the Municipality to account for revenues derived from grants, contributions or other revenue sources that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in major capital projects which are accounted for in the capital project funds). The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

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

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

- ***Proprietary fund*** – Proprietary fund is a fund used to report the financial position, results of operation and cash flows of Villas del Parque (FmHA Project No. 63-033-

0690660049),which are activities for which the intent of management is to recover, partially through user charges for services (rent) and mostly through federal grants, the cost of low-income housing services to the general public.
The activities of Villas del Parque have been reported as a proprietary fund since GAAP permits the use of enterprise funds to report any activity for which a fee is charged to external users of goods or services, regardless of whether the government intends to fully recover the cost of the goods or services provided. Thus, it is common to use proprietary fund reporting to account for services where the government intends to recover only a portion of its costs through fees or user charges (GASB No. 34, paragraph 67).

As required by GASB No. 34, the proprietary fund of the Municipality applies all pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB) and the Committee on Accounting Procedure, issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict the standards of the Governmental Accounting Standards Board. However, the Municipality has elected to continue following more recent FASB guidance, provided it neither conflicts nor contradicts GASB pronouncements.

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

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund is classified as a major governmental fund in the FFS if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. In addition, the same element that meets the 10 percent criterion must be at least 5 percent of the corresponding element total for all governmental and enterprise (proprietary) funds combined. For the purposes of applying the aforementioned major fund criteria, no eliminations of inter-fund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures\expenses for these purposes mean all expenditures\expenses, including operating and non-operating expenditures\expenses, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying FFS are: (1) the general fund, (2) the debt service fund, (3) the head start fund, (4) the legislative joint resolutions fund and (5) the section 108 loan guarantee fund. In addition, Villas del Parque has been reported separately from governmental funds as the only proprietary fund of the Municipality.

The head start fund is a special revenue fund used to account for the receipts and disbursements of the head start program grant administered by the Administration for the Integral Care and Development of Children of the Commonwealth of Puerto Rico, as a pass-through entity of the U.S. Department of Health and Human Services.

The legislative joint resolutions fund is a major capital projects fund used to account for financial resources that are assigned by the Legislature of the Commonwealth of Puerto Rico principally for use in the acquisition, construction or improvement of major capital facilities and assets.

The section 108 loan guarantee fund is a major capital projects fund used to account for loan proceeds received pursuant to an application under Section 108 of the Housing and Community Development Act of 1974 (Section 108). These loan proceeds are uses in the construction of the Fine Arts Center and other major capital facilities for the benefit of low- income communities.

The accompanying FFS are accompanied by other statements and schedules required by GAAP: (1) the reconciliation of the balance sheet – governmental funds to the statement of net assets, and (2) the reconciliation of the statement of revenues, expenditures and changes in fund balances – governmental funds to the statement of activities.

e) Measurement Focus and Basis of Accounting

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

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

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

Proprietary funds distinguish operating revenue and expenses from non-operating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenue and expenses not meeting this definition are reported as non-operating revenue and expenses. The major operating revenue of the Municipality's enterprise fund is from rent charges collected principally from a Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with U.S. Department of Housing and Urban Development.

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

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

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to the Municipality and the provider government requires the Municipality to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

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

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

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

Governmental fund financial statements – The accompanying governmental fund financial statements are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances (deficits) – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality considers most revenues to be available if collected generally within 90 days after June 30, 2006, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred (earned and unavailable) revenues at June 30, 2006.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, construction excise taxes, intergovernmental grants and contributions, interest on deposits and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying governmental fund financial statements, except for amounts recorded as deferred (earned and unavailable) revenues.

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

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

Interest on deposits is recorded when earned only if collected within 90 days after the fiscal year-end since these revenues would be considered both measurable and available.

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

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

- Principal and interest on bonds payable are recorded when they mature (when payment is due), except for principal and interest due on July 1, 2006, which have been recorded as governmental fund liabilities at June 30, 2006, which is the date when resources are available in the debt service fund (generally, June 30).

- Notes payable, obligations under capital leases, compensated absences, and amounts subject to accrued claims and judgments under litigation are recorded only when they mature (when payment is due).

- Certain accrued liabilities not due and payable or not normally expected to be liquidated with current available and expendable financial resources are recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.

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

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

f) Stewardship, Compliance and Accountability

Budgetary Control

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

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

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

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

The annual budgets may be updated for any estimate revisions as well as fiscal year-end encumbrances, and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.
The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the function/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

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

Budgetary Accounting

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

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

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

The accompanying budgetary comparison schedule – general fund and the budgetary comparison schedule – debt service fund provide information about the general and debt service funds' original budgets, its amendments, and the actual results of operations of such major governmental funds under the budgetary basis of accounting for the fiscal year ended June 30, 2006. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2006, which is prepared by the Municipality's Department of Finance. Copies of that report may be obtained by writing to the Municipality's Director of Finance.

Because accounting principles applied for the purposes of the developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the general and debt service funds' budgetary bases and GAAP actual amounts are presented at the bottom of the respective budgetary comparison schedules.

g) Unrestricted and Restricted Deposits

The Municipality's deposits are composed of: (1) cash on hand, (2) demand deposits in commercial banks, (3) demand deposits in the Government Development Bank for Puerto Rico (fiscal agent) and (4) cash equivalents in commercial banks.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements and any unrestricted excess, if any, is invested in certificates of deposit with commercial banks. Any deficiency in the pooled cash account is assumed by the general fund and covered through future budgetary appropriations. At June 30, 2006, the deficiency in the pooled cash account amounted to $220,379, which has been recorded within accounts payable and accrued liabilities. However, no budgetary resources have been provided by the general fund for such purposes at June 30, 2006.

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

Cash in fiscal agent in the debt service fund consists of cash related to property tax collections amounting to $1,969,495 which are restricted for the payment of the Municipality's debt service of bonds payable, as required by law. Cash in fiscal agent in the other governmental funds, amounting to $1,577,749, consists principally of unspent proceeds of bonds, which are restricted for the acquisition, construction or improvement of major capital assets.

Restricted cash in commercial banks of the head start fund, amounting to $13,251, represents the balance of a non-interest bearing account restricted to finance the operations of this federal financially assisted program. Restricted cash in commercial banks for the legislative joint resolutions fund, amounting to $166,216, represents the balance of an interest bearing account whose proceeds arose from grants and contributions from the Legislature of the Commonwealth of Puerto Rico which are restricted to principally finance the acquisition, construction or improvement of major capital assets and other activities. The restricted cash in commercial banks of the Section 108 loan guarantee fund, amounting to $1,712,389, consists of unspent proceeds from notes payable to the U.S. Department of Housing and Urban Development under the Section 108 loan guarantee program, which are restricted for the construction of major capital assets. Restricted cash in commercial banks for other governmental funds, amounting to $1,953,893, represents the balance of interest bearing and non-interest bearing accounts restricted to finance the operations of certain federal, state and local funded programs.

Restricted cash equivalents consist of certificates of deposit with original maturities of three months or less, amounting to $1,500,000 at June 30, 2006, which arose from unspent proceeds from notes payable to the U.S. Department of Housing and Urban Development under the Section 108 loan guarantee program, which is restricted to finance the construction of major capital assets.

Restricted cash in commercial banks of Villas del Parque (proprietary fund), amounting to $77,170, represents the balance of interest and non-interest bearing accounts restricted to finance the project operations. Villas del Parque is required to set amounts for the replacement of property and other project expenditures, as approved by the U.S. Department of Housing and Urban Development. Accordingly, the restricted cash balances of Villas del Parque include a replacement reserve of $21,417.

h) Unrestricted and Restricted Accounts Receivable

Accounts receivable consist of all revenues earned but not collected at June 30, 2006. These accounts receivables are stated net of estimated reserved for doubtful accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

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

i) Other Current Assets

Other current assets in the accompanying statement of net assets and the balance sheet – governmental funds consist principally of prepaid costs, which are capitalized rather that charged to operations.

j) Deferred Charges

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

k) Capital Assets

Capital assets used in governmental and business-type activities include land and land improvements, buildings, structures and building improvements, machinery and equipment (including equipment held under capital leases), furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets and the statement of net assets – proprietary fund. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost basis of $25 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under $25 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities and the statement of revenues, expenses and changes in fund net assets. In the governmental funds, all capital assets are recorded as capital outlays (expenditures), while all assets with individual costs under $25 are recorded as expenditures in the corresponding function/program identified with the asset.

In the statement of net assets and the statement of net assets – proprietary fund, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a portion of the infrastructure constructed or acquired prior to June 30, 2003 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2003 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

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

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

	Years
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Motor vehicles	5
Furniture, fixtures, machinery and equipment, excluding those held under capital leases	5 to 20
Office equipment held under capital leases	3 to 5

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

l) Deferred Revenues

In the governmental fund financial statements, deferred revenue arises when one of the following situations occur:

- Potential revenue does not meet both the "measurable" and "available" criteria for revenue recognition in the current period (reported as *"earned and unavailable revenue"* in the accompanying balance sheet-governmental funds). As previously discussed, available is defined as due (or past due) at June 30, 2006 and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria (measurable and available) are met, the liability for deferred revenue is removed and revenue is recognized.

- The Municipality receives resources before it has a legal claim to them (reported as *"unearned revenue"* in the accompanying balance sheet-governmental funds). In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

Unearned revenues at the government-wide and the proprietary fund levels arise only when the Municipality receives resources before it has a legal claim to them (reported as *"unearned revenue"* in the accompanying statement of net assets). No *"earned and unavailable revenue"* is accounted for in the accompanying statement of net assets nor the statement of net assets – proprietary fund.

m) Compensated Absences

The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2006 and (2) is not contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

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

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

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

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

n) Long-term Debt

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

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due on July 1, 2006 have been recorded as governmental fund liabilities in the debt service fund at June 30, 2006, when resources were available. In the governmental fund financial statements, the face amount of debt issued (gross debt proceeds) is reported as other financing sources when issued.

In the governmental activities of the GWFS, debt issuance costs have been capitalized and reported as deferred charges, which are being amortized under the straight-line method over the respective lives of the debts. In the GFFS, such costs are recorded as expenditures as incurred.

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

o) Leases

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

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

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

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

In the governmental fund financial statements, the net present value of the minimum lease payments at the inception of the capital lease, if applicable, is recorded simultaneously as: (1) capital outlays and (2) other financing sources. Minimum lease payments are recorded as expenditures in the governmental fund financial statements.

p) *Accounting for Pension Costs*

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the state government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto

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

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

q) *Risk Management*

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

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration (ACAA, by its Spanish acronym), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium applicable at June 30, 2006 is $35 per licensed motor vehicle, which is paid directly to ACAA.

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

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a cost reimbursement basis.

The Municipality also obtains medical insurance coverage from several health insurance companies for its employees. Different health insurance coverage and premium options are negotiated each year by the Department of Treasury on behalf of the Municipality. The current insurance policies have not been canceled or terminated at June 30, 2006. Premiums are paid on a monthly basis directly to the insurance company. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

r) Reservations of Fund Balances

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

- ***Encumbrances*** – Represent reservations of fund balances for commitments related to unperformed (executory) contracts for goods or services (future expenditures under purchase orders, contracts and other commitments). These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future fiscal years as the goods or services are received.

- ***Debt service*** – Represent fund balances available and restricted to cover future debt service payments (principal and interest) on bonds payable, which are accounted for in the debt service fund.

- ***Capital projects*** – Represent the reservation of financial resources that are restricted for the acquisition, construction or improvement of major capital assets under contracts and other commitments. These amounts are accounted for in the capital projects funds.

- ***Advances from other governmental funds*** – Represent the reservation of financial resources set aside for long-term inter-fund receivables, which are not considered current available financial resources at June 30, 2006.

- ***Other restricted assets*** – Represent fund balance restricted for other assets which are not considered current available financial resources at June 30, 2006.

- ***Federal and state funded programs*** – Represent financial resources set aside for use in federal and state grant programs.

s) Inter-fund Activities

The Municipality has the following types of reciprocal and non-reciprocal inter-fund activities recorded among governmental funds in the accompanying FFS:

- ***Inter-fund loans*** – Represent resources (assets) provided by one governmental fund to other governmental fund with a requirement and commitment for repayment (reimbursement), which are recorded as *"due from"* in the lender governmental fund and *"due to"* in the borrower governmental fund. Inter-fund receivables, which are not considered to be currently available financial resources, are reported as *"advances"*. For amounts not expected to be collected, inter-fund receivables/payables are reduced to their estimated realizable (settlement) value, and the portion of the inter-fund loan that is not expected to be repaid is reported as a *"transfer-in"* from the governmental fund that provided the loan.

- ***Inter-fund transfers (transfers-in/(out))*** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as *"other financing uses"* in the governmental fund making transfers and as *"other financing sources"* in the governmental fund receiving transfers.

- ***Inter-fund reimbursements*** – Represent repayments (reimbursements) from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

In the FFS, inter-fund activity has not been eliminated, as permitted by GAAP.

t) Use of Estimates

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

u) Future Adoption of Accounting Pronouncements

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

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

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

v) Reclassifications

During the current fiscal year, the Municipality made certain fund and balance reclassifications to obtain a more meaningful financial reporting as of and for the fiscal year ended June 30, 2006. In addition, the Municipality made significant changes in content and structure to the basic financial statements as of and for the fiscal year then ended. Accordingly, the accompanying basic financial statements are not easily comparable with prior years' financial statements.

The effects of implementing the aforementioned fund and balance reclassifications have been reported as restatements of fund balances/deficits at July 1, 2005 in the accompanying governmental and proprietary fund financial statements (see note 14).

As more fully described in Note 1, the Municipality recorded a fund reclassification to properly account for the financial position, the results of operations and the cash flows of Villas del Parque as a business-type activity (proprietary fund under the accrual basis of accounting) instead of as a blended component unit as of and for the fiscal year ended June 30, 2006.

2. Deposits

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

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

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico.* Accordingly, the Municipality is only allowed to invest its obligations of the Commonwealth, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2006.

- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investments portfolio at June 30, 2006, (2) limiting the weighted average maturity of its investments to periods of three months or less and (3) keeping most of its banks deposits in interest bearing accounts generating interest at prevailing market rates. At June 30, 2006, the interest rate risk associated with the Municipality's cash and cash equivalent is considered low.

- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico,* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of $100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits of GDB, amounting to $3,547,244 at June 30, 2006, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2006. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2006, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

- **Foreign exchange risk** – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2006.

Cash and cash equivalents at June 30, 2006, are classified in the accompanying balance sheet – governmental funds a follows:

	Major governmental funds						
	General fund	Debt service fund	Head start fund	Legislature joint resolutions fund	Section 108 loan guarantee fund	Other governmental funds	Total
Unrestricted:							
Cash in commercial banks	$ 2,267	-	-	-	-	-	$ 2,267
Cash equivalents in commercial banks	-	-	-	-	-	-	-
Total unrestricted deposits	2,267	-	-	-	-	-	2,267
Restricted:							
Cash in commercial banks	-	-	13,251	166,216	1,712,389	1,953,893	3,845,749
Cash in GDB, as fiscal agent	-	1,969,495	-	-	-	1,577,749	3,547,244
Cash equivalents in commercial banks	-	-	-	-	1,500,000	-	1,500,000
Total restricted deposits	-	1,969,495	13,251	166,216	3,212,389	3,531,642	8,892,993
Total carrying amount of deposits	$ 2,267	1,969,495	13,251	166,216	3,212,389	3,531,642	$ 8,895,260
Excess of checks drawn over bank recorded within accounts payable and accrued liabilities	$ 220,379	-	-	-	-	-	$ 220,379

As more fully described in Note 12, during the prior fiscal years, the general fund of the Municipality suffered recurring excesses of expenditures and other financing uses over revenues and other financing sources which have lead to a general fund's deficit of $1,394,006 at June 30, 2006 and certain liquidity and cash flows shortfalls during the fiscal year then ended. In addition, the Municipality has cash in commercial banks of $2,267 and an excess of checks drawn over bank balances of $220,379 recorded within accounts payable and accrued liabilities of the general fund at June 30, 2006.

3. Municipal License Taxes

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of Juana Díaz. This is a self-assessed tax generally based on the business volume of taxpayers, measured by gross revenues. The Municipality establishes the applicable tax rates. At June 30, 2006, the municipal license tax rates imposed by the Municipality were 1.50 percent for financial institutions and 0.50 percent for other types of taxpayers. Any taxpayers that have been granted with a partial tax exemption under any of the tax incentive acts of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

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

Total municipal license tax receivable, net of its reserve for doubtful accounts of $35,711, amounted to $83,744 at June 30, 2006.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as unearned revenues in the GWFS and the general fund. Unearned municipal license tax revenues recorded in the accompanying GWFS and the general fund amounted to $1,406,054 at June 30, 2006. Those unearned municipal license revenues collected in advance pertain to the general fund's operating budget of the fiscal year 2006-2007, therefore, generally cannot be used to pay obligations of the fiscal year 2005-2006.

The unearned municipal license, recorded in the general fund at June 30, 2006, include municipal license tax revenues of the fiscal year 2006-2007 amounting to $1,382,454, which were collected in advance from taxpayers between January and June, 2006 (known in Spanish as "Patente en Suspenso"). These amounts were consumed by the Municipality prior to June 30, 2006 to cover certain operating costs incurred and certain cash flows shortages suffered by the Municipality during the fiscal year ended June 30, 2006.

In addition, the deferred revenue related to the earned and unavailable municipal licenses recorded in the accompanying general fund amounted to $12,099 at at June 30, 2006.

4. Property Taxes

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

The Municipal Revenue Collection Center (CRIM, by its Spanish acronym) is a governmental entity not related to the Municipality which is responsible for the billings and collections of real and personal property taxes on behalf of the Municipality and all other municipalities in the Commonwealth of Puerto Rico. Prior to the beginning of each fiscal year, CRIM informs to the Municipality the estimated amount of property taxes expected to be collected for the ensuing fiscal year. Throughout the fiscal year, CRIM advances funds (estimated collections) to the Municipality based on the initial estimated (forecasted) collection amounts for the fiscal year. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and the property tax amounts actually collected from taxpayers on behalf of the Municipality during the fiscal year. This settlement has to be completed on a preliminary basis not later than December 31 following the fiscal year end. If in any given fiscal year, CRIM remits to the Municipality property tax advances that are less than the property taxes actually collected by CRIM on behalf of the Municipality, then CRIM will increase the amount of the monthly property tax advances during for the next fiscal year. However, if advances exceed the amount actually collected by CRIM, then CRIM will reduce the amount of the monthly property tax advances during the next fiscal year

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2006 was 7.03 percent (of which taxpayers pay 6.83 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property, deflated to 1957 market prices. The total real property tax rate in force at June 30, 2006 was 9.03 percent (of which 8.83 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

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

According to Law No. 81, included within the total personal and real property tax rates of 7.03 percent and 9.03 percent, respectively, there is a levy of an annual special tax of 1.03 percent of the assessed value of all real and personal property not exonerated from taxation. This special tax is levied by the Commonwealth of Puerto Rico but is collected by CRIM. Collections of this special tax are directly remitted by CRIM to the debt service fund of the Commonwealth of Puerto Rico, for the payment of the general long-term debt of the state government.

In addition, included within the total personal and real property tax rates of 7.03 percent and 9.03 percent, respectively, there is a portion of the tax rate in the amount of 2.00 percent that is restricted for the Municipality's debt service requirements of bonds. Such amounts are recorded in the Municipality's debt service fund.

The portion of the property taxes recorded in the general fund is used to finance the operating activities of the Municipality, including the payment of: (1) the insurance premiums acquired through the Puerto Rico Department of Treasury, (2) the monthly contributions to CRIM, which are statutorily required as the Municipality's share of CRIM's operating expenses, (4) statutory contributions to the Puerto Rico Health Services Administration (PRHSA), as the Municipality's share of the cost of the public health insurance coverage provided to qualifying low-income citizens, (5) certain notes payable to CRIM and the Puerto Rico Department of Treasury and, (6) certain amounts due to certain agencies and component units of the Commonwealth, which are recorded within intergovernmental payables in the accompanying GWFS and GFFS. The 0.20 percent of unrestricted personal and real property taxes paid by the Puerto Rico Department of Treasury as a subsidy is recorded in the Municipality's general fund.

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

- Thirty five percent of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth of Puerto Rico, of which a maximum of $26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.

- An additional amount not exceeding $16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the thirty-five percent corresponding to the municipalities of the Commonwealth of Puerto Rico. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to PRHSA.

At June 30, 2006, property taxes receivable recorded in the general and debt service fund amounted to $1,018,173 and $388,749, respectively, net of a reserve for doubtful accounts of $8,337,456 and $3,183,327, respectively.

At June 30, 2006, unearned property taxes amounted to $49,293 which was recorded in the debt service fund. In addition, at June 30, 2006, the earned and unavailable property taxes (deferred revenues) reported in the accompanying general fund and debt service fund, amounted to $969,372 and $322,198, respectively.

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5. Intergovernmental Receivables and Payables

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

	Major governmental funds	Other governmental funds	Total governmental funds	Statement of net assets
Intergovernmental receivables:				
Grants and contributions:				
U.S. Department of Housing and Urban Development - Community Development Block Grants Program	$ -	336,102	336,102	$ 336,102
U.S. Department of Justice - Public Safety Partnerships and Community Policing Grants	-	75,219	75,219	75,219
Puerto Rico Department of Transportation and Public Works	-	154,286	154,286	154,286
Legislature of the Commonwealth of Puerto Rico	1,519,154	-	1,519,154	1,519,154
Puerto Rico Rural Development Corporation	-	66,585	66,585	66,585
Puerto Rico Department of Labor	-	5,000	5,000	5,000
Puerto Rico Treasury Department – general fund	176,150	-	176,150	176,150
Puerto Rico Department of Education	-	65,211	65,211	65,211
Puerto Rico Office of the Commissioner of Municipal Affairs	-	117,547	117,547	117,547
Puerto Rico Administration for Integral Care and Development of Children	-	221,321	221,321	221,321
Puerto Rico Department of Agriculture	-	202,057	202,057	202,057
Puerto Rico Special Communities Office	-	75,843	75,843	75,843
Total intergovernmental receivables	$ 1,695,304	1,319,171	3,014,475	$ 3,014,475
Intergovernmental payables:				
Payroll withholdings (general fund):				
U.S. Department of Treasury - Internal Revenue Service	$ 60,149	-	60,149	$ 60,149
Association of Employees of Commonwealth of Puerto Rico	8,850	-	8,850	8,850
Puerto Rico Treasury Department	5,889	-	5,889	5,889
State Insurance Fund Corporation	33,488	-	33,488	33,488
Employees Retirement System of the Government of the Commonwealth of Puerto Rico	74,244	-	74,244	74,244
Puerto Rico Department of Labor	17,345		17,345	17,345
Utilities (general fund):				
Puerto Rico Aqueduct and Sewer Authority	47,837	-	47,837	47,837
Puerto Rico Electric Power Authority	32,229	-	32,229	32,229
Miscellaneous (general fund):				
Puerto Rico Solid Waste Authority	21,928	-	21,928	21,928
Puerto Rico Land Authority	2,988	-	2,988	2,988
General Services Administration	76,435	-	76,435	76,435
Total intergovernmental payables	$ 381,382	-	381,382	$ 381,382

Intergovernmental receivables and payables represent the pending settlements of the aforementioned intergovernmental transactions.

As noted above, the other governmental (nonmajor) funds of the Municipality reported as part of its assets, intergovernmental receivables amounting to $1,319,171 at June 30, 2006 of which $522,926 represent intergovernmental receivables that have been outstanding for a period of time significantly longer than one fiscal year without being collected. The Municipality did not have complete and accurate accounting records of intergovernmental receivables at June 30, 2006, including a subsidiary record documenting the collection procedures made by management and the repayment and other terms and conditions of such balances. The ultimate outcome of the existence, valuation and collectibility of the aforementioned receivables cannot presently be determined. However, If these balances would have been written-off and charged to expenditures during the current fiscal year, the total fund balances of the other governmental (nonmajor) funds would have been reduced by $522,926 in the accompanying balance sheet - governmental funds at June 30, 2006 and, the net decrease in fund balances (deficits) of such nonmajor governmental funds would have been increased also by $522,926 in the accompanying statement of revenues, expenditures and changes in fund balances (deficits).

6. Inter-fund Transactions

The composition of inter-fund balances at June 30, 2006 and for the fiscal year then ended is as follows:

	Due/advances from:					
	Major governmental funds					
Due/advances to:	General fund	Debt service fund	Head start fund	Legislature joint resolutions fund	Other governmental funds	Total governmental funds
Major governmental funds:						
General fund	$ -	346,738	39,670	20,369	436,177	$ 842,954
Debt service fund	17,229	-	-	-	-	17,229
Head start fund	-	-	-	-	10,000	10,000
Non-major governmental funds:						
Capital projects funds	140,195	-	-	-	-	140,195
Special revenue funds	1,386,384	-	-	-	68,749	1,455,133
Total	$ 1,543,808	346,738	39,670	20,369	514,926	$ 2,465,511

	Transfers out:					
	Major governmental funds					
Transfers in:	General fund	Debt service fund	Head start fund	Legislature joint resolutions fund	Other governmental Funds	Total governmental funds
Major governmental funds:						
General fund	$ -	55,196	-	-	462,207	$ 517,403
Debt service fund	372,874	-	-	-	-	372,874
Head start fund	921,578	-	-	-	-	921,578
Section 108 loan guarantee fund	-	-	-	-	650,637	650,637
Non-major governmental funds:						
Capital projects funds	13,238	-	-	46,187	-	59,425
Special revenue funds	172,648	-	-	-	14,454	187,102
Total	$ 1,480,338	55,196	-	46,187	1,127,298	$ 2,709,019

The principal purposes of inter-fund receivables and payables are:

- Recognize in the debt service fund the amounts due from the general fund to cover the principal and interest payments on certain bonds, amounting to $346,738. These payments are due on July 1, 2006.

- Recognize in the head start fund the amounts advances from the general fund to record the commitment of the general fund to cover the fund deficit of $39,670 at June 30, 2006.

- Recognize in the joint resolutions fund the amounts due from the general fund for cash loans to the general fund, amounting to $20,369, to satisfy general fund current bank account cash needs.

- Recognize in the other governmental funds the amounts due from the general fund mostly for loans to the general fund, amounting to $436,177, to satisfy general fund current bank account cash needs.

- Recognize in the general fund the outstanding balance of the loans granted to non-major capital project and special revenue funds ($140,195 and $1,386,384, respectively) to temporarily cover the payroll and other operating costs of several federally and state funded programs.

- Recognize in the general fund the interests earned by the deposits of the debt service fund during the quarter ended June 30, 2006 ($17,229), which were transferred to the general fund subsequently in July 2006.

The principal purposes of inter-fund transfers are to:

- Make a routinary transfer of interest income, amounting to $55,196, from the debt service fund to the general fund, as permitted by law. This interest income is generated by the debt service fund's deposits and is transferred on a quarterly basis to the general fund.

- Make a non-routinary residual equity transfer from other governmental funds, amounting to $391,541 (included in the $462,207 detailed above), to the general fund, due to the closing of a special revenue fund.

- Make a routinary transfer of interest income, amounting to $59,161 (included in the $462,207 detailed above), from the other governmental funds to the general fund, as permitted by law. This interest income is generated by the other governmental fund's deposits and is transferred on a monthly basis to the general fund.

- Make a routinary transfer of resources, amounting to $372,874, from the general fund to the debt service fund to cover the principal and interest payments on certain bonds. These debt service payments were made on January and July 2006.

- Make a routinary transfer of general fund matching share contributions from the general fund to the head start fund, amounting to $921,578.

- Make a routinary transfer of resources, amounting to $650,637, from the Community development block grants program fund (recorded within other governmental funds) to the Section 108 loan guarantee fund to cover the debt service interest payments of certain notes payable to the U.S. Department of Housing and Urban Development. These debt service payments were made on August 2005 and February 2006.

- Make a routinary transfer of cash from the general fund, amounting to $185,886, to non-major capital projects funds and special revenue funds ($13,238 and $172,648, respectively), to cover the costs of program operations, and for the acquisition, construction and improvement of capital assets.

Inter-fund receivables and payables represent the pending settlements of the aforementioned transfers. At June 30, 2006, the general fund of the Municipality reported as part of its inter-fund receivables, the advances due from other governmental funds amounting to $1,090,987 of which $994,075 represent inter-fund loans that have been outstanding for a period of time significantly longer than one fiscal year without being collected. The Municipality did not have complete and accurate accounting records of inter-fund balances, including a subsidiary record documenting the collection procedures made by management and the repayment and other terms and conditions of inter-fund loans, transfers and reimbursements among governmental funds. The ultimate outcome of the existence, valuation and collectibility of the aforementioned inter-fund advances cannot presently be determined. However, if these balances would have been written-off and charged to inter-fund transfer expenditures during the current fiscal year, the total accumulated deficit of the general fund would have been increased by $994,075 in the accompanying balance sheet – governmental funds. In the other hand, the results of operations of the general fund would have reflected a deficiency of revenues and other financing sources under expenditures and other financing uses of $982,643 for the fiscal year then ended, instead of an excess of revenues and other financing sources over expenditures and other financing uses of $11,432, as reported in the accompanying statement of revenues, expenditures and changes in fund balances (deficits). An inverse effect to that of the general fund is present in the other (nonmajor) governmental funds were the respective advances due to general fund amounting to $994,075 were recorded in the accompanying balance sheet – governmental funds at June 30, 2006.

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7. Capital Assets

Capital assets activity for the fiscal year ended June 30, 2006:

a) *Governmental Activities*

	Cost basis at beginning of fiscal year, as restated	Additions	Cost basis at end of fiscal year
Cost basis:			
Capital assets, not being depreciated:			
Land	$ 2,441,035	-	$ 2,441,035
Construction in progress	7,849,504	-	7,849,504
Total capital assets, not being depreciated	10,290,539	-	10,290,539
Capital assets, being depreciated:			
Buildings, structures, and improvements	24,016,868	6,142,241	30,159,109
Infrastructure	5,744,173	1,198,218	6,942,391
Machinery and equipment, and furniture and fixtures	3,550,730	401,277	3,952,007
Office equipment under capital leases	176,854	30,214	207,068
Licensed vehicles	4,601,846	549,350	5,151,196
Total capital assets, being depreciated	38,090,471	8,321,300	46,411,771
Total cost basis of capital assets	$ 48,381,010	8,321,300	$ 56,702,310

	Accumulated depreciation at beginning of fiscal year, as restated	Depreciation expense	Accumulated depreciation at end of fiscal year
Accumulated depreciation:			
Buildings, structures, and improvements	$ 7,778,941	704,500	$ 8,483,441
Infrastructure	1,088,744	244,357	1,333,101
Machinery and equipment, and furniture and fixtures	2,901,253	287,913	3,189,166
Office equipment under capital leases	33,376	37,050	70,426
Licensed vehicles	3,438,874	507,949	3,946,823
Total accumulated depreciation	15,241,188	1,781,769	17,022,957
Net capital assets, governmental activities	$ 33,139,822	6,539,531	$ 39,679,353

The Municipality did not have complete and accurate accounting records of capital assets at June 30, 2006 and a physical inventory and a valuation of its capital assets of governmental activities was not performed during the fiscal year ended June 30, 2006.

The infrastructure assets recorded in the accompanying statement of net assets for $5,809,290 (net of accumulated depreciation of $1,133,101) do not include a substantial portion of the Municipality's general infrastructure assets that were constructed or acquired by the Municipality from 1980 through June 30, 2006.

Construction in progress assets have not bee updated at June 30 2006 to reflect the construction activity for the fiscal year ended June 30, 2006. The balance of $7,849,504 recorded in the accompanying statement of net assets at June 30, 2006 has been carried over from the prior fiscal year's financial statements.

Several real property assets, including buildings, structures, land and land improvements have not been recorded in the accompanying statement of net assets at June 30, 2006.

During the fiscal year ended June 30, 2006, the Municipality did not adopt the provisions of Statement No. 42, *Accounting and Financial Reporting of Impairments of Capital Assets and for Insurance Recoveries*, issued by the Governmental Accounting Standards Board (GASB No. 42), which required the Municipality to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred.

Depreciation and amortization expense of governmental activities for the fiscal year ended June 30, 2006 was charged to functions/programs in the accompanying statement of activities as follows:

General government	$ 82,690
Public safety	158,152
Economic and urban development	759,450
Health and sanitation	34,406
Culture, recreation, and education	747,071
Total depreciation and amortization expense	$ 1,781,769

b) *Business-type Activities*

	Cost basis at beginning of fiscal year	Additions	Cost basis at end of fiscal year
Business-type activities:			
Cost basis:			
Capital assets, not being depreciated - land	$ 96,229	-	$ 96,229
Total capital assets, not being depreciated	96,229	-	96,229
Capital assets, being depreciated:			
Buildings, structures, and improvements	3,327,536	109,728	3,437,264
Machinery and equipment, and furniture and fixtures	257,054	1,187	258,241
Total capital assets, being depreciated	3,584,590	110,915	3,695,505
Total cost basis of capital assets	$ 3,680,819	110,915	$ 3,791,734

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	Accumulated depreciation at beginning of fiscal year	Depreciation expense	Accumulated depreciation at end of fiscal year
Accumulated depreciation and amortization:			
Buildings, structures, and improvements	$ 1,806,667	86,144	$ 1,892,811
Machinery and equipment, and furniture and fixtures	229,556	8,264	237,820
Total accumulated depreciation	2,036,223	94,408	2,130,631
Net capital assets, business-type activities	$ 1,644,596	16,507	$ 1,661,103

Depreciation and amortization expense of business-type activities, amounting to $94,408 for the fiscal year ended June 30, 2006, was charged to the public housing and welfare function in the accompanying statement of activities.

c) *Construction Commitments*

The following table shows the most significant active commitments on construction projects as of June 30, 2006. Those projects include the construction of the Fines Arts Center and the construction of the Recreational and Sports Stadium.

Project	Spent to date	Remaining commitment
Fines Arts Center	$ 2,977,052	$ 2,021,094
Recreational and Sports Stadium	2,498,432	6,604,788
Total construction commitments	$ 5,475,484	$ 8,625,882

The commitment for the Fines Art Center project is being financed with the proceeds of notes payable under the Section 108 loan guarantee program, sponsored by the U.S. Department of Housing and Urban Development. Those notes will be repaid with grant resources from the Community Development Block Grants – Entitlement Grants and with grants from legislative joint resolutions assigned by the Legislature of the Commonwealth of Puerto Rico. The commitment for the Recreational and Sports Stadium is being financed with grants from legislative joint resolutions assigned by the Legislature of the Commonwealth of Puerto Rico.

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8. Deferred Revenues

At June 30, 2006, deferred revenues recorded in the GWFS and the governmental fund financial statements are as follows:

	General fund	Debt service fund	Nonmajor special revenue funds	Nonmajor capital project funds	Total governmental funds	Statement of net assets
Measurable and unavailable revenues:						
Municipal licenses	$ 12,099	-	-	-	12,099	$ -
Construction excise taxes	10,502	-	-	-	10,502	-
Charges for services – rent	1,551	-	-	-	1,551	-
Property taxes	969,372	322,198	-	-	1,291,570	-
Intergovernmental grants and contributions	176,150	-	-	-	176,150	-
Total measurable and unavailable revenue	1,169,674	322,198	-	-	1,491,872	-
Unearned revenues:						
Municipal licenses	1,406,054	-	-	-	1,406,054	1,406,054
Property taxes	-	49,293			49,293	49,293
Intergovernmental grants and contributions	-	-	845,845	109,590	955,435	955,435
Total unearned revenues	1,406,054	49,293	845,845	109,590	2,410,782	2,410,782
Total deferred revenues	$ 2,575,728	371,491	845,845	109,590	3,902,654	$ 2,410,782

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9. Long-Term Obligations

The general long-term debt activity for the fiscal year ended June 30, 2006 is as follows:

	Balance at beginning of fiscal year, as restated	Borrowings or additions	Payments and deductions	Balance at end of fiscal year	Balance due within one year
Governmental activities:					
Bonds payable:					
General obligation serial bonds	$ 9,030,000	-	(455,000)	8,575,000	$ 590,000
Public improvement serial bonds	2,989,000	-	(290,000)	2,699,000	195,000
Notes payable:					
Section 108 loan guarantee notes – series 2004-A	5,500,000	-	-	5,500,000	-
Puerto Rico Health Services Administration (PRHSA)	356,882	-	-	356,882	-
Municipal Revenue Collection Center:					
Law No. 146 of October 11, 2001	384,934	-	(45,842)	339,092	40,000
Land Information Management System	273,974	-	(35,662)	238,312	37,816
Others	133,432	-	(133,432)	-	-
Puerto Rico Department of Treasury:					
Financing agreement to pay legal judgment; JDP-1993-0218, 1993-0294, 1993-0240	106,970	-	(49,545)	57,425	52,863
Financing agreement to pay legal Judgment; JAC-96-0341 (603)	248,642	-	(12,108)	236,534	21,251
Financing agreement to pay legal judgment; JDP-1993-0037, 1993-0058, 1993-0119, 1993-0047, 1993-0133	99,412	-	(30,434)	68,978	44,837
Financing agreement to pay legal judgment; JAC-2002-02-02, PE-2002-0223, 63-033-0660433516	-	291,328	(24,984)	266,344	45,089
Financing agreement for payment of the excess of property tax advances over collections through 1992	30,312	-	(6,547)	23,765	6,984
Obligations under capital leases	146,970	30,214	(35,393)	141,791	41,774
Compensated absences	2,307,332	758,619	(906,148)	2,159,803	800,000
Claims and judgments	386,123	162,187	(386,123)	162,187	162,187
Totals for governmental activities	$ 21,993,983	1,242,348	(2,411,218)	20,825,113	$ 2,037,801
Business-type activities:					
Mortgage notes payable:					
Section 515 loan no. 001	$ 1,265,141	-	(17,347)	1,247,794	$ 18,787
Section 515 loan no. 002	131,080	-	(1,311)	129,769	4,219
Totals for business-type activities	$ 1,396,221	-	(18,658)	1,377,563	$ 23,006

Historically, the general fund has been used to liquidate the notes payable to CRIM, the Puerto Rico Health Services Administration and the Puerto Rico Department of Treasury, compensated absences, obligations under capital leases and any other long-term liabilities other than bonds, except for notes payable to the Puerto Rico Department of Treasury used to finance the payment of legal judgments, which are accounted for within the nonmajor governmental funds.

a) Debt Limitation

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

- Direct obligations of the Municipality (evidenced principally by bonds) are backed by the full faith, credit and taxing power of the Municipality; and

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

b) Bonds Payable

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

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

As more fully described in Note 4, the Municipality levies an annual additional special property tax of 2.00 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at the Government Development Bnak for Puerto Rico, fiscal agent, whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual and semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

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For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2006:

	Outstanding balance
General Obligation Bonds:	
1995 serial bonds (face amount of $1,200,000) due in annual principal installments ranging from $30,000 to $660,000; plus interests due in semiannual installments at variable rates (5.08% at June 30, 2006) through July, 1, 2006.	$ 65,000
1996 serial bonds (face amount of $1,180,000) due in annual principal installments ranging from $25,000 to $110,000; plus interests due in semiannual installments at variable rates (6.00% at June 30, 2006) through July, 1, 2016.	855,000
1999 serial bonds (face amount of $2,270,000) due in annual principal installments ranging from $45,000 to $215,000; plus interests due in semiannual installments at variable rates (5.52% at June 30, 2006) through July, 1, 2019.	1,870,000
1999 serial bonds (face amount $1,025,000) due in annual principal installments ranging from $40,000 to $115,000; plus interests due in semiannual installments at variable rates (3.21% at June 30, 2006) through July, 1, 2014.	745,000
2003 serial bonds (face amount $900,000) due in annual principal installments ranging from $15,000 to $75,000; plus interests due in semiannual installments at variable rates (3.21% at June 30, 2006) through July 1, 2026.	840,000
2003 serial bonds (face amount of $215,000) due in annual principal installments ranging from $5,000 to $15,000; plus interests due in semiannual installments at variable rates (3.21% at June 30, 2006) through July 1, 2026.	195,000
2003 serial bonds (face amount of $1,510,000) due in annual principal installments ranging from $25,000 to $120,000; plus interests due in semiannual installments at variable rates (4.23% at June 30, 2006) through July 1, 2027.	1,430,000
2003 serial bonds (face amount of $1,050,000) due in annual principal installments ranging from $120,000 to $180,000; plus interests due in semiannual installments at variable rates (6.25% at June 30, 2006) through July 1, 2009.	660,000

	Outstanding balance
2004 serial bonds (face amount of $785,000) due in annual principal installments ranging from $15,000 to $65,000; plus interests due in semiannual installments at variable rates (4.23% at June 30, 2006) through July 1, 2027.	$ 740,000
2005 serial bonds (face amount of $875,000) due in annual principal installments ranging from $10,000 to $65,000; plus interests due in semiannual installments at variable rates (4.23% at June 30, 2006) through July 1, 2028.	850,000
2006 serial bonds (face amount of $325,000) due in annual principal installments ranging from $100,000 to $115,000; plus interests due in semiannual installments at variable rates (6.25% at June 30, 2006) through July 1, 2008.	325,000
Total general obligation bonds	8,575,000
Public Improvement Bonds:	
1995 serial bonds (face amount of $1,758,000) due in annual principal installments ranging from $44,000 to $142,000; plus interests due in annual installments at variable rates (5.63% at June 30, 2006) through January 1, 2016.	1,101,000
1995 serial bonds (face amount of $615,000) due in annual principal installments ranging from $10,000 to $55,000; plus interests due in semiannual installments at variable rates (7.41% at June 30, 2006) through July 1, 2018.	460,000
1996 serial bonds (face amount of $835,000) due in annual principal installments ranging from $18,000 to $58,000; plus interests due in annual installments at fixed rate of 4.50% through January 1, 2019.	568,000
1996 serial bonds (face amount of $1,680,000) due in annual principal installments ranging from $70,000 to $205,000; plus interests due in annual installments at variable rates (6.00% at June 30, 2006) through July 1, 2008.	570,000
Total public improvement bonds	2,699,000
Total bonds payable	$ 11,274,000

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

Interest expense on bonds payable amounted to $624,391 for the fiscal year ended June 30, 2006. Annual debt service requirements of maturity for bonds payable are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2007	$ 900,000	586,662	$ 1,486,662
2008	907,000	528,416	1,435,416
2009	964,000	473,879	1,437,879
2010	681,000	436,279	1,117,279
2011	544,000	407,616	951,616
2012-2016	3,233,000	1,528,553	4,761,553
2017-2021	2,120,000	704,695	2,824,695
2022-2026	1,295,000	307,783	1,602,783
2027-2031	630,000	18,825	648,825
Totals	$ 11,274,000	4,992,708	$ 16,266,708

At June 30, 2006, accrued interest payable on bonds amounted to $310,265, however, the accompanying statement of net assets include accrued interests on bonds of only $266,520. Because of this departure from accounting principles generally accepted in the United States of America, the liabilities and net assets reported in the accompanying statement of net assets are understated and overstated, respectively, for $43,745 at June 30, 2006.

c) Section 108 Loan Guarantee Notes Payable - Series 2004-A

On June 30, 2004, the Municipality entered into a loan guarantee commitment of $5,500,000 with the U.S. Department of Housing and Urban Development (HUD) pursuant to an application under Section 108 of the Housing and Community Development Act of 1974 (Section 108). Section 108 commitments are required to be supported by a credit subsidy appropriation pursuant to the Federal Credit Reform Act of 1990 (Credit Reform Act) and implementing guidance issued by the U.S. Office of Management and Budget (OMB). Therefore, in connection with its guarantee of these notes, HUD obligated appropriated funds to cover the credit subsidy cost of the loan guarantee, as required under the Credit Reform Act. Under the Credit Reform Act procedures, such funds are disbursed into a financing account as loan proceeds are disbursed by the lender (a commercial bank). The financing account is in some respects equivalent to an internal loss reserve for the federal government. Each disbursement into the financing account is equal to the loan advance times the credit subsidy rate, which is part of HUD's budget approved by OMB and the Congress.

The proceeds of $5,000,000 of the loan guarantee commitment are used by the Municipality to finance the construction of the Fine Arts Center and to provide low-income communities with another source of financing for the economic development, housing rehabilitation, public facilities and large-scale physical development projects. The notes on the loan guarantee commitment bear interest at various rates ranging from 3.50 percent to 6.70 percent. The proceeds and uses of the loan guarantee commitment are accounted for in the Section 108 loan guarantee, a major capital projects fund. The loan guarantee commitment is repaid with grant awards received from the Community Development Block Grants – Entitlement Grants Program (CDBG), administered by HUD. Principal and interest on these notes are accounted for in the Section 108 loan guarantee fund, a major capital projects fund. At June 30, 2006, the outstanding principal balance of the loan guarantee commitment amounted to $5,500,000.

The loan guarantee commitment is subject to various positive, negative and restrictive covenants that the Municipality has to comply. During the fiscal year ended June 30, 2006, the Municipality did not comply with the following debt covenants of the Section 108 loan guarantee commitment:

- Part II (1)(b) of the contract between the Municipality and HUD, dated June 4, 2004, for the Loan Guarantee Assistance Under Section 108 of the Housing and Community Development Act of 1974, as amended, 42 U.S.C. Section 5308 (the Contract), requires that the Municipality shall, by the fifteenth day of each month, provide the Secretary of Housing and Urban Development of the United States of America with a written statement showing the balance of funds in the Guaranteed Loan Funds Account and the withdrawals from such account during the preceding calendar month, and a statement identifying the obligations and their assignments in the Guaranteed Loan Funds Investment Account, until such accounts are fully disbursed. The aforementioned required statements were not prepared by the Municipality during the fiscal year ended June 30, 2006.

- Article 11(a) of the Contract states that a default under the notes payable and the Contract shall occur upon failure by the borrower (the Municipality) to: (i) pay when due an installment of principal or interest on the notes payable; or (ii) punctually and properly perform, observe, and comply with any covenant, agreement, or condition contained in the Contract. The debt service installments of the Section 108 loan guarantee commitments that were due on August 1, 2004, February 1, 2005 and August 1, 2005, respectively, were paid by the Municipality after the scheduled deadlines on July 1, 2005 and August 3, 2005.

Interest expense on the Section 108 loan guarantee notes payable amounted to $623,780 for the fiscal year ended June 30, 2006. The principal and interest maturities on the Section 108 loan guarantee commitment are as follows:

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Fiscal year ending June 30,	Principal	Interest	Total
2007	$ -	311,890	$ 311,890
2008	50,000	310,985	360,985
2009	50,000	309,080	359,080
2010	50,000	307,000	357,000
2011	50,000	304,777	354,777
2012-2016	700,000	1,443,172	2,143,172
2017-2021	2,200,000	1,066,350	3,266,350
2022-2026	2,400,000	422,490	2,822,490
Totals	$ 5,500,000	4,475,744	$ 9,975,744

d) Notes Payable to Puerto Rico Health Services Administration

The Municipality entered into a financing agreement with the Puerto Rico Health Services Administration (PRHSA) for the payment of the Municipality's debt on the payment of the government's public health insurance program (the Puerto Rico Health Reform) applicable to the residents of Juana Díaz for fiscal years 1994-1995 through 1996-1997. The note bears no interests and is payable with the Municipality's share on the state's Additional Lottery System of the Commonwealth of Puerto Rico (the Additional Lottery) as established by Law No. 29 of July 1, 1997 and described below.

As more fully described in Note 4, the Additional Lottery is required every fiscal year to distribute a portion of its excess of revenues over expenses as follows:

- Thirty five percent of its net earnings is earmarked to the municipalities of the Commonwealth of Puerto Rico, of which a maximum of $26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.

- An additional amount not exceeding $16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the thirty-five percent corresponding to the municipalities of the Commonwealth of Puerto Rico. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to PRHSA.

During fiscal year ended June 30, 2006, there were no payments or deductions applied to the notes payable due to PRHSA. The outstanding balance of these notes payable amounted to $356,882 at June 30, 2006. No principal maturities are due during the fiscal 2006-2007.

e) Notes Payable to Municipal Revenue Collection Center

The Municipality had the following notes payables to Municipal Revenue Collection Center (CRIM, by its Spanish acronym) at June 30, 2006:

- **Land Information Management System (LIMS)** – On July 10, 2001, the Municipality entered into a financing agreement with CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The face amount of the loan was $383,542 and bears no interest. The note is payable in monthly installments of $2,972 through November 28, 2011. This note has an imputed interest rate of 5.95%. At June 30, 2006, the balance of this note, net of the unamortized discount of $44,613, amounted to $238,312. The principal and discount amortization (recorded as interest expense) maturities are as follows.

Fiscal year Ending June 30,	Principal	Amortization of discount	Total
2007	$ 37,816	13,625	$ 51,441
2008	40,099	11,342	51,441
2009	42,521	8,920	51,441
2010	45,088	6,353	51,441
2011	47,811	3,630	51,441
2012-2016	24,977	743	25,720
Totals	$ 238,312	44,613	$ 282,925

At June 30, 2006, accrued interest payable on the notes payable to CRIM under LIMS amounted to $1,182. Discount amortization recorded as interest expense on notes payable to CRIM under LIMS amounted to $15,779 for the fiscal year ended June 30, 2006.

- **Law No. 146** – On September 24, 2002, CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Law No. 146 of October 11, 2001, as amended (Law No. 146). The purpose of this financing agreement was to extinguish in advance certain bonds payable issued by Public Finance Corporation (PFC), a subsidiary of the Government Development Bank for Puerto Rico, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996, which were acquired by PFC with recourse.

  The original face amount of the note allocated by CRIM to the Municipality was $736,727, for a term not exceeding 30 years. The note bears interest at 6.50 percent during its first five years. Subsequently, from years 6 through 30, the loan shall bear variable interest at a rate of 125 points over the 5-year LIBOR rate, which will be adjusted every five years. During the first five years of the note, commenced on July 1, 2003, the Municipality shall pay only interest, except for property tax receivables collections related to the transaction explained in the above paragraph, which will be applied as principal payment to reduce the debt balance. At the end of the first five years of the note, the repayment terms and conditions of the note shall be renegotiated to allow the Municipality to pay the outstanding balance of the note in equal installments of principal plus interest, through maturity. Interest payments on this financing agreement are accounted for in the general fund. The outstanding principal of the note payable to CRIM amounted to $339,092, at June 30, 2006. Interest expense on these notes amounted to $25,021 for the fiscal year ended June 30, 2006. Accrued interest payable on these notes amounted to $1,182 at June 30, 2006.

f) Notes Payable to Puerto Rico Department of Treasury

- **Financing Agreement to Settle Legal Judgments (JDP-1993-0218, 1993-0294, 1993-0240)** – On July 23, 2002 the Municipality obtained a loan from the Puerto Rico Department of Treasury to pay three legal judgments. The face amount of the loan was $275,195, and bears no interest. The note is payable in monthly installments of $4,587 through July 1, 2007. This note has an imputed interest rate of 6.50%. At June 30, 2006, the balance of this note, net of the unamortized discount of $2,201, amounted to $57,425. The principal and discount amortization (recorded as interest expense) maturities are as follows.

Fiscal year Ending June 30,	Principal	Amortization of discount	Total
2007	$ 52,863	2,176	$ 55,039
2008	4,562	25	4,587
Totals	$ 57,425	2,201	$ 59,626

Discount amortization recorded as interest expense on these notes payable amounted to $5,494 for the fiscal year ended June 30, 2006, which are recorded in the general fund.

- **Financing Agreement to Settle Legal Judgments (JAC-96-0341 (603)** – On February 20, 2002 the Municipality obtained a loan from the Puerto Rico Department of Treasury to pay a legal judgment. The face amount of the loan was $361,005, and bears no interest. The note is payable in monthly installments ranging from $1,000 to $10,055 through February 1, 2012. This note has an imputed interest rate of 6.50%. At June 30, 2006, the balance of this note, net of the unamortized discount of $55,522, amounted to $236,534. The principal and discount amortization (recorded as interest expense) maturities are as follows.

Fiscal year Ending June 30,	Principal	Amortization of discount	Total
2007	$ 21,251	14,749	$ 36,000
2008	22,674	13,326	36,000
2009	32,258	11,742	44,000
2010	51,081	8,919	60,000
2011	58,535	5,465	64,000
2012-2016	50,735	1,321	52,056
Totals	$ 236,534	55,522	$ 292,056

Discount amortization recorded as interest expense on these notes payable amounted to $15,891 for the fiscal year ended June 30, 2006, which are recorded in the general fund.

- **Financing Agreement to Settle Legal Judgments (JDP-1993-0037, 1993-0058, 1993-0119, 1993-0047)** – On July 1, 2003 the Municipality obtained a loan from the Puerto Rico Department of Treasury to pay five legal judgments. The face amount of the loan was $145,000, and bears no interest. The note is payable in monthly installments ranging from $1,000 to $4,000 through June 1, 2008. This note has an imputed interest rate of 6.50%. At June 30, 2006, the balance of this note, net of the unamortized discount of $4,022, amounted to $68,978. The principal and discount amortization (recorded as interest expense) maturities are as follows.

Fiscal year Ending June 30,	Principal	Amortization of discount	Total
2007	$ 44,837	3,163	$ 48,000
2008	24,141	859	25,000
Totals	$ 68,978	4,022	$ 73,000

Discount amortization recorded as interest expense on these notes payable amounted to $5,566 for the fiscal year ended June 30, 2006, which are recorded in the general fund.

- **Financing Agreement to Settle Legal Judgments (JAC-2002-02-02, JPE-2002-0223, 63-033-0660433516)** – On November 3, 2005 the Municipality obtained a loan from the Puerto Rico Department of Treasury to pay three legal judgments. The face amount of the loan was $291,338, and bears no interest. The note is payable in monthly installments of $4,855.83 through November 1, 2010. This note has an imputed interest rate of 6.50%. At June 30, 2006, the balance of this note, net of the unamortized discount of $34,167, amounted to $266,344. The principal and discount amortization (recorded as interest expense) maturities are as follows.

Fiscal year Ending June 30,	Principal	Amortization of discount	Total
2007	$ 45,089	13,179	$ 58,268
2008	48,106	10,160	58,266
2009	51,329	6,938	58,267
2010	54,767	3,500	58,267
2011	67,053	390	67,443
Totals	$ 266,344	34,167	$ 300,511

Discount amortization recorded as interest expense on these notes payable amounted to $7,594 for the fiscal year ended June 30, 2006, which are recorded in the nonmajor governmental funds.

- **Financing Agreement for Payment of the Excess of Property Tax Advances over Collections** - On November 1994 the Municipality entered into a financing agreement with the Puerto Rico Treasury Department to pay a debt related to the excess of property tax advances over collections made by the Puerto Rico Treasury Department prior to the creation of CRIM in 1993. The outstanding principal balances of the note payable to CRIM amounted to $23,766 at June 30, 2006. The principal and discount amortization maturities are as follows:

Fiscal year Ending June 30,	Principal	Amortization of discount	Total
2007	$ 6,984	1,343	$ 8,327
2008	7,453	875	8,328
2009	7,953	375	8,328
2010	1,375	13	1,388
Totals	$ 23,765	2,606	$ 26,371

Discount amortization recorded as interest expense on these notes payable amounted to $1,778 for the fiscal year ended June 30, 2006, which are recorded in the general fund.

g) *Lease Obligations*

The Municipality is obligated under capital leases with third parties that expire through 2011 for the acquisition of machinery and equipment. At June 30, 2006, the capitalized costs and the related accumulated depreciation of the leased machinery and equipment amounted to $207,068 and $70,426, respectively, which are accounted for as capital assets in the accompanying statement of net assets. Amortization charges applicable to capital leases and included within depreciation expense amounted to $37,050 for the fiscal year ended June 30, 2006. The present value of the future minimum capital lease payments reported in the accompanying statement of net assets is as follows:

	Fiscal year ending June 30,	Amount
	2007	$ 49,639
	2008	45,286
	2009	35,941
	2010	23,875
	2011	4,379
Total future minimum lease payments		159,120
Less: amounts representing future interests at a rate ranging from 4.20% to 7.50%		(17,330)
Present value of minimum lease payments at June 30, 2006		141,790
Less: current portion of obligation under capital leases		(41,774)
Obligation under capital leases, excluding current portion		$ 100,016

At June 30, 2006, accrued interest payable on obligations under capital leases amounted to $336. Interest expense on the obligations under capital leases amounted to $8,911 for the fiscal year ended June 30, 2006, which is recorded in the general fund.

h) *Compensated Absences*

At June 30, 2006, the liability for compensated absences is composed as follows:

	Due within one year	Due after one year	Total
Accrued vacations	$ 334,336	568,288	$ 902,624
Accrued sick leave	465,664	791,515	1,257,179
Total compensated absences	$ 800,000	1,359,803	$ 2,159,803

At June 30, 2006, the Municipality has not adopted certain requirements established by Statement No. 16, *Accounting for Compensated Absences*, issued by the Governmental Accounting Standards Board (GASB No. 16). The Municipality did not have accurate and updated records of compensated absences (accrued vacations and sick leave). The time and attendance records of the employees of the Municipality were incomplete and were not updated to reflect the real accumulated vacation and sick leave time of each employee of the Municipality. In addition, the liability for compensated absences, recorded in the accompanying statement of net assets for $2,159,803, does not include the accumulated sick leave of a significant number of employees and the accumulated compensatory time of all employees of the Municipality, which are required by GASB No. 16. Furthermore, the accompanying statement of net assets and the statement of net assets – proprietary fund do not include a liability for compensated absences related to Villas del Parque (FmHA Project No. 63-033-0690660049).

i) *Mortgage Notes Payable - Section 515 (business-type activities)*

The long-term debt of Villas del Parque (FmHA Project No. 63-033-0690660049) consist of two mortgages notes, collateralized with land and buildings, payable to the U.S. Department of Agriculture Rural Development in monthly installments of $8,880 and $1,094, respectively, including interest at an annual rate of 8.00% and 10.00%, respectively, (reduced to 7.00% and 9.00%, respectively) through December 2029.

At June 30, 2006, the outstanding principal balance of the two mortgage notes amounted to $1,247,794 and $129,769, respectively. The mortgages notes are subject to various positive, negative and restrictive covenants that the Municipality has complied with at June 30, 2006. The principal and interest maturities on each mortgage notes are as follows:

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- **Section 515 Notes Payable No. 001**

Fiscal year ending June 30,	Principal	Interest	Total
2007	$ 18,787	87,777	$ 106,564
2008	20,346	86,217	106,563
2009	22,035	84,528	106,563
2010	23,864	82,699	106,563
2011	25,844	80,719	106,563
2012-2016	165,188	367,629	532,817
2017-2021	246,105	286,713	532,818
2022-2026	366,658	166,159	532,817
2027-2029	358,967	20,635	379,602
Totals	$ 1,247,794	1,263,076	$ 2,510,870

- **Section 515 Notes Payable No. 002**

Fiscal year ending June 30,	Principal	Interest	Total
2007	$ 4,219	8,916	$ 13,135
2008	1,600	11,535	13,135
2009	1,767	11,368	13,135
2010	1,952	11,183	13,135
2011	2,156	10,979	13,135
2012-2016	14,681	50,995	65,676
2017-2021	24,155	41,521	65,676
2022-2026	39,743	25,933	65,676
2027-2029	39,496	6,977	46,473
Totals	$ 129,769	179,407	$ 309,176

Accrued interest payable on these notes amounted to $7,236 at June 30, 2006 which is recorded as part of business-type activities in the accompanying statement of net assets and the statement of net assets – proprietary fund. Interest expense on these notes amounted to $101,041 for the fiscal year ended June 30, 2006, which is recorded in the accompanying statement of activities and the statement of revenues, expenses and changes in fund net assets – proprietary fund.

10. Employees' Retirement Systems

a) Plan Description

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the

Commonwealth. Substantially all full-time employees of the Commonwealth and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed.

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

- ***Retirement Annuity***

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

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

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

- ***Merit Annuity***

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

- ***Deferred Retirement Annuity***

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

- ***Coordinated Plan***

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

(a) $165 per month, if retired with 55 years of age and 30 years of credited service.

(b) $110 per month, if retired with less than 55 years of age and 30 years of credited service.

(c) All other between $82 and $100 per month.

(d) Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over $165 per month.

- ***Non-Coordinated Plan***

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

- ***Reversionary Annuity***

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

- ***Occupational Disability Annuity***

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

- ***Nonoccupational Disability Annuity***

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

- ***Death Benefits***

Occupational:

(a) **Surviving spouse** – annuity equal to 50 percent of the participating employee's salary at the date of the death.

(b) **Children** - $10 per month for each child, minor or student, up to a maximum benefit per family of $100.

Nonoccupational:

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

Post-retirement:

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

- ***Refunds***

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

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

Public Act No. 10 of May 21, 1992 (Act No. 10) provided for increases of 3 percent every three or more years of retirement. Act No. 10 requires further legislation to grant this increase every three years subject to the presentation of actuarial studies regarding its costs and the source of financing. To protect the financial health of ERS, the increase granted during 2001 and the one granted on January 1, 2005 are being financed by the Municipality and the other participating employers.

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

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

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

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

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

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

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

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

c) ***Three-Year Actual Contributions***

The actual combined employer and employee contributions to ERS and System 2000, which are equal to the statutory required contributions, is as follows:

Fiscal year ended June 30,	Act No. 447	System 2000	Total
2006	$ 253,729	90,134	$ 343,863
2005	257,371	91,370	348,741
2004	247,364	87,818	335,182
Totals	$ 758,464	269,322	$ 1,027,786

During the fiscal years ended June 30, 2004, 2005, and 2006, the Municipality and the participating employees contributed at least 100 percent of the required contributions to ERS and System 2000. The authority under which obligations to contribute to ERS and System 2000 by the plans' members, employers and other contributing entities (i.e., state or municipal contributions) are established or may be amended by law by the House of Representatives, the Senate and the Governor of the Commonwealth of Puerto Rico.

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

private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

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

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

- ***Recent Amendments to Act No. 447***

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

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

(a) Increase in minimum monthly pension payments to $300, effective January 1, 2005.

(b) Triennial 3 percent increase in all pensions, effective January 1, 2005.

(c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2005.

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

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

b) Funding Policy

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

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11. Landfill Closure and Postclosure Care Costs Obligations

The Municipality owns a municipal solid waste landfill. However, the Municipality has not adopted the required provisions of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, issued by the Governmental Accounting Standards Board (GASB No. 18) and the regulations set forth by the U.S. Environment Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991. According to these standard and regulations, the Municipality is required to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. The Municipality has not performed an independent study of the activities that need to be implemented at the Municipality's solid waste landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations and, accordingly, the accompanying statement of net assets does not include the required liability for closure and postclosure care costs of the solid waste landfill using current costs allocated based on the actual landfill capacity used at June 30, 2006.

The Municipality has a contract with a private company to operate its municipal solid waste landfill for a period of twenty (20) years started on June 1, 2004. As part of its contract to operate the landfill, the private company agreed to provide closure and postclosure care subject to the following conditions: (1) the private company will be operating the landfill up to the termination of the space of the landfill; (2) the landfill will not be ordered to stop accepting waste in the first ten (10) years of contract term; (3) if during the contract period, the company is ordered to close the landfill to develop any other alternate facility for waste disposition, the private contractor will have preference status to operate it.

However, because as owner of a solid waste landfill the Municipality is primarily liable under applicable federal, state, or local law and regulations, the Municipality, as part of the evaluation of the proposals submitted by private companies interested to operate the landfill, partially considered the financial capability and stability of all of interested private companies to meet closure and postclosure care obligations when they are due. However, since the independent required study referred to above has not been prepared at June 30, 2006, the Municipality was unable to verify the economic impact of the closing and postclosing care costs, which remain undetermined at June 30, 2006. It is the management's conclusion that the private company selected and actually operating the landfill will be able to meet its contractual obligations about the closure and postclosure care costs, subject to the conditions listed above.

12. Commitments, Contingencies and Uncertainties

Claims and Judgments

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

With respects to pending or threatened litigation, the Municipality has reported liabilities amounting to $162,187 for awarded or anticipated unfavorable judgments as of June 30, 2006. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significant, if any.

Encumbrances

The Municipality has reported, outstanding encumbrances amounting to $229,329 in the general fund at June 30, 2006. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

Questioned Costs on Federal Financially Assisted Programs

The Municipality receives financial assistance from the federal government in the form of grants and entitlements. Receipts of grants are generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal law and regulations, including the expenditure of resources for eligible purposes. Substantially all grants are subject to audit under Circular A-133 of the Office of Management and Budget of the United States of America (OMB Circular A-133). Disallowance as a result of these audits may become liabilities of the Municipality, At June 30, 2006, the *"Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133* for the fiscal year ended June 30, 2006 (dated December 22, 2006), disclosed various instances of noncompliance with applicable laws and regulations and reported questioned costs amounting to $4,447,418. These findings and questioned costs have not been evaluated by federal grantors, consequently, a final resolution of these findings has not been made at June 30, 2006.

In addition, as of the date of this report, the Municipality has been subject to various program audits and monitoring activities performed by the U.S. Department of Housing and Urban Development and the Administration for the Integral Care and Development of Children of the Commonwealth of Puerto Rico (ACUDEN, by its Spanish Acronyms) related to the Community Development Block Grants Program – Entitlement Grants and the Head Start Program, respectively. The program audit reports have reported questioned costs of $2,271,026 and $1,647,285, respectively, for various program years of these two federal financially assisted programs. These findings and questioned costs from monitoring activities have been evaluated by the respective grantors, however, a final resolution has not been made at June 30, 2006 for such findings. The ultimate outcome of these findings and questioned costs cannot presently be determined. However, management believes that the Municipality will be able to comply with the terms of corrective action plans that may be requested by the federal grantors, if any. Consequently, the accompanying basic financial statements do not include any provision or reserve for possible disallowed costs arising from the federal funds disbursed during the fiscal year ended June 2006.

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Central Government's Financial Crisis, General Fund's Operating Deficiencies and Liquidity

During April and May 2006, the government of the Commonwealth of Puerto Rico shut down its operations for approximately two weeks due to a publicly announced temporary cash flows and budgetary financial crisis. As a result of that situation, the monthly property tax advances received by the municipalities from the Municipal Revenue Collection Center (CRIM) for the month of May 2006 was postponed and the Government Development Bank for Puerto Rico (GDB) temporarily canceled all available short-term and long-term financing options for the municipalities of Puerto Rico until the financial crisis was resolved. In addition, all grants and contributions assigned by the government of the Commonwealth of Puerto Rico to the municipalities were also postponed until the financial crisis was resolved.

Since the Municipality is significantly dependent on the intergovernmental grants and contributions received from the government of the Commonwealth of Puerto Rico and from property tax advances received from CRIM, the municipality suffered a significant financial burden for certain scheduled intergovernmental revenues that could not be collected during the period of crisis referred to above and, accordingly, also shut down operations until the financial crisis of the central government was resolved.

In addition, during the prior fiscal years, the general fund of the Municipality suffered recurring excesses of expenditures and other financing uses over revenues and other financing sources, which have lead to a general fund's total accumulated deficit of $1,394,006 at June 30, 2006, and significant liquidity and cash flows shortfalls during the fiscal year then ended. In addition, the Municipality has cash in commercial banks of only $2,267 and an excess of checks drawn over bank balances of $220,379 recorded within accounts payable and accrued liabilities of the general fund at June 30, 2006 which represent a significant liquidity deficiency at June 30,, 2006.

Going forward, if the Municipality continues to have expenditures in excess of revenues before other financing sources or if liquidity problems are not resolved within a reasonable period of time, a financial risk will continue to exist regarding the dependability on financing from GDB and advances in excess of actual property tax collections from CRIM.

Management is currently evaluating alternatives for the permanent financing of the operations of the general fund and the Municipality. Among the actions currently taken by the management of the Municipality in relation to these matters are: (1) the implementation of a cost reduction plan and related activities, (2) the implementation of a sales and use tax effective July 1, 2006 (see note 15), (3) the implementation of increased collection efforts over accounts receivable and inter-fund balances, and (4) the evaluation of different alternatives through possible long-term financing agreements with GDB.

In order to achieve its budget control and cost reduction objectives, management is currently trying to manage the Municipality within its cash and budget constraints, including the periodic review and update of its cash flows projections, actual vs. budget comparisons for budget adjustments as needed, and the monitoring of the execution of the property tax and sales and use taxes projects.

In order to increase its financing capabilities with the Government Development Bank for Puerto Rico (GDB), effective July 1, 2005, the Municipality increased to 2.00 percent its ad-valorem portion of the property tax rates which is restricted for the debt service of bonds payable. This increase in the tax rate may increase the Municipality's possibilities of increasing its borrowing capacity with GDB and obtain additional loans during the near future.

The success of the foregoing plans and strategies to reduce the general fund's accumulated deficit, to improve the cash flows and liquidity of the Municipality and to achieve excess revenues over expenditures in the general fund of the Municipality cannot be assured, as it is significantly dependent upon events and circumstances which outcome cannot presently be determined. However, management is committed to undertake whatever actions may be necessary to prevent operating deficiencies in the future, but without affecting its fiduciary duty with its citizens regarding services and city improvements.

Management Agreement of Villas del Parque (FmHA Project No. 63-033-0690660049)

The Municipality maintains entered into a maagement agreement with GR Management Corp., for the administration of Villas del Parque (FmHA Project No. 63-033-0690660049). Management fees amounted to $35,280 for the fiscal year ended June 30, 2006 and consist of a monthly fixed payment established in the Administrative Notice PR AN No. 125 (Inst. 1930-C).

13. Special and Extraordinary Items

Special Item

In December 2000, the Municipality and other municipalities of Puerto Rico filed a complaint against the Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth, in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years. The complaint challenged the application by PREPA of the "net revenue" formula, which reduced the amount available to pay contributions in lieu of taxes, and energy sales set aside for the Municipality. On March 18, 2003, the Board of Directors of PREPA approved a resolution by which PREPA agreed to settle the claims with all municipalities. Accordingly, PREPA offered to pay $125 million to all municipalities of the Commonwealth of Puerto Rico to settle the claim, which were divided in $68 million in cash and $57 million in the construction of electric infrastructure projects on behalf of the municipalities. Of such amounts, the Municipality collected a cash amount in a prior fiscal year.

During the fiscal year ended on June 30, 2006, the Municipality collected and additional amount of $481,768 from the legal judgment referred to above as the Municipality's share of the $57 million referred to above for the construction of electric infrastructure projects on behalf of the municipalities. This transaction falls under the definition of special item set forth by GASB No. 34, as it is a transaction of unusual and infrequent nature within the control of the Municipality's management, since the settlement arose as a result of management negotiations in court after evaluating different alternatives. Accordingly, the proceeds of $481,768 have been recorded in the accompanying statement of activities and within nonmajor governmental funds in the accompanying statement of revenues, expenditures and changes in fund balances (deficits). The use of these amounts is limited to finance the construction of electrical infrastructure projects in the territory of Juana Díaz.

Extraordinary Item

During the fiscal year ended on June 30, 2006, the Municipality collected certain proceeds from surpluses arising from the sale of bond pools of all of the Municipalities of Puerto Rico. The Municipality's share of such surpluses amounted to $181,177, which have been recorded as an extraordinary item in the accompanying statement of activities and within nonmajor governmental funds in the accompanying statement of revenues, expenditures and changes in fund balances (deficits). This transaction falls under the definition of extraordinary item set forth by GASB No. 34, as it is a transaction of unusual and infrequent nature, but not within the control of the Municipality's management, since the surpluses referred to above were negotiated and determined by the Government Development Bank for Puerto Rico.

14. Prior-Period Adjustments and Restatements

During the current fiscal year, the Municipality revised the classifications of its governmental funds, which resulted in reclassifications of various funds and the correction of various accounting errors and omissions reported in the prior year's governmental funds. These errors consist principally in the effect of not adopting adequately the provisions of GASB No. 33, *Accounting and Financial Reporting for Non-exchange Transactions,* prior to June 30, 2005, as required by GAAP, and the effect of various unrecorded accounts receivables, accounts payable, deferred revenues, inter-fund transactions, deferred charges, long-term liabilities (principally certain notes payable and obligations under capital leases) and certain capital asset transactions at June 30, 2005.

In addition, as more fully described in Note 1, On July 1, 2005, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). Based on the criteria established by GASB No. 39, the Municipality's management concluded that there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2006. Villas del Parque (FmHA Project No. 63-033-0690660049) was erroneously reported as a blended component as part of the special revenue funds (under the modified accrual basis of accounting) on the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2005. Accordingly, after adopting GASB No. 39, on July 1, 2005, the Municipality recorded a fund reclassification to properly account for the financial position, the results of operations and the cash flows of Villas del Parque as a business-type activity (proprietary fund under the accrual basis of accounting) instead of as a blended component unit as of and for the fiscal year ended June 30, 2006. The effect of the fund reclassification and the change in basis of accounting were reported as prior-period adjustments to the respective fund balances and fund net assets as of July 1, 2005 in the amount of $429,441.

a) Governmental Fund Financial Statements

The following schedule presents a summary of the prior-period adjustments recorded in the accompanying balance sheet – governmental funds, and reconciles the fund balances, as previously reported by the Municipality at June 30, 2005, to the beginning fund balances in the accompanying basic financial statements, as restated:

	Major governmental funds						
	General fund	Debt service fund	Head start fund	Legislative joint resolutions fund	Section 108 loan guarantee fund	Other governmental funds	Total governmental funds
Assets:							
As previously reported in the audited financial statements at June 30, 2005	$2,468,360	2,143,104	188,440	830,197	5,234,019	7,441,812	$18,305,932
Add:/(deduct): prior-period adjustments	141,428	(130,682)	-	-	59,396	213,680	283,822
Total assets at June 30, 2005, as restated	2,609,788	2,012,422	188,440	830,197	5,293,415	7,655,492	18,589,754
Liabilities:							
As previously reported in the audited financial statements at June 30, 2005	3,756,366	9,710	188,440	432,054	-	3,292,589	7,679,159
Add:/(deduct): prior-period adjustments	258,860	903,240	-	395,008	-	884,178	2,441,286
Total liabilities at June 30, 2005, as restated	4,015,226	912,950	188,440	827,062	-	4,176,767	10,120,445
Fund balance:							
As previously reported in the audited financial statements at June 30, 2005	$(1,288,006)	2,133,394	-	398,143	5,234,019	4,149,223	$10,626,773
Add:/(deduct): prior-period adjustments	(117,432)	(1,033,922)	-	(395,008)	59,396	(670,498)	(2,157,464)
Total fund balance at June 30, 2005, as restated	$(1,405,438)	1,099,472	-	3,135	5,293,415	3,478,725	$8,469,309

b) *Proprietary Fund Financial Statements*

The following schedule presents a summary of the reclassifications and other adjustments of Villas del Parque (FmHA Project No. 63-033-0690660049) referred to above recorded in the accompanying statement of net assets – proprietary fund, and reconciles the fund net assets, as previously reported by the Municipality at June 30, 2005, to the beginning fund net assets in the accompanying basic financial statements, as restated:

	Net assets – proprietary fund
Beginning fund net assets, as previously reported in the audited financial statements at June 30, 2005	$ -
Add:/(deduct): reclassifications and other adjustments	429,441
Beginning fund net assets at June 30, 2005, as restated	$ 429,441

c) *Government-Wide Financial Statements*

The following schedule reconciles the total net asset balance at June 30, 2005, as previously reported by the Municipality, to the beginning net assets, as restated in the accompanying GWFS:

	Net assets – governmental activities	Net assets – business-type activities	Total net assets
As previously reported in the audited financial statements at June 30, 2005	$ 21,684,500	-	$ 21,684,500
Add:/(deduct): prior-period adjustments	(93,483)	-	(93,483)
Fund reclassifications and other adjustments	-	429,441	429,441
Total net assets at June 30, 2005, as restated	$ 21,591,017	429,441	$ 22,020,458

15. Subsequent Events

On May 10, 2006, the Municipal Legislature of the Municipality of Juana Díaz approved the Municipal Ordinance No. 44, Series 2005-2006 (the Municipal Ordinance), to impose a Municipal Sales and Use Tax of 1.00 percent to substantially all products and services sold or provided within the territorial limits of the Municipality starting on July 1, 2006. This Municipal Ordinance was subsequently amended on June 16, 2006 principally to delay the effective date of the Sales and Use Tax to July 18, 2006.

On July 4, 2006, the Legislature of the Commonwealth of Puerto Rico approved Law No. 117, known as *Tax Justice Law of Puerto Rico* (the Law), which impose a Sales and Use Tax in all Puerto Rico (applicable to most consumer goods or services sold, used, stored or used), know in Spanish as "Impuesto Sobre Ventas y Uso" (IVU). The new Sales and Use Tax, which became effective November 15, 2006, includes a State Sales and Use Tax of 5.50 percent for the government of the Commonwealth Puerto Rico and authorized the Municipality to, subject to the approval of the Municipal Legislature, increase the approved Municipal Sales and Use Tax rate from 1.00 percent up to 1.50 percent.

Upon the approval of the Law, the Sales and Use Tax imposed by the Municipality through the Municipal Ordinance No. 44, must be modified to conform certain substituted by the Sales

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF JUANA DÍAZ
Budgetary Comparison Schedule – General Fund
Fiscal Year Ended June 30, 2006

	Budgeted amounts		Actual amounts (budgetary basis)	Variance with final budget – over (under)
Revenues:	**Original**	**Final**		
Property taxes	$2,735,763	2,735,763	3,025,161	$289,398
Municipal license taxes	1,711,058	1,711,058	1,612,392	(98,666)
Construction excise taxes	2,204,052	2,514,070	1,375,068	(1,139,002)
Intergovernmental grants and contributions	5,753,005	5,753,005	5,543,388	(209,617)
Interest on deposits	100,900	100,900	158,413	57,513
Charges for services	416,000	416,000	395,563	(20,437)
Miscellaneous	344,650	344,650	577,609	232,959
Total revenues	13,265,428	13,575,446	12,687,594	(887,852)
Expenditures:				
General government	5,120,236	5,616,035	5,203,288	(412,747)
Urban and economic development	1,787,809	1,760,088	1,685,744	(74,344)
Health and sanitation	1,406,304	1,460,179	1,400,036	(60,143)
Public safety	2,959,258	2,846,860	2,773,589	(73,271)
Public housing and welfare	304,042	300,297	265,662	(34,635)
Culture, recreation and education	1,687,779	1,591,987	1,363,668	(228,319)
Total expenditures	$13,265,428	13,575,446	12,691,987	$(883,459)

Reconciliation of differences:

Sources/inflows of financial resources:	
Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	$12,687,594
Differences - budgetary basis to GAAP:	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(114,357)
Differences in bases of accounting:	
Net increase in tax receivables	1,176,985
Net increase in intergovernmental receivables	53,946
Net decrease in accrued interests on deposits	(5,425)
Net increase in other receivables	26,138
Net increase in unearned and unavailable revenues	(1,195,634)
Total revenues and special item reported on the statement of revenues, expenditures and changes in fund balances	$12,629,247

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF JUANA DÍAZ
Budgetary Comparison Schedule – General Fund
Fiscal Year Ended June 30, 2006

Reconciliation of differences (concluded):

Uses/outflows of financial resources:	
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	$12,691,987
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary purposes	(229,329)
Prior year encumbrances recorded as expenditures for GAAP purposes	95,167
Entity differences - non-budgeted expenditures	218,669
Differences - budgetary basis to GAAP:	
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(1,106,761)
Differences in bases of accounting:	
Net increase in accounts payable and accrued liabilities	15,361
Total expenditures reported on the statement of revenues, expenditures and changes in fund balances	$11,685,094

See accompanying notes to financial statements.

Schedule of Expenditures of Federal Awards
Fiscal Year Ended June 30, 2006

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Schedule of Expenditures of Federal Awards
Fiscal Year Ended June 30, 2006

Federal Grantor / Pass-through Grantor / Program or Cluster Title	CFDA Number	Entity Identifying Number		Federal Expenditures
U.S. Department of Health and Human Services:				
Pass-through the Administration for Integral Care and Development of Children of the Commonwealth of Puerto Rico:				
Head Start Program	93.600	2006-001337 / 2005-000944	*	$ 5,731,909
Child Care and Development Block Grant	93.575	2006-058		102,482
Pass-through the Municipality of Ponce, Commonwealth of Puerto Rico - HIV Emergency Relief Project Grant	93.914	2006-001037		262,217
Subtotal - U.S. Department of Health and Human Services				6,096,608
U.S. Department of Housing and Urban Development:				
Section 108 Loan Guarantee	14.218	B-03-MC-72-0020	*	3,600,832
Community Development Block Grants - Entitlement Grants	14.218	B-04-MC-720020	*	1,423,379
Community Development Block Grants - Entitlement Grants	14.218	B-03-MC-720020	*	165,152
Section 8 New Construction and Substantial Rehabilitation Program	14.182	N/A	**	493,446
Section 8 Housing Choice Voucher	14.871	RQ-038-4NPH	*	678,691
Community Development Block Grants – State-Administered Small Cities Program - Pass-through the Office of the Commisssioner of Municipal Affairs of the Commonwealth of Puerto Rico	14.228	N/A	*	280,694
Emergency Shelter Grants	14.231	S-03-MC-720017		61,354
Family Self Sufficiency Program	14.871	RQ-038-4NPH		14,454
Subtotal - U.S. Department of Housing and Urban Development				$ 6,718,002

* Major federal program

** Represents major federal program of Villas del Parque (FmHA Project No. 63-033-0690660049), a proprietary fund of the Municipality of Juana Díaz, which was audited by other auditors. See Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133. Refer to separate Single Audit Report performed by other auditors, dated August 24, 2006.

MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Schedule of Expenditures of Federal Awards
Fiscal Year Ended June 30, 2006

Federal Grantor/Pass-through Grantor/ Program or Cluster Title	CFDA Number	Entity Identifying Number		Federal Expenditures
U.S. Department of Agriculture:				
Pass-through the Department of Education of the Commonwealth of Puerto Rico - Child and Adult Care Food Program	10.558	CCC-007JD	*	443,105
Federal Emergency Management Agency:				
Pass-through the Governor's Authorized Representative at the Federal Emergency Management Agency:				
Public Assistance Grants:				
November Storms - Disaster No. 1613	83.544	1613-DRPR		109,798
Hurricane Georges - Disaster No. 1247	83.544	1247-DRPR		85,786
Storm Jeanne – Disaster No. 1552	83.544	1552-DRPR		31,018
Emergency Management Performance Grants	83.552	N/A		24,243
Subtotal - Federal Emergency Management Agency				250,845
U.S. Department of Labor:				
Pass-through the South Central Local Area of Investment in Work Force of the Commonwealth of Puerto Rico	-	N/A		131,013
U.S. Department of Transportation:				
Pass-through the Transit Safety Commission of the Commonwealth of Puerto Rico:				
Traffic Enforcement	20.601	N/A		13,981
Regional Community Program	-	06-06-19		51,365
Subtotal - U.S. Department of Transportation				65,346
Total expenditures of federal awards				**$ 13,704,919**

* Major federal program

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality of Juana Díaz, Commonwealth of Puerto Rico (the Municipality), including Villas del Parque (FmHA Project No. 63-033-0690660049), a proprietary fund of the Municipality which separate single audit report reflect total expenditures of federal awards of $493,446 for the fiscal year ended June 30, 2006. The Municipality's reporting entity is disclosed in Note 1 to the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2006.

The accompanying schedule of expenditures of federal awards is presented on the modified accrual basis of accounting, except for the expenditures of Villas del Parque, which have been reported on the accrual basis of accounting.

The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

RMS-CPA & Company, PSC

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INDEPENDENT AUDITORS' 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

The Honorable Mayor, Members of
the Municipal Legislature and Federal
Awarding Agencies of the Municipality
of Juana Díaz, Commonwealth of Puerto Rico

We have audited the financial statements of the governmental activities, each major governmental fund and the aggregate remaining governmental fund information of the Municipality of Juana Díaz, Commonwealth of Puerto Rico (the Municipality), as of and for the fiscal year ended June 30, 2006. The Municipality's basic financial statements include the financial statements of Villas del Parque (FmHA Project No. 63-033-0690660049), a business-type activity (proprietary fund) of the Municipality which single audit report reflect total assets, liabilities, net assets, revenues and expenses of $1,742,043, $1,408,670, $333,373, $347,926 and $493,446, respectively, as of and for the fiscal year ended June 30, 2006. We did not audit the financial statements of Villas del Parque as of and for the fiscal year ended June 30, 2006. The accompanying statement of net assets – proprietary fund and the statement of revenues, expenses and changes in fund net assets – proprietary fund are financial statements of Villas del Parque, which were audited by other auditors whose report, dated August 24, 2006, has been furnished to us, and our opinions, insofar as it relates to Villas del Parque, was based solely on the report of the other auditors. The accompanying statement of cash flows – proprietary fund is a financial statement of the Villas del Parque, which we did not audit nor has been audited by the other auditors. Except as discussed in the following paragraphs, 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.

In our report on the basic financial statements, we expressed an adverse opinion on the statement of net assets principally because the Municipality did not have complete, updated and accurate accounting records of capital assets, compensated absences and intergovernmental grants and contributions receivable. In addition, the Municipality did not adopt the provisions of Statement No. 42, *Accounting and Financial Reporting of Impairments of Capital Assets and for Insurance Recoveries*, and Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs,* both issued by the Governmental Accounting Standards Board.

Also, in our report on the basic financial statements, we expressed a qualified opinion on the balance sheet – governmental funds principally because the Municipality did not have complete, updated and accurate accounting records of inter-fund balances and intergovernmental grants and

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INDEPENDENT AUDITORS' 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)

contributions receivable, for which we had substantial doubts about the existence and valuation of such assets at June 30, 2006.

Also, in our report on the basic financial statements, we expressed a qualified opinion on the statement of net assets – proprietary fund, which was based solely on the report of the other auditors, because that financial statements did not include a liability for compensated absences required by Statement No. 16, *Accounting for Compensated Absences*, issued by the Governmental Accounting Standards Board.

Also, in our report on the basic financial statements, we did not express an opinion on the governmental activities reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances (deficits) principally because we were not engaged to audit the basic financial statements of the Municipality as of and for the fiscal year ended June 30, 2005 (the preceding fiscal year) and we were unable to satisfy ourselves, by means of other audit procedures, regarding the balances of assets, liabilities, net assets (liabilities) and fund balances (deficits) of the governmental activities reported in the statement of net assets and the balance sheet - governmental funds at June 30, 2005. Those balances materially affect the determination of the results of operations and cash flows for the fiscal year ended June 30, 2006.

Also, in our report on the basic financial statements, we expressed an unqualified opinion on the statement of revenues, expenses and changes in fund net assets – proprietary fund, which was based solely on the report of the other auditors.

Also, in our report on the basic financial statements, we did not express an opinion on the statement of cash flows – proprietary fund because it was not audited by us nor has been audited by the other auditors.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our 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 the Municipality'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 items 06-01, 06-02, 06-03, 06-04, 06-05, 06-06, 06-07, 06-08, 06-09, 06-10, 06-11, 06-12 and 06-13.

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INDEPENDENT AUDITORS' 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 (CONCLUDED)

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, we consider items 06-01, 06-02, 06-03, 06-04, 06-05, 06-06, 06-07, 06-08, 06-09, 06-10, 06-11, 06-12 and 06-13 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 06-14, 06-16, 06-19, 06-21, 06-25, 06-26, 06-27, 06-31, 06-32, 06-33, 06-36, 06-39, 06-41, 06-42, 06-43, 06-45, 06-48, 06-49, 06-50, 06-51 and 06-53.

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

RMS-CPA & Company, PSC

Bayamón, Puerto Rico
December 22, 2006

Stamp No. 2122887 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the original of this report

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

The Honorable Mayor, Members of
the Municipal Legislature and Federal
Awarding Agencies of the Municipality
of Juana Díaz, Commonwealth of Puerto Rico

Compliance

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

The Municipality's basic financial statements include the financial statements of Villas del Parque (FmHA Project No. 63-033-0690660049) (Villas del Parque), a proprietary fund which single audit report reflect total revenues and expenditures (expenses) of federal awards of $347,926 and $493,446, respectively, for the fiscal year ended June 30, 2006. We did not audit the compliance of Villas del Parque, 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 the major program of Villas del Parque for the fiscal year ended June 30, 2006. The compliance with those requirements were audited by other auditors whose report, dated August 24, 2006, has been furnished to us, and our opinion, insofar as it relates to the major federal program of Villas del Parque, is based solely on the report of the other auditors. Compliance with the requirements of laws, regulations, contracts, and grants applicable to Villas del Parque is the responsibility of the Municipality's management.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal

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

program occurred. An audit includes examining, on a test basis, evidence about the Municipality's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Municipality's compliance with those requirements.

As described in items 06-14, 06-16 and 06-17 in the accompanying schedule of findings and questioned costs, the Municipality did not comply with the activities allowed/allowable costs, equipment and real property management, reporting and procurement, suspension and debarment requirements that are applicable to its Child and Adult Care Food Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

As described in items 06-19, 06-20, 06-21, 06-24, and 06-26 in the accompanying schedule of findings and questioned costs, the Municipality did not comply with the activities allowed/allowable costs, procurement, suspension and debarment, Davis-Bacon Act, reporting, cash management, and equipment and real property management requirements that are applicable to its Section 108 Loan Guarantee Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

As described in items 06-27, 06-28, 06-29, 06-31, 06-32, 06-34 and 06-36 in the accompanying schedule of findings and questioned costs, the Municipality did not comply with the activities allowed/allowable costs, cash management, Davis-Bacon Act, procurement, suspension and debarment, special tests and provisions – rehabilitation projects, equipment and real property management and reporting requirements that are applicable to its Community Development Block Grants Program - Entitlement Grants and the Community Development Block Grants – State-Administered Small Cities Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to those programs.

As described in items 06-39, 06-40, 06-42, 06-43, 06-44, 06-45 and 06-46, in the accompanying schedule of findings and questioned costs, the Municipality did not comply with the special tests and provisions – housing quality standards inspections, special tests and provisions – selection from the waiting list, activities allowed/allowable costs, cash management, equipment and real property management and eligibility requirements that are applicable to its Section 8 Housing Choice Voucher Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

As described in items 06-47, 06-48, 06-50, 06-51 and 06-53 in the accompanying schedule of findings and questioned costs, the Municipality did not comply with the cash management, equipment and real property management, procurement, matching, procurement, reporting and

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

activities allowed/allowable costs requirements that are applicable to its Head Start Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

In our opinion, based on our audit and the report of the other auditors, except for the instances of noncompliance described in the preceding paragraphs for the Head Start Program, the Community Development Block Grants Program – Entitlement Grants, the Community Development Block Grants – State-Administered Small Cities Program, the Section 8 Housing Choice Voucher Program, the Section 108 Loan Guarantee Program and the Child and Adult Care Food Program, the Municipality of Juana Díaz, Commonwealth of Puerto Rico, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2006.

The results of our auditing procedures also disclosed other 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 06-15, 06-18, 06-22, 06-23, 06-25, 06-30, 06-33, 06-35, 06-37, 06-38, 06-39, 06-40, 06-41, 06-49, 06-52 and 06-54.

Internal Control Over Compliance

The management the Municipality of Juana Díaz, Commonwealth of Puerto Rico, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance 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 the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-14, 06-16, 06-17, 06-19, 06-20, 06-21, 06-24, 06-26, 06-27, 06-28, 06-29, 06-31, 06-32, 06-34, 06-36, 06-42, 06-43, 06-44, 06-45, 06-46, 06-47, 06-48, 06-50, 06-51 and 06-53.

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

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 weaknesses. However, of the reportable conditions described above, we consider items 06-14, 06-16, 06-17, 06-19, 06-20, 06-21, 06-24, 06-26, 06-27, 06-28, 06-29, 06-31, 06-32, 06-34, 06-36, 06-39, 06-42, 06-43, 06-44, 06-45, 06-46, 06-47, 06-48, 06-50, 06-51 and 06-53 to be material weaknesses.

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

RMS-CPA & Company, PSC

Bayamón, Puerto Rico
December 22, 2006

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MUNICIPALITY OF JUANA DÍAZ,
COMMONWEALTH OF PUERTO RICO
Schedule of Findings and Questioned Costs
Section I: Summary of Auditors' Results
Fiscal Year Ended June 30, 2006

Financial Statements:

Type of auditors' report issued: Qualified for balance sheet – governmental funds and the statement of net assets – proprietary funds; adverse for statement of net assets; unqualified for statement of revenues, expenses and changes in fund net assets; and disclaimer of opinion on statement of activities, statement of revenues, expenditures and changes in fund balances (deficits) and statement of cash flows

Internal control over financial reporting:
Material weakness(es) identified? __X__ Yes ____ No
Reportable condition(s) identified not considered to be material weakness? ____ Yes __X__ None reported

Noncompliance material to financial statements noted? __X__ Yes ____ No

Federal Awards:

Internal control over major programs:
Material weakness(es) identified? __X__ Yes ____ No
Reportable condition(s) identified not considered to be material weaknesses? ____ Yes __X__ None reported

Type of auditor's report issued on compliance for major programs: Unqualified opinion for Section 8 New Construction and Substantial Rehabilitation Program and qualified opinion for each other major program

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

Identification of major programs:

CFDA Numbers	Name of Federal Program or Cluster
93.600	Head Start Program
14.218	Section 108 Loan Guarantee
14.218	Community Development Block Grants – Entitlement Grants
14.871	Section 8 Housing Choice Voucher
14.228	Community Development Block Grants – State-Administered Small Cities Program
14.182	Section 8 New Construction and Substantial Rehabilitation Program
10.558	Child and Adult Care Food Program

Dollar threshold used to distinguish between Type A and Type B Programs $396,344

Auditee qualified as low-risk auditee? ____ Yes __X__ No

06-01 DEFICIENCIES IN THE UNIFORM ACCOUNTING SYSTEM AND OTHER ACCOUNTING RECORDS

Statement of Condition

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

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

The following specific additional conditions were noted in relation to the UAS of the Municipality as part of our internal control and substantive tests:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems (including UAS) for which no reconciliation procedures are made among them, including the accounting records currently used by federal financially assisted programs of the Municipality which are not reconciled with the UAS. Substantially all balance sheet accounts in the UAS are generally not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.

- The UAS does not have the capabilities of: (1) distinguishing between expenditures (or expenses) incurred and encumbered, (2) recording and processing all types of capital asset transactions, principally the accounting and reporting of depreciation and amortization expense, (3) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (4) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, estimated liability for municipal solid waste landfill closure and post-closure maintenance costs, etc.

- No adequate year-end closing procedures are made to account for all transactions affecting all funds.

- No adequate segregation is made between items representing actual accounts payable and those representing outstanding encumbrances. Accordingly, material amounts of unrecorded liabilities are generally recorded at fiscal year-end manually, which causes inadequate interim financial reporting for managerial purposes and untimely financial reporting for external parties.

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

- No adequate and complete accounting records are kept for inter-fund balances and transactions. The Municipality's accounting records do not maintain adequate documentation to support the existence, completeness and valuation of inter-fund balances.

- No adequate and complete accounting records are kept for accounts receivable transactions. The Municipality's accounting records do not maintain adequate documentation to support the existence, completeness and valuation of accounts receivable balances and the efforts carried out by the management of the Municipality to collect those balances periodically. Generally, material amounts of unrecorded receivables are recorded at fiscal year-end manually, which causes inadequate interim financial reporting for managerial purposes and untimely financial reporting for external parties.

- The audit adjustments resulting from Single Audits are not posted in the UAS, consequently, the UAS do not reflect the real financial position and the results of operations of the Municipality and its governmental and proprietary funds.

Currently, in order to achieve an accurate financial reporting for external parties, the basic financial statements of the Municipality are prepared using financial information obtained from various municipal departments and accounting records outside of the official UAS, and from information obtained from regulators, federal and state governmental agencies, and independent third parties. In addition, the Department of Finance of the Municipality does not maintain accounting records and working papers supporting the balances and disclosures reported in the basic financial statements, principally those related to government-wide financial reporting.

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

- The conversion of accounting records from the cash basis of accounting used by the UAS to the modified accrual basis and the accrual basis of accounting used by governmental funds and proprietary funds for financial reporting purposes, respectively;

- The conversion of governmental funds from the modified accrual basis to the accrual basis of accounting used by government-wide financial statements; and

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

Criteria

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

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

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

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

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

Cause and Effect:

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2006 was completed during December 2006. A significant amount of accounting and audit adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the incorrect accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent a material weakness in the Municipality's internal controls over financial reporting.

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

As a partially mitigating factor, the Municipality established a *Financial Reporting Task Force* composed of the management team of the Department of Finance and outside consultants. Such team worked together after the year-end closing to prepare the Municipality's basic financial statements, including most of the accounting records and reports needed to support the balances and disclosures reported in the basic financial statements as of and for the fiscal year ended June 30, 2006.

Questioned Costs: None

Independent Auditors' Recommendation

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

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

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

The selection and implementation of a new accounting system must be made with the approval of the Office of the Commissioner of Municipal Affairs and in compliance with Law No. 81 and other applicable regulations.

06-02 MANUAL ACCOUNTING SYSTEM AND LACK OF RECONCILIATION WITH UNIFORM ACCOUNTING SYSTEM (UAS)

Statement of Condition

During fiscal year ended June 30, 2006, the Municipality used a manual accounting system for the purpose of preparing various accounting cycles of the Municipality. Such system consists principally of electronic spreadsheets in which the Municipality accounts for all financial transactions of substantially all accounting cycles, including the disbursements and collections cycles.

However, the Uniform Accounting System (UAS), which is the official accounting system of the Municipality (required by law to be used for financial reporting purposes and the preparation of the basic financial statements), has been actually used by the management of the Municipality in a limited manner. Several significant transactions are not accounted for in the UAS in timely manner, and other transactions incurred during the fiscal year ended June 30, 2006 were not recorded in the UAS at such balance sheet date. The Municipality does not perform a reconciliation process of both systems, although both systems have significant timing and permanent differences at June 30, 2006, principally those arising for a significant number of checks issued manually from various bank accounts.

At June 30, 2006, the Municipality has not obtained the approval from the Office of the Commissioner of Municipal Affairs for the use of the manual system referred to above.

Criteria

Article 8.010(c) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that every municipality shall be obligated to use the UAS designed and approved by the Office of the Commissioner of Municipal Affairs for all municipalities of the Commonwealth of Puerto Rico, including its charts of accounts, the reporting requirements and its internal control regulations.

The Municipalities may adopt an accounting system different than the UAS, subject to previous evaluation and approval of the Office of the Commissioner of Municipal Affairs.

Cause and Effect

Due to the inherent limitations of the UAS, some of which have been reported in audit finding number 06-01, the management of the Municipality implemented and used the manual accounting system referred to above.

The lack of a reconciliation process between the UAS and the manual accounting system may increase the risk of fraudulent financial reporting and may increase the risks of misappropriation of assets and undetected errors and irregularities, including those related to federal financially assisted programs. This situation may lead to incorrect or fraudulent budgetary reporting since the budgetary system of the UAS may not have all disbursements incurred during a given fiscal year, which may cause that the Budgetary Liquidation Report prepared at the end of the fiscal year to be misleading. Accordingly, these conditions represent a material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Municipality to ascertain that all accounting transactions of the Municipality are accounted for in the UAS and a reconciliation process between the UAS and the manual accounting system is made and documented on a monthly basis. Differences between both accounting systems must be identified and adjusted on a monthly basis also.

We also recommend the Municipality to limit the use of the manual system to accounting areas and transactions for which the UAS is not capable of handling, such as capital assets' depreciation expense, long-term debt, etc. In the other hand, the Municipality must maintain the UAS as its primary and official accounting system, which implies that it must account for all financial transactions, principally all disbursements.

06-03 MANUAL CHECKS NOT RECORDED IN THE UNIFORM ACCOUNTING SYSTEM (UAS)

Statement of Condition

Per our examination of the bank accounts of the Municipality, we noted that for the following bank accounts, there were numerous checks issued manually during the current fiscal year that were not recorded in the check register of the UAS at June 30, 2006:

Bank Account Name	Dollar Value of Manual Checks Not Recorded in the UAS
Professional services account	$ 391,559.18
ACOOP	112.00
Parents' Contributions – Child Care	2,141.21
Arús Special Community	59,447.97
Chalecos	179.51
Improvements Head Start Arús	948.85
Office of the Youth	167.07
Public Works Convenue	3,168.00
Bond Issuance - $1,510,000	111,021.22
Bond issuance - $1,050,000	3,288.15
Bond issuance - $530,000	24.41
Bond issuance - $785,000	17,023.70
Bond issuance - $1,680,000	989.00
Reserve Surplus 1999	91.98
FEMA – Hurricane Georges	174,269.95

Bank Account Name	Dollar Value of Manual Checks Not Recorded in the UAS (concluded)
FEMA – Storm Jeanne	59,330.01
Bond LC 57 MMAEE	268,613.90
Manzanilla Special Community	7,288,479.12
Total	**$ 8,380,855.23**

The checks referred to above were recorded in the basic financial statements of the Municipality as of and for the fiscal year ended June 30, 2006 through adjusting journal entries and the manual accounting systems of the Municipality.

Criteria

Article 8.010(c) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that every municipality shall be obligated to use the UAS designed and approved by the Office of the Commissioner of Municipal Affairs for all municipalities of the Commonwealth of Puerto Rico, including its charts of accounts, the reporting requirements and its internal control regulations.

Cause and Effect

This condition arose because of the lack of a reconciliation process between the UAS and the manual accounting system. This situation may increase the risk of fraudulent financial reporting and may increase the risks of misappropriation of assets and undetected errors and irregularities, including those related to federal financially assisted programs. This situation may lead to incorrect or fraudulent budgetary reporting since the budgetary system of the UAS may not have all disbursements incurred during a given fiscal year, which may cause that the Budgetary Liquidation Report prepared at the end of the fiscal year to be misleading. Accordingly, these conditions represent a material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Municipality to ascertain that all accounting transactions of the Municipality are accounted for in the UAS and a reconciliation process between the UAS and the manual accounting system is made and documented on a monthly basis. Differences between both accounting systems must be identified and adjusted on a monthly basis also.

06-04 DEFICIENCIES IN BANK ACCOUNT RECONCILIATIONS

Statement of Condition

For each of the twelve months of the fiscal year ended June 30, 2006, the Municipality did not reconcile the cash balances reported in the monthly bank statements of several bank accounts against their respective balances reported in the general ledgers of the Municipality's Uniform Accounting System (UAS). The reconciliation process performed by the Municipality's Department of Finance has been limited to present, in a form of a "partial bank reconciliation report", the bank balances at the end of each month for each bank account, reduced by the effect of outstanding checks and increased by deposits in transit of each account, as applicable. However, such reconciliations did not compare the adjusted bank balances at the end of each month with the book cash balances carried over in the UAS.

In addition, the Municipality does not have an effective internal control structure to ensure the prompt reconciliation of all bank accounts at the fiscal year-end. As part of our audit procedures, we noted that for the month ended June 30, 2006, the "partial bank reconciliation reports" were completed in September 2006. The "Model 4A Cash Transaction Report" as of June 30, 2006 was also not prepared in a timely manner and various unreconciled differences presented in such report were not adjusted.

Furthermore, the Municipality has not established adequate internal controls and procedures to ensure that cash collections are deposited in the corresponding bank accounts. We noted that the Municipality erroneously deposited the following cash collections in the incorrect bank accounts:

Incorrect Bank Account In Which the Deposit Was Made	Bank Account in Which the Deposit Should Have Been Made	Deposit Amount
Child and Adult Care Food Program Fund	Section 108 Loan Guarantee Program Fund (see Audit Finding No. 06-22)	$5,618,000
Department of Labor– Law 82 Payroll Grant Fund	Department of Labor– Law 52 Payroll Grant Fund	$ 107,484
Manzanilla Special Community Fund	Arus Special Community Fund	$ 50,225

Criteria

Article 8.011 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality has the obligation of protecting its assets and financial resources against any type of financial loss. The bank reconciliation process is the primary internal control procedure needed to avoid misappropriation of cash balances and to minimize the risks of possible errors, irregularities or fraud.

In addition, Article E, Section 5(d) of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico*, establishes that the accounting system of the Municipality shall provide for the timely and accurate preparation of bank reconciliations as a control procedure to prevent or timely detect possible errors or irregularities.

Cause and Effect

This condition occurs because the Municipality's management is not enforcing the preparation of bank reconciliations in a complete manner and within the time required by law.

The process of fiscal year-end closing of the Municipality's accounting records was extended through September 2006; therefore, the process of preparing the "partial bank reconciliations" was also delayed until September 2006.

The efficiency and effectiveness of the bank reconciliation process as a control over recorded cash balances is greatly diminished when the reconciliations are not prepared in a timely and complete manner. This situation increases the risks of undetected events of possible frauds, errors or irregularities. In addition, the continued occurrence of depositing financial resources in the incorrect bank accounts increases the risks of incurring unallowable disbursements and possible future questioned costs.

The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation:

We recommend the Municipality to develop procedures to ensure that all bank accounts are reconciled each month on a timely basis and in a complete manner, which includes the reconciliation of the cash balances reported in the monthly bank statements against the balances reported in the general ledger of the Municipality's UAS. This process should be made and completed each month within thirty (30) days after month-end. Since the Municipality receives the bank statements approximately twenty (20) days after each month, the Municipality may request cut-off statements from the respective banks within five (5) business days after each month, in order to have sufficient time to prepare the reconciliations on a monthly basis.

The implementation of this recommendation will help ensure that reconciling items are resolved in a timely manner and the Municipality will be able to identify and resolve potential errors or irregularities.

06-05 DEFICIENCIES IN ACCOUNTING RECORDS OF CAPITAL ASSETS

Statement of Condition

The Municipality does not have and effective system to accurately account for capital assets. There are no internal controls and procedures to ensure that all capitalizable expenditures and property dispositions are recorded in the capital assets subsidiary ledger. A significant portion of the real property, personal property and infrastructure acquired, constructed or improved with federal and local funds is not currently recorded in the capital assets subsidiary ledger. Accordingly, the Municipality has not maintained complete and adequate records over capital assets.

The Municipality has not performed periodical physical inventories of its capital assets (real property, personal property and infrastructure). As part of our internal control and substantive tests, we noted that the Municipality has not organized and performed a physical inventory during the fiscal year ended June 30, 2006. Accordingly, the capital assets recorded in the accompanying statement of net assets do not include several items of the real property and the infrastructure assets, which should be reported as part of the capital assets of the Municipality according to Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended, *Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments*.

The following additional conditions were noted in relation to capital assets:

- The Municipality's capital asset subsidiary ledger is not reviewed or updated on a regular basis for the purposes of identifying and removing those items that have been impaired, taken out of service or provide no future benefit. As a result, the capital assets subsidiary ledger does not accurately provides sufficient and competent evidence of the existence, ownership and valuation of the capital assets owned by the Municipality.

- Currently, the capital asset records are prepared manually which may increase the risks of clerical errors or irregularities over capital assets.

- The Municipality does not have formal accounting and control procedures and policies to ensure compliance with the capital assets requirements established by GASB No. 34 and Statement No. 42 of the Governmental Accounting Standards Board, *Accounting and Reporting for Impairments of Capital Assets and Insurance Recoveries* (GASB No. 42).

- The subsidiary ledger of capital assets is not periodically reconciled with the property subsidiary ledgers maintained by the Municipality's several individual federal financially assisted programs.

Criteria

Article 9.002 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that all municipalities must prepare and maintain an updated subsidiary ledger (record) of all real properties.

In addition, Chapter VII, Section 22, of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico,* requires that each Municipality must maintain an adequate control of capital assets through annual physical inventories. In addition, any differences between physical inventory amounts and subsidiary records must be investigated and adjusted. Considering that according to accounting records of the Municipality, the capital assets represent the most significant assets of the Municipality, there is a significant risk of unauthorized use or disposition of capital assets because there are no adequate internal controls in place to ensure accountability of capital assets by department or federal program.

Chapter VII, Sections 3, 4, 14, 15 and 21 of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico* establish the following guidelines regarding property management:

- Section 3 establishes that the Finance Director is responsible for the accountability of the capital assets acquired by the Municipality through purchases or donations.
- Section 4 establishes that the Municipal Property Administrator shall be responsible to the Mayor and the Finance Director for the direct administration, use and maintenance of the entire real and personal property owned by the Municipality.
- Section 14(1) establishes that all municipal property shall be numbered and identified as to ownership by the Municipal Property Administrator.
- Section 15(1) establishes that the Municipal Property Administrator is responsible for accurately maintaining the central property records.
- Section 21(c) establishes that management shall write-off from the property records all property and equipment sold or disposed of when certified by the Internal Auditor of the Municipality upon determination that such disposal is adequate.

Cause and Effect

These instances of non-compliance occurred because the Property Division of the Municipality has not enforced the requirement to perform a capital assets inventory and to ensure the proper accountability of capital assets during the fiscal year ended June 30, 2006. Accordingly, the Municipality's internal controls in place over capital assets are not designed to effectively account for capital assets, since it do not allow for the reconciliation of detailed property records with the general ledger. This inadequate property internal controls may expose the Municipality to questioned or disallowed costs by the federal government for lost or stolen property. This condition represents a material weakness in the Municipality's internal controls over financial reporting.

Furthermore, this situation represents a significant risk of loss of capital assets because there is a lack of accountability for acquired capital assets. Any federally funded capital assets lost would need to be repaid to the federal government with municipal funds.

Questioned Costs: None

Independent Auditors' Recommendation

A physical inventory of the Municipality's capital assets should be taken as soon as possible and subsequently on annual basis. Physical inventory amounts should be reconciled with the capital assets recorded in the subsidiary ledgers. Furthermore, the Mayor may issue an executive order to require compliance with this requirement. For these purposes, the Property Division of the Municipality must require from each Municipal Department that acquires or manage capital assets to submit a report including a full description of the asset, location, use, source of funds used to acquire the asset, responsible personnel, cost and any other pertinent data required by state and local regulations. This information should be reconciled with the monthly disbursements (capital outlays) made against the budgetary accounts used for property acquisitions. Sales or other dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance Director, and should be carried out by persons other than the users and through public announcements or bids.

We also recommend that the Municipality implement a formal policy whereby all capital expenditures in excess of an established amount are capitalized with all other amounts charged to operations. This will lead to improved consistency and simplification of accounting records.

We also recommend that the subsidiary ledger of capital assets be updated on a monthly basis for the write-off of non-operational, fully depreciated, or impaired items. Having such a procedure in place will ensure that the Municipality has an accurate record of its capital assets and will ensure that gains and losses on disposals are recorded in the proper accounting period.

We also recommend that the subsidiary ledger shall be periodically reconciled with the property subsidiary ledgers maintained by the Municipality's several individual federal programs.

To provide greater control over the recording of capital asset additions and retirements, we also recommend the Municipality to consider purchasing a software package to automate the recording of capital assets along with automatically computing depreciation expense for financial reporting purposes. The use of such software package would improve the overall efficiency within the accounting function and allow for departmental reporting of depreciation expense, including federal programs.

06-06 UNAUTHORIZED INTER-FUND LOANS AND INADEQUATE ACCOUNTING RECORDS OF INTER-FUND BALANCES AND TRANSACTIONS

Statement of Condition

The Municipality has made various inter-fund cash loans from restricted financial resources without the previous authorization from federal or state grantors. As part of our audit procedures, we noted the following unauthorized loans made during the fiscal year ended June 30, 2006:

Lending Fund	Borrowing Fund	Loan Amount
Child and Adult Care Food Program	Head Start Program Fund	$ 50,000
Manzanilla Special Community Fund	General Fund	$ 714,084

Lending Fund	Borrowing Fund	Loan Amount
State Legislative Joint Resolutions Fund	Rural Development Corporation – Tijeras and Río Cañas Repaving Fund	$ 46,187
State Legislative Joint Resolutions Fund	General Fund	$ 131,013

In addition to the above conditions, the Municipality does not have formal accounting policies for inter-fund transactions. During our audit we noted that financial resources transferred among different funds are accounted for as "expenditures" in the fund making the transfer and as "revenues" in the receiving fund. Also, there are no subsidiary records to accurately account for the inter-fund receivable and payable balances and the proper authorization of such transactions.

The Municipality determined the amounts presented in the basic financial statements after searching for transfer transactions in its accounting records, but this process does not reduce the risk that these transactions are correctly accounted for. No consideration is given to the nature of the transaction as a transfer or as an inter-fund loan. Accordingly, revenues, expenditures, and inter-fund receivables and payables reported in the Uniform Accounting System (UAS) were adjusted for financial reporting purposes to partially conform to the presentation in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP). The above treatment of inter-fund transactions is not in accordance with GAAP.

In addition, the Municipality does not record in the UAS the audit adjustments of inter-fund transactions arising in the Single Audit, which creates permanent differences between the UAS and the audited financial statements.

Furthermore, the Municipality does not maintain adequate records showing the nature and collectibility of inter-fund balances, including the repayment terms and the repayment schedule. There are no subsidiary records documenting the efforts made by the Department of Finance to collect or pay inter-fund balances among funds.

Criteria

Article 8.010(b) of the Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the accounting system shall provide for the accounting procedures and records to be maintained in accordance with GAAP applicable to governmental entities.

In addition, the activities and the use of the financial resources of funds obtained through state or federal grants and contributions, are subject to the specific requirements found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program. Accordingly, these revenue sources are set aside for a specific purposes based on restrictions requiring that they be spent only for specified purposes.

Cause and Effect

The continued occurrence of these situations may result in additional uses of one fund's moneys to finance the activities of another fund, and the funds not being reimbursed to the proper fund. Accordingly, there is a possibility that situations occur in which the Municipality may need to refund the federal agencies for amounts owed resulting from unauthorized inter-fund transactions, including the possibility of being assessed penalties and interest costs on such advances. This may represent an additional financial burden to the Municipality's general fund, which currently has an accumulated deficit.

The aforementioned conditions represent a material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

The Municipality should establish and maintain a subsidiary ledger to accurately account for inter-fund transactions, including adequate information about the nature, terms and repayment schedule of such balances. Furthermore, the Municipality should immediately refund amounts owed to the federal funds, if any, to prevent the assessment the assessment of interest and penalties on such funds.

06-07 INACTIVE BANK ACCOUNTS AND FUNDS ARE NOT CLOSED

Statement of Condition

The Municipality is maintaining a number of bank accounts that have been inactive for a long period of time. During our audit, we noted that the Municipality's accounting records include eight (8) bank accounts that have been inactive or had insignificant transactions during the fiscal year ended June 30, 2006. The inactive bank accounts are the following:

Account Name	Balance
SBGP Sentencia	$ 81,320
Peñoncito	138
FEMA – October 2005 Storms	123,971
Los Buenos	29,690
Bond Issuance - $475,000	1,592
Bond Issuance - $160,000	3,301
Bond Issuance - $2,150,000	2,125
Summer Camp – ADFAM	3,554
Total	**$ 245,691**

In addition, at June 30, 2006 there were seventy-two (72) inactive special funds recorded within the pool cash account. Such funds had no transactions during the fiscal year ended June 30, 2006.

Criteria

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

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

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

Cause and Effect

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

Questioned Costs: None

Independent Auditors' Recommendation

The Municipality should determine whether the intended objectives of these funds were met. For all funds that have complied with the requirements, the Municipality should close them. Remaining balances in those funds should be disposed of in accordance with local and federal laws and regulations.

06-08 INADEQUATE RECORDS OF HUMAN RESOURCES AND COMPUTATION OF ACCRUED COMPENSATED ABSENCES

Statement of Condition

The Municipality does not maintain accurate and updated records of compensated absences (accrued vacations, sick leave and compensatory time). At June 30, 2006, the time and attendance records of the employees of the Municipality were incomplete and were not updated to reflect the real accumulated vacation, sick leave and compensatory time of each employee of the

Municipality, including those paid with the resources of federal and state financially assisted programs.

In addition, the Municipality does not have an effective system to ensure the completeness and accuracy of the employee files in the Human Resources Department.

Criteria

The Municipality must maintain accurate records of compensated absences pursuant to the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by the Governmental Accounting Standards Board (GASB No. 16). This statement establishes standards for accounting and reporting for compensated absences for all state and local governments.

Article 11.016 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that every municipality must prepare and manage a vacation plan designed to avoid that employees accumulate vacation licenses in *excess of the maximum* permitted by law per year.

Cause and Effect

Due to the fact that the time and attendance records of the Municipality were not updated at June 30, 2006, there were several differences between the number of days accrued in the cumulative records of several employees and the subsidiary ledger of compensated absences prepared by the Municipality at June 30, 2006.

This condition results from the failure to update the personnel cumulative records and other human resources files on a monthly basis. This could result in an over accumulation of time and payment of the cost at a higher rate than when earned by the employee. This condition represents a material weakness in the Municipality's internal control over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

The Municipality shall maintain and update on a monthly basis the personnel cumulative record with the monthly accrual, days taken, and the balance on a current basis, therefore, providing accurate information for the liquidation of accrued benefits at any moment and for the determination of the estimated liability for the financial statement presentation. In addition, the Human Resources Department must review all human resources files to ascertain that all human resources documents required by law are included in the employees' files.

06-09 MUNICIPAL SOLID WASTE LANDFILL CLOSURE AND POSTCLOSURE CARE AND MAINTENANCE COSTS

Statement of Condition

At June 30, 2006, the Municipality has not complied with the "Solid Waste Disposal Facility Criteria", issued on October 9, 1991 by the U.S. Environmental Protection Agency and the Statement No. 18 of the Governmental Accounting Standards Board, *Accounting for Municipal Solid Waste Landfill Closure and Post closure Care Costs*, issued by GASB (GASB No. 18).

The Municipality has not performed a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. In addition, the Municipality has not recognized a liability in the accompanying statement of net assets using current costs allocated based on the actual landfill capacity.

Criteria

Various state and federal regulations make the governments that operate municipal solid waste landfills financially responsible for properly closing the site at the end of its useful life and then monitoring and maintaining it afterwards, typically for thirty (30) years.

According to the regulations set forth by the U.S. Environment Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", the Municipality is required to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure.

In addition, GASB No. 18 requires the Municipality to perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality must recognize a liability in its government-wide financial statements using current costs allocated based on the actual landfill capacity used at June 30, 2006.

Furthermore, the governments that operate municipal solid waste landfills may be required to provide financial assurance that they will meet their legal obligation to close, monitor, and maintain the landfill site properly once it is no longer in active use. Governments that operate municipal solid-waste landfills may place assets in trust for this purpose.

Cause and Effect

This condition occurred because the Municipality has not allocated the financial resources needed to perform the study required by EPA and GASB No. 18. The continued occurrence of this situation will result in unexpected significant financial burdens to the Municipality at the future date when it closes its municipal solid waste landfill, and will result in continued future audit qualifications or disclaimers of opinions from the independent auditors of the Municipality over its basic financial statements. The aforementioned conditions represent a material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

The Municipality should perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. We also recommend that the Municipality commence a planning and budgeting process or to place assets in trust for these purposes.

06-10 FAILURE TO APPROPRIATE FINANCIAL RESOURCES FOR THE AMORTIZATION OF THE ACCUMULATED DEFICIT IN THE GENERAL FUND

Statement of Condition

The Municipality is not taking the appropriate steps to amortize or reduce the accumulated deficit in the general fund. At June 30, 2003, 2004 and 2005 and 2006, the accumulated deficit of the Municipality's general fund has been \$1,161,589, \$1,066,402, \$1,405,434 (as restated) and \$1,394,002, respectively. Such accumulated deficit is caused by the cumulative results from many years in which expenditures have exceeded revenues, and because the economic measures taken by the Municipality have not yet resulted in the reduction of the accumulated deficit.

Criteria

Article 7.011(a) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81) states that for any accumulated deficit incurred in the general fund at the end of any given fiscal year, the Municipality must reserve the necessary financial resources in the general fund's operating budget of the immediately following fiscal year to cover such deficit.

Cause and Effect

The foregoing situation is primarily due to the failure to establish the required budget appropriation by the Municipality in order to amortize the accumulated deficit at June 30, 2003, 2004, 2005 and 2006 because this would have required a significant reduction of services to citizens and activities to achieve the required reduction. This situation will affect the Municipality's future ability to finance current operations since a significant amount of its future financial resources will be already committed to pay expenditures incurred in previous years.

The aforementioned condition represents a material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Municipality to include in the next fiscal year's budget the necessary financial resources to amortize the accumulated deficit reported at June 30, 2006. The Municipality may also evaluate the possibility of seeking long-term financing to fund such deficit.

06-11 UNAUTHORIZED USE OF NEXT FISCAL YEAR'S MUNICIPAL LICENSE REVENUE

Statement of Condition

Municipal license tax revenues of the fiscal year 2006-2007, which were collected in advance from taxpayers between January 1 and June 30, 2006 (known in Spanish as "Patente en Suspenso"), were used by the Municipality to cover certain operating costs and cash flows shortages of the general fund incurred during the fiscal year ended June 30, 2006. Such unearned municipal license tax revenues amounted to $1,382,454 and were related to the Volume of Business Declaration Return of the fiscal year 2006-2007 which were filed by taxpayers between January and June 2006.

Those unearned revenues collected in advance pertain to the general fund's operating budget of the fiscal year 2006-2007, could not be used to pay obligations of the fiscal year 2005-2006 and were not authorized by a municipal ordinance or resolution.

Criteria

Article 8.004(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81) states that the Municipality cannot use or obligate any amount in a given fiscal year that exceeds the appropriations and the resources authorized by ordinance or resolution for such fiscal year. In addition, the Municipality cannot be committed, in any form, to any contract or negotiation for the future payment of amounts that exceed the current fiscal year's budgeted resources.

Cause and Effect

The foregoing condition is primarily due to the following reasons:

- During prior fiscal years, the general fund's expenditures have exceeded its revenues consistently, which have lead the Municipality to also consistently consume in each fiscal year, the unearned municipal license revenues collected in advance for the next fiscal year.

- The Uniform Accounting System (UAS) does not provide for the gathering and recording of accurate financial information and preparation of accurate financial reports on a timely basis. Therefore, since current financial information is not readily available, management is not able to make effective and efficient decisions concerning the use of resources.

- The Municipality does not prepare cash flows forecasts and projections to anticipate any cash flows shortage.

- Management does not have timely and accurate information regarding its operations and cannot monitor the adherence to the established budget appropriations and cash flows.

- The Municipality is appropriating expenditures assuming that budgeted revenues have been actually collected.

- The budgeting system does not reflect actual revenues, therefore cannot prevent the obligation of expenditures for which current resources will not be available.

The continued occurrence of this situation will result in possible significant general fund limitations and eventual reduction or elimination of municipal services since future revenues will need to be used to pay for accumulated liabilities. The aforementioned conditions represent a material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Municipality to prepare cash flows forecasts and projections to anticipate any cash flows shortages and to avoid using financial resources of future fiscal years to cover the operating needs of the current fiscal year.

We also recommend that annual budgets must be developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budgets are prepared. This process must ensure that the operational budget of the general fund is adjusted for uncollected budgeted revenues.

06-12 QUARTERLY EXPENDITURES REPORTS NOT SUBMITTED

Statement of Condition

The Municipality does not have a reliable financial reporting system to ensure the preparation and submission of quarterly reports for the use of funds assigned to each municipal department. During our audit, we noted that most municipal departments failed to submit to Department of Finance the required quarterly reports of expenditures and encumbrances.

Criteria

Chapter II, Section 5(1) of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico*, requires from each of the municipal department directors to prepare and submit to the Department of Finance an estimate of expenditures per quarter. This information should be used by the Director of Finance to prepare a general quarterly report. Copies of this report should be forwarded to the Mayor, the Internal Auditor and to the Office of the Commissioner of Municipal Affairs.

Cause and Effect

This condition results from the failure of various municipal departments to monitor compliance with the required reporting requirements by ensuring the timely preparation and submission of financial reports. The aforementioned conditions represent a material weakness in the Municipality's internal controls over financial reporting.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Municipality to establish a report calendar to inform all Department Directors of the due dates of each quarterly financial report. The report calendar will help to establish the priorities by ensuring that accounting books shall be accurately and promptly closed to allow for the accurate and timely submission of the financial reports.

06-13 LACK OF EVIDENCE OF MONITORING AND FRAUD PREVENTION ACTIVITIES BY THE INTERNAL AUDIT DEPARTMENT

Statement of Condition

As part of our evaluation of internal controls, the Internal Audit Department could not provide us evidence of:

- The internal audits and monitoring activities performed by such department during the fiscal year ended June 30, 2006;

- The quarterly reports submitted to the Mayor and the Office of the Commissioner of Municipal Affairs, required by Law;

- The implementation of several corrective actions related to the following Audit Reports issued by the Office of the Comptroller of Puerto Rico: (1) Report No. M-04-11 of October 14, 2003, Report No. M-04-12 of October 22, 2003 and Report No. M-04-21 of December 4, 2003;

- The implementation of several corrective actions related to the Single Audit findings of the following federal programs for the fiscal year ended June 30, 2005: (1) Community Development Block Grant – Entitlement Grant (CFDA No. 14.218), (2) Community Development Block Grant – State's Program (CFDA No. 14.228), (3) Head Start (CFDA No. 93.600), (4) HIV Emergency Relief Project Grants (CFDA No. 93.914), and (5) Public Assistance Grant (CFDA No. 83.544)

- The implementation of the corrective actions related to the monitoring reports issued by the Administration of Children and Families of the Commonwealth of Puerto Rico, the U.S. Department of Housing and Urban Development, and other regulators and grantors.

In addition to the conditions referred to above, the Internal Audit Department and the management of the Municipality have not designed, documented nor placed in operations specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material fraudulent financial reporting. In addition, the Internal Audit Department does not keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality's core processes.

The aforementioned conditions represent a material weakness in the Municipality's internal controls over financial reporting.

Criteria

Article 6.004 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states the internal audit department shall perform interventions, audits and monitoring activities over all municipal operations financed with public funds, including: (1) the acquisition, use and disposition of capital assets, (2) transactions and operations of all administrative units (municipal departments), (3) all accounts, records, books, contracts, budgets and any other financial activities, (4) prepare audit reports for the Mayor at least every three (3) months, (4) evaluate the recommendations of the Office of the Comptroller of Puerto Rico and any other audit or monitoring report and (5) give the appropriate follow-up procedures to all municipal department directors to ascertain that corrective action plans and audit recommendations are implemented in a timely manner.

Cause and Effect

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

The aforementioned conditions have caused that the corrective actions related to findings issued by the independent auditors and regulators have not been implemented in a timely manner, which ultimately results in repeated findings year after year. In addition, the lack of adequate monitoring activities by the Internal Audit Department increases the risks of undetected frauds, errors and irregularities in the operations of the Municipality.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Internal Audit Department to prepare achievable audit plans for the different operational and financial areas of the Municipality. Adequate audit programs should be prepared to carry out the monitoring activities in each operational area, and continued professional education of internal audit techniques and governmental accounting should be taken by internal auditors.

We also recommend the Municipality to adopt the necessary measures to ascertain that corrective actions are implemented in a reasonable period of time after the corrective action is determined. Proper follow up should be given to municipal department directors in charge of the implementation procedures.

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

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06-14 U.S. DEPARTMENT OF AGRICULTURE
Child and Adult Care Food Program – CFDA No. 10.558
Internal Control / Compliance:
Activities Allowed / Allowable Costs / Cost Principles
Procurement, Suspension and Debarment

Statement of Condition

As part of our testing of compliance with activities allowed and allowable costs for the program, we examined 12 disbursements amounting to $356,215 for the fiscal year ended June 30, 2006. The following exceptions were noted in the items examined:

- For six (6) disbursements amounting to $299,130 (all of the same supplier), the Municipality did not verify that the supplier was not suspended or debarred or otherwise excluded. The Municipality did not check the Excluded Parties List System (EPLS) maintained by the General Services Administration, nor obtained a certification from the supplier and did not add a clause in the supplier's contract with the Municipality.

- For six (6) disbursements amounting to $299,130 (all of the same supplier and included in one single contract), the contract with the supplier did not have a clause stating the monetary limit of the contract, although such limit was reported to the Office of the Comptroller of Puerto Rico for the amount of $450,000.

- For the ten (10) disbursements, the payment vouchers and the related documents supporting the payment were not stamped as "paid".

- Four (4) disbursements amounting to $7,085 could not be traced to the general ledger and the payment voucher did not have the general ledger account to which the disbursement would be charged.

- Two (2) disbursements amounting to $50,000 represent unauthorized unallowable cash loans given by the Child and Adult Care Food Program to the Head Start Program. Of these two loans, the Head Start Program reimbursed $40,000 to the Child and Adult Care Food Program prior to June 30, 2006 and $10,000 remained outstanding at year-end (questioned cost $10,000).

Criteria

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

Section 7 of Chapter IV of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico* establishes that the pre-auditing unit or person in charge of pre-auditing disbursement documents shall keep a record of the authorized signatures of the Municipality. He or she shall ascertain that the officers certifying the disbursement documents are so authorized. He or she shall verify the correctness of the documents in all of its parts and that the transactions in order to pursuant the correct legislation, ordinances, resolutions, contracts and regulations. Once everything is found to be in order, the document shall be certified as pre-audited and shall be sent for the approval of the Director of Finance. In addition, the payment vouchers, all canceled checks and any other document that support a payment should be filed by the Director of Finance to be audited by the Puerto Rico Comptroller's Office or any other regulator, as required by law.

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of certain procurement, suspension and debarment regulations applicable to federal financially assisted programs, as well as, the lack of internal controls and procedures designed to appropriately review payment vouchers prior to the issuance of a payment.

The continued occurrence of this situation will result in possible unsupported disbursements and payments to suspended or debarred suppliers.

Questioned Costs: $10,000

Independent Auditors' Recommendation

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

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the process of acquisition of goods and services.

06-15 U.S. DEPARTMENT OF AGRICULTURE
Child and Adult Care Food Program – CFDA No. 10.558
Internal Control / Compliance:
Eligibility

Statement of Condition

As part of our testing of compliance with eligibility requirements, we examined a sample of 60 participants out of a population of 938 participants. For one participant of the sample, we could not evaluate her eligibility because its participant file was not found by the Municipality within a reasonable period of time after requested by us for examination and by the time the audit procedures were performed.

Criteria

7 CFR 226.2 states that any individual meeting the definition of "children" or "adult participant", and who is enrolled in a participating nonresidential institution (or, with respect to children, an emergency shelter), may receive meals under the Child and Adult Care Food Program. A participant's eligibility may be established by the following methods: (1) household application (general rule) or (2) categorical eligibility (exception).

Cause and Effect

These conditions occurred because of the lack of internal controls and procedures designed to safeguard participant files and eligibility records. The continued occurrence of this situation will result in possible ineligible participants.

Questioned Costs: $480

Independent Auditors' Recommendation

We recommend the Child and Adult Care Food Program to establish the necessary internal controls and procedures to ensure that all participant files and eligibility records are safeguarded at all times.

06-16 U.S. DEPARTMENT OF AGRICULTURE
Child and Adult Care Food Program – CFDA No. 10.558
Internal Control / Compliance
Equipment and Real Property Management

Statement of Condition

The Child and Adult Care Food Program has not complied with the property management requirements. There were no physical inventories performed during the fiscal years ended June 30, 2006 and 2005.

The Child and Adult Care Food Program has a subsidiary ledger of equipment acquired with federal funds, however, such subsidiary ledger does not comply with federal requirements because it does not: (1) have information needed to calculate the federal share of the cost of the equipment, (2) have information about the identification number of the asset, such as the manufacturer's serial numbers, (3) identify the grant under which the program acquired the equipment, (4) have information about the location, use and condition of the equipment and the date the information was obtained, (5) have all pertinent information on the ultimate transfer, replacement, or disposal of the equipment, and (6) have information about each asset's book value and accumulated depreciation.
Furthermore, there is no evidence that the total amount of capital expenditures and the composition of capital assets incurred of the Child and Adult Care Food Program have been reconciled with the general ledger or other control account to enhance the controls to prevent unauthorized disposition of assets.

Criteria

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

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

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

Cause and Effect

This situation occurred because the Municipality's property division is not performing physical inventories of the property periodically as required by law, nor requiring the accurate completion and documentation of the inventory lists.

This situation allows for the unauthorized disposition of assets because there is no reconciliation with a permanent property subsidiary to ensure that the assets acquired by the Municipality and charged to this federal financially assisted program still exist. Furthermore, there is no officer taking responsibility for the existence of such assets, thus this record may be altered or modified without the authorization of an authorized officer.

Questioned Costs: None

Independent Auditors' Recommendation

A physical inventory of the Child and Adult Care Food Program's capital assets should be taken as soon as possible and subsequent physical inventories should be made at least every two years. Physical inventory amounts should be reconciled with the property recorded on the subsidiary ledgers. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions. Dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance Director.

06-17 U.S. DEPARTMENT OF AGRICULTURE
Child and Adult Care Food Program – CFDA No. 10.558
Internal Control / Compliance
Reporting

Statement of Condition

The Child and Adult Care Food Program has not complied with the reporting requirements established by the Administration for Integral Care and Development of Children (ACUDEN, by its Spanish acronym), the pass-through entity of the grant award. The following *Quarterly Reports of Disbursements and Reimbursements* and the *Monthly Receipts of Claim for Reimbursement and Payment Voucher* required by the grant agreement with ACUDEN have been filed after the respective deadlines as follows:

Quarterly Report of Disbursements and Reimbursements for the Quarter Ended	Deadline for Filing per Grant Award	Actual Filing Date
September 30, 2005	October 14, 2005	March 21, 2006
December 31, 2005	January 10, 2006	March 21, 2006

In addition, the following monthly report of claim receipt for reimbursement required by the grant agreement with ACUDEN have been filed after the respective deadlines as follows:

Receipt of Claim for Reimbursement and Payment Voucher for the Month Ended	Deadline for Filing per Grant Award	Actual Filing Date
August 31, 2005	September 10, 2005	October 10, 2005
December 31, 2005	January 10, 2006	January 17, 2006

In addition to the above conditions, we noted that all of the *Quarterly Reports of Disbursements and Reimbursements* and the *Receipts of Claim for Reimbursement and Payment Voucher* for the fiscal year ended June 30, 2006 were prepared with accounting records kept by the Child and Adult Care Food Program, which were not reconciled with the general ledger of the Uniform Accounting System (UAS). Furthermore, such reports were not prepared following the Accounting Principles Generally Accepted in the United States of America (GAAP).

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Criteria

OMB No. 0584-0078 requires the Municipality to prepare Claims for Reimbursement Reports on a monthly basis to be submitted to ACUDEN. Such reports must present the number of meals served, by category and type, in institutions under ACUDEN's oversight during the report month. An initial monthly report, which may contain estimated participation figures, is due 30 days after the close of the report month. A final report containing only actual participation data is due 90 days after the close of the report month. Revisions to the data presented in a 90-day report must be submitted by the last day of the quarter in which they are identified.

Cause and Effect

This situation occurred because the Municipality has not adequate internal controls in place to ensure the timely preparation and filing of monthly and quarterly reports required by ACUDEN. This situation increases the possibility of increased oversight procedures from ACUDEN and delays in the process of collecting the reimbursement of costs of the program.
Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Child and Adult Care Food Program to establish adequate internal controls and procedures to ensure that the *Quarterly Reports of Disbursements and Reimbursements* and the *Monthly Receipts of Claim for Reimbursement and Payment Voucher* are prepared in a timely manner using financial data in agreement and reconciled with the Uniform Accounting System (UAS) and following the Accounting Principles Generally Accepted in the United States of America (GAAP). Adequate training should be given to the employees assigned to the preparation of these reports.

06-18 U.S. DEPARTMENT OF AGRICULTURE
Child and Adult Care Food Program – CFDA No. 10.558
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles
Procurement, Suspension and Debarment

Statement of Condition

As part of our procurement tests of the Child and Adult Care Food Program, we selected one contract from a supplier for examination. The disbursements related to that contract amounted to $299,130 for the fiscal year ended June 30, 2006.

Based on our examination of this contract, we noted that it did not include several contractual clauses required by the procurement standards established by 24 CFR 85.36, known as *Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments.* The contract examined did not include the contractual clauses described in the "Criteria" section below.

Criteria

24 CFR 85.36 requires that all grantee's and sub-grantee's contracts must contain the following provisions :

1. Administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as may be appropriate.

2. Notice of awarding agency requirements and regulations pertaining to reporting.

3. Access by the grantee, the sub-grantee, the federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions.

4. Mandatory standards and policies relating to energy efficiency which are contained in the state energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94A 163, 89 Stat. 871).

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the procurement requirements applicable to federal financially assisted programs, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with this federal requirement.

The continued occurrence of this situation will result in future instances of noncompliance with the federal procurement requirements.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Child and Adult Care Food Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of the federal procurement standards of 24 CFR 85.36. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

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06-19 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles
Procurement, Suspension and Debarment

Statement of Condition

As part of our testing of compliance with activities allowed and allowable costs for the program, we examined sixteen (16) disbursements totaling $1,869,807 for the fiscal year ended June 30, 2006. The following exceptions were noted in the items examined:

- For the sixteen (16) disbursements amounting to $1,869,807, the Municipality did not verify that the supplier was not suspended or debarred or otherwise excluded. The Municipality did not check the Excluded Parties List System (EPLS) maintained by the General Services Administration, nor obtained a certification from the supplier and did not add a clause in the supplier's contract with the Municipality.

- For nine (9) professional services disbursements amounting to $77,655 (all of the same supplier and consisting of the inspection of the construction of the Municipality's Fine Arts Center), the Municipality did not comply with the bidding requirements established by law. Although the professional services contract was for a total amount of $153,000, there was no evidence of a bidding process and the supplier selection processes. There was no evidence of full and open competition, there was no documentation as to the analysis performed by the Municipality for the procurement actions taken, and no approval from the U.S. Department of Housing and Urban Development was obtained by the Municipality. In addition, the Municipality did not obtain price estimates from three (3) suppliers.

- For the sixteen (16) disbursements amounting to $1,869,807, the payments could not be traced to the general ledger since were unrecorded at June 30, 2006.

Criteria

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

According to 40 CFR 12.76(d)(2) and (3), if a project is estimated to cost $100,000 or more, the sealed bid process or the "competitive proposals" procedure should be used for contracting services. Under the sealed bid process, bids are publicly solicited and the contract is awarded to the lowest responsible bidder. The sealed bid process is the preferred federal method for procuring construction. Under the "competitive proposals" procedure, a municipality must publicly notice the project (for services), and solicit an adequate number of bids. The bidders' qualifications are evaluated and the most qualified competitor is selected, subject to negotiations of a fair and reasonable prices. The "competitive proposals" procedure, where price is not used as a selection factor, may only be used in the procurement of architectural or engineering services.

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

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

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

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of certain procurement, suspension and debarment regulations applicable to federal financially assisted programs, as well as, the lack of internal controls and procedures designed to appropriately review payment vouchers prior to the issuance of a payment.

The continued occurrence of this situation will result in possible unsupported disbursements and payments to suspended or debarred suppliers, as well as accounting errors or omissions.

Questioned Costs: $77,655

Independent Auditors' Recommendation

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

The Municipality should enforce strict compliance with the procurement procedures prescribed by 40 CFR 12.76(d)(2) and (3) for contracting services in excess of $100,000.

Furthermore, the Municipality must ascertain that all transactions are recorded in the general ledger of the Uniform Accounting System.

06-20 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance
Davis-Bacon Act

Statement of Condition

As part of our testing of compliance with the Davis-Bacon Act for the program, we examined seven (7) construction cost disbursements totaling $1,792,152 for the fiscal year ended June 30, 2006. These costs were all related to the construction of the Fine Arts Center. For those seven disbursements, which all are related to one contractor, the Municipality did not include a clause in the contract with the contractor by which the contractor: (1) certifies that it will comply with the provisions of the Davis-Bacon Act, (2) agrees and discloses the prevailing wage rates for its employees, and (3) commits to submit certified payroll reports on a weekly basis.

In addition to the previous test, for the Fine Arts Center construction project, we selected the payroll reports for the payroll periods ended October 23, 2005, November 27, 2005 and December 18, 2005 for examination of the WH-347 Reports and the related payroll reports. Based on our review of such documents, we noted the following:

- For the payroll period ended October 23, 2005, the contract of the subcontractor was not available for our examination, therefore, we could not ascertain if the required Davis-Bacon contract clauses were present or not in such contract.

- For the payroll period ended October 23, 2005, the pre-conference minutes were not present in the project file.

- For the payroll periods ended October 23, 2005 and November 27, 2005, the certifications of the payroll reports was not present in the file.

- For a sample of eighteen (18) payroll payments made during the three (3) payroll periods selected for testing, the information about the complete address of thirteen (13) employees was not present in the file nor the payroll reports.

- For a sample of eighteen (18) payroll payments made during the three (3) payroll periods selected for testing, the interview documents of seventeen (17) employees were not present in the file nor the payroll reports.
- For a sample of eighteen (18) payroll payments made during the three (3) payroll periods selected for testing, the required income tax and other payroll withholdings of sixteen (16) employees were not made in the payroll reports.

Criteria

The A-102 Common Rule and 29 CFR 5.5 and 5.6 state that for all construction contracts in excess of $2,000 financed with federal funds, the Municipality shall include in its construction contract a requirement that the contractor or subcontractor complies with the requirements of the Davis-Bacon Act and the regulations of the U.S. Department of Labor. This includes the use of a contractual clause in the contract where the prevailing wage rate is agreed and disclosed. This also includes a requirement for the contractor or subcontractor to submit to the Municipality weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls). This reporting is often done using Optional Form WH-347 which includes the required statement of compliance (OMB No. 1215-0149).

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the requirements of the Davis-Bacon Act applicable to federal programs, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with this federal requirement.

The continued occurrence of this situation will result in future instances of noncompliance with the Davis-Bacon Act.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 108 Loan Guarantee Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of the Davis-Bacon Act. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-21 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance
Cash Management
Reporting

Statement of Condition

The Section 108 Loan Guarantee Program has not complied with the treasury regulations of the Cash Management Improvement Act of 1990, as amended. The Section 108 Loan Guarantee Program collected interest income amounting to $131,562 for the fiscal year ended June 30, 2006 that was earned from loan guarantee advances kept in two certificates of deposit. Such interest income was not recorded as part of the financial transactions of the loan guarantee program and was not reported to the U.S. Department of Housing and Urban Development.

In addition, the Section 108 Loan Guarantee Program has not established adequate internal controls and procedures to ensure the proper management of cash advances under the loan guarantee agreement since the Municipality erroneously deposited cash advances under the Section 108 Loan Guarantee, amounting to $5,618,000, in the bank account of the Child and Adult Care Food Program.

Criteria

Treasury regulations at 31 CFR part 205, which implement the Cash Management Improvement Act of 1990 (CMIA), as amended (Pub. L. No. 101-453; 31 USC 6501 *et seq.*), require that interest earned on advances by local government grantees and sub-grantees is required to be submitted promptly, but at least quarterly, to the federal agency. Up to $100 per year may be kept for administrative expenses.

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the requirements of the Cash Management Improvement Act of 1990 and the program income regulations applicable to federal programs, as well as, the lack of adequate internal controls and procedures designed to appropriately ascertain compliance with these federal requirements. The continued occurrence of this situation will result in future instances of noncompliance with the Cash Management Improvement Act of 1990, as amended.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 108 Loan Guarantee Program to ascertain that interest income is recorded as part of the financial transactions of the program and used for eligible activities before additional cash withdrawals are made.

We also recommend the Section 108 Loan Guarantee Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of the Cash Management Improvement Act of 1990, as amended. Furthermore, we recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements, including adequate internal controls to ensure that loan guarantee advances are deposited in the correct bank account.

06-22 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance
Procurement, Suspension and Debarment

Statement of Condition

As part of our procurement tests of the Section 108 Loan Guarantee Program, we selected two contracts from suppliers for examination. One contract was the construction contract of the Fine Arts Center and the other contract was the professional services contract for the inspection of the construction of such project. The disbursements related to these two contracts amounted to $1,869,807 for the fiscal year ended June 30, 2006.

Based on our examination of these contracts, we noted that both of them did not include several contractual clauses required by the procurement standards established by 24 CFR 85.36, known as *Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments.*

The construction contracts examined did not include the contractual clauses 1, 2, 3, 4, 5, 6, 7 and 8 described in the "Criteria" section below. In the other hand, the professional services contract examined did not include the contractual clauses 1, 4, 5 and 6.

Criteria

24 CFR 85.36 requires that all grantee's and sub-grantee's contracts must contain the following provisions:

1. Administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as may be appropriate.

2. Compliance with Executive Order 11246 of September 24, 1965, entitled "Equal Employment Opportunity", as amended by Executive Order 11375 of October 13, 1967, and as supplemented in Department of Labor regulations (41 CFR chapter 60). (All construction contracts awarded in excess of $10,000 by grantees and their contractors or sub-grantees).

3. Compliance with Sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327A 330) as supplemented by Department of Labor regulations (29 CFR part 5). (Construction contracts awarded by grantees and sub-grantees in excess of $2,000, and in excess of $2,500 for other contracts which involve the employment of mechanics or laborers).
4. Notice of awarding agency requirements and regulations pertaining to reporting.

5. Notice of awarding agency requirements and regulations pertaining to patent rights with respect to any discovery or invention which arises or is developed in the course of or under such contract.

6. Access by the grantee, the sub-grantee, the federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions.

7. Compliance with all applicable standards, orders, or requirements issued under section 306 of the Clean Air Act (42 U.S.C. 1857 (h)), section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and Environmental Protection Agency regulations (40 CFR part 15). (Contracts, subcontracts, and sub-grants of amounts in excess of $100,000).

8. Mandatory standards and policies relating to energy efficiency which are contained in the state energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94A 163, 89 Stat. 871).

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the procurement requirements applicable to federal programs, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with this federal requirement.

The continued occurrence of this situation will result in future instances of noncompliance with the federal procurement requirements.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 108 Loan Guarantee Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of the federal procurement standards of 24 CFR 85.36. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-23 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance
Block Grant National Objectives

Statement of Condition

The Section 108 Loan Guarantee Program has not maintained adequate records to demonstrate that the activities undertaken in the Fine Arts Center Construction Project meet one of the block grant national objectives. Although the Fine Arts Center Construction Project has not been completed at June 30, 2006, the Section 108 Loan Guarantee Program has not yet established an "Admission Fee Policy" or any other documentation or procedure in order to anticipate compliance with the national objective of activities benefiting low and moderate income persons.

Criteria

24 CFR 570.208, 24 CFR 200 and the fifth special condition of the approval letter dated May 20, 2004 of the Section 108 Loan Guarantee, require that the activities carried out by the Program demonstrate compliance with one of the block grant national objectives. Specifically, the Program must demonstrate that activities are carried out to benefit Low and Moderate Income Persons – Area Benefits Activities.

A low-moderate area benefit activity is an activity which is available to benefit all the residents of an area where at least fifty-one percent (51%) of the residents are low/moderate income persons and which is primarily residential.

Cause and Effect

This condition occurred because the management of the Program has not commenced the preparation of the Admission Fee Policy requested by letter from the U.S. Department of Housing and Urban Development during the current fiscal year. If this situation is not corrected by the time the construction project is completed and before the first artistic event is made in the Fine Arts Center, the Section 108 Loan Guarantee Program will not be in compliance with the requirements about the national objectives met by the program.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 108 Loan Guarantee Program to establish the Admission Fee Policy for the Fine Arts Center and maintain records in its files that demonstrate that the activities undertaken meet the national objective referred to above.

06-24 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance
Reporting

Statement of Condition

For each of the twelve (12) months of fiscal year ended June 30, 2006, the Section 108 Loan Guarantee Program did not submit the required monthly statements of the Guaranteed Loan Funds Account and the Guaranteed Loan Funds Investment Account to the Secretary of Housing and Urban Development of the United States of America.

Criteria

Part II (1)(b) of the contract between the Municipality and the U.S. Department of Housing and Urban Development, dated June 4, 2004, for the Loan Guarantee Assistance Under Section 108 of the Housing and Community Development Act of 1974, as amended, 42 U.S.C. Section 5308, requires that the Municipality shall, by the fifteenth day of each month, provide the Secretary of Housing and Urban Development of the United States of America with a written statement showing the balance of funds in the Guaranteed Loan Funds Account and the withdrawals from such account during the preceding calendar month, and a statement identifying the obligations and their assignments in the Guaranteed Loan Funds Investment Account, until such accounts are fully disbursed.

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Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the contractual requirements of the Section 108 Loan Guarantee Program, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with this federal requirement.

The continued occurrence of this situation will result in future instances of noncompliance with the federal reporting requirements of the Section 108 Loan Guarantee Program.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 108 Loan Guarantee Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the contractual provisions of the Section 108 Loan Guarantee Program. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-25 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance

Statement of Condition

The Section 108 Loan Guarantee Program has not complied with the positive covenants of the *Contract for Loan Guarantee Assistance under Section 108 of the Housing and Community Development Act, as Amended, 42 U.S.C., Section 5308* (the Act), between the Municipality of Juana Díaz (the Municipality) and the U.S. Department of Housing and Urban Development (HUD) (the Contract). The Section 108 Loan Guarantee Program failed to pay the following debt service installments in a timely manner:

Original Installment Due Date	Actual Installment Payment Date	Total Installment Amount
August 1, 2004	July 1, 2005	$ 26,857
February 1, 2005	July 1, 2005	$155,945
August 1, 2005	August 3, 2005	$155,945

Criteria

Article 11(a) of the Contract states that a default under the notes payable and the Contract shall occur upon failure by the borrower to: (i) pay when due an installment of principal or interest on the notes payable; or (ii) punctually and properly perform, observe, and comply with any covenant, agreement, or condition contained in the Contract.

Cause and Effect

The foregoing situation is primarily due to the failure to establish the required budget appropriation by the Section 108 Loan Guarantee Program through the Community Development Block Grant Program in order to amortize the Section 108 long-term debt. This situation may cause that HUD accelerate the future payments with respect to the principal or interest on the notes payable or may withhold the guarantee of any or all obligations not yet guaranteed or the disbursement of any or all grants not yet disbursed in full under outstanding guarantee commitments or grant approvals for the Municipality under Section 108 of the Act.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 108 Loan Guarantee Program to ascertain that all debt service payments of the Section 108 Loan Guarantee Commitment are made according to the agreed repayment schedule. The Municipality must establish the required budget appropriation through the Community Development Block Grant Program.

06-26 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 108 Loan Guarantee – 24 CFR Part 570 / CFDA No. 14.218
Internal Control / Compliance
Equipment and Real Property Management

Statement of Condition

The Section 108 Loan Guarantee Program has not complied with the property management requirements. Currently, the Fine Arts Center is being constructed with Section 108 Loan Guarantee funds. The Section 108 Loan Guarantee Program does not have a subsidiary ledger of the construction-in-progress assets of the Fine Arts Center, which should be reported as part of the Municipality's capital assets as of June 30, 2006.

The Program does not have records of the accumulated construction costs of the Fine Arts Center, including the costs of design and planning. Such records must include all the necessary information to comply with federal requirements, including: (1) information needed to calculate the federal share of the cost of the property, (2) information about the identification number of the asset, (3) identification of the grant under which the program is being constructing the property, (4) information about the location, use and condition of the property and the date the information was obtained, (5) all pertinent information on the ultimate transfer, replacement, or disposal of the property, and (6) information about the property's book value.

Furthermore, there is no evidence that the total amount of capital expenditures and the composition of capital assets incurred by the Section 108 Loan Guarantee Program have been reconciled with the general ledger or other control account to enhance the controls to prevent unauthorized disposition of assets.

Criteria

29 CFR 97.32(d)(2) establishes that the Section 108 Loan Guarantee Program should take the physical inventory and reconcile the results with the property records. In addition, section (d)(3) establishes that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property.

Property records shall include the following for each item:

- A description of the property.
- Identification number.
- Identification of the grant under which the recipient constructed the property.
- The information needed to calculate the federal share of the cost of the property.
- Construction date and unit construction cost.
- Location, use and condition of the property and the date the information was obtained.
- All pertinent information on the ultimate transfer, replacement, or disposal of the property.

Cause and Effect

This situation occurred because the Municipality's property division is not requiring the accurate completion and documentation of the inventory lists.

This situation allows for clerical errors or omissions of property records because there is no reconciliation with a permanent property subsidiary to ensure that the assets acquired by the Municipality and charged to this federal program still exist. Furthermore, there is no officer taking responsibility for the existence of such assets, thus this record may be altered or modified without the authorization of an authorized officer.

Questioned Costs: None

Independent Auditors' Recommendation

A subsidiary ledger of the construction-in-progress assets related to the Fine Arts Center project should be prepared as soon as possible. Physical inventory amounts should be reconciled with the property recorded on the subsidiary ledgers. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions.

06-27 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles

Statement of Condition

As part of our tests of allowable costs of the Community Development Block Grants Programs, we examined a sample of twenty-two (22) payroll disbursements totaling $5,079, and the respective human resources' files of the corresponding employees. The following exceptions were noted for the items examined:

Exceptions related to the payroll disbursements:

- For three (3) items, the canceled check supporting the payroll payment was not provided to us for examination (questioned cost of $618).

- For one (1) item, the amount paid to the employee did not agree with the documented approved amount shown in the human resources' file of the corresponding employee. Amount paid were $11 per month less than the approved amounts, for a total underpayment of $22.

- For two (2) items, the time and attendance sheet of the employees was not properly approved by the supervisor or authorized official.

Exceptions related to the human resources files of the employees for which payroll disbursements were examined:

- For four (4) items, the copy of a valid identification card with photo was not included in the employees' human resources files.

- For three (3) items, the copy of the social security card was not included in the employees' human resources files.

- For four (4) items, the original birth certificate was not included in the employees' human resources files.

- For eighteen (18) items, the Form I-9 of the Service of Naturalization and Immigration included in the human resources files were not completed in all the required parts of the form.

- For seven (7) items, the human resources files did not include the academic background reports of the employee (original credit transcript from accredited academic institution or diploma).

- For one (1) item, the human resources files did not include the hiring notice signed by the Mayor or authorized representative.

- For three (3) items, the human resources files did not include the documents related to the employees' changes in status, compensation, classifications, promotions or demotions.

- For ten (10) items, the human resources files did not include the documents related to the employees' approved payroll deductions, withholdings and fringe benefits.

- For two (2) items, the human resources files did not include the documents related to the employees' exemption of income tax withholdings and the computation of the concession for deductions according to the optional method prescribed by the Puerto Rico Internal Revenue Code (Form 499R-4).

- For two (2) items, the human resources files did not include the Form ASM-5, *Report of New Employees*, required by the Child Support Administration (ASUME, by its Spanish acronym).

- For three (3) items, the human resources files did not include the designation of beneficiaries.
- For three (3) items, the health certificate was not included in the employees' human resources files.

- For three (3) items, the employee's property tax debt certification from the Municipal Revenue Collection Center (CRIM, by its Spanish acronym) were not included in the employees' human resources files.

- For one (1) item, the employee's child support debt certification from the Puerto Rico Child Support Administration (ASUME, by its Spanish Acronym) was not included in the employee's human resources file.

- For one (1) item, the employee's income tax debt certification from the Puerto Rico Treasury Department was not included in the employee's human resources file.

- For eight (8) items, the drug test results documents were not included in the employees' human resources files.

- For one (1) item, the medical report was not included in the employee's human resources file.

- For one (1) item, the labor or professional history report was not included in the employee's human resources file.

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Criteria:

OMB Circular A 102, Subpart C, Section 20 (2), states that 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 the grant or sub-grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Accounting records must be supported by such source documentation as cancelled invoices, pre-audited invoices, paid bills, payrolls, time and attendance records, etc. Except as otherwise provided, records must be retained for three years.

Article 11.023 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that each municipality must maintain a complete human resources file for each of its employees. Those files must include the historical information of each employee from the original hiring date through the termination or retirement date of the employee, including the employee's human resources information from his or her previous public employers.

Cause and Effect

These conditions occurred because the Municipality does not update the human resources files of its employees periodically, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with these federal and state requirements.

The continued occurrence of this situation will result in future instances of unsupported or incorrect payroll payments and other instances of noncompliance with federal and state regulations related to human resources management.

Questioned Costs: $618

Independent Auditors' Recommendation

We recommend the Community Development Block Grant Program to update all human resources files as soon as possible and ascertain that all employee-related documents required by law are maintained in the human resources file of each employee. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal and state requirements, including continued professional education and training to the employees assigned to human resources duties.

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06-28 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Cash Management

Statement of Condition

In testing compliance with the Cash Management compliance requirements, we examined the monthly cash balances of the Community Development Block Grants Programs and evaluated the procedures implemented to minimize the time elapsed between the transfer of federal funds and the payment of funds for program purposes.

Based on our tests, we noted that the Community Development Block Grants Program has not established effective cash management procedures. During the fiscal year ended June 30, 2006, the total disbursements of the Community Development Block Grants Program cleared by bank amounted to $1,182,027 while the total drawdowns and deposits amounted to $1,219,618.

Consequently, the Community Development Block Grant Program had a monthly average ending cash balance of $71,897 during the fiscal year ended June 30, 2006. The ending monthly cash balances in bank ranged between $9,686 and $179,629 during the fiscal year ended June 30, 2006.

In addition to the above test, we selected three (3) drawdowns for examination and noted that the time elapsed between the drawdown date and the last subsequent disbursement date exceeded three days as follows:

Drawdown Date	Drawdown Amount	Last Subsequent Disbursement Date	Number of days that elapsed
June 6, 2006	$13,500	June 26, 2006	20 days
June 14, 2006	$47,262	After June 30, 2006	More than 16 days
June 19, 2006	$6,154	After June 30, 2006	More than 11 days

Criteria:

OMB Circular A-102 and the Treasury Regulations at 31 CFR 205, state that drawdown of federal funds should be made only for immediate needs. In addition, when grant award funds are advanced to the Community Development Block Grants Program, the Municipality must follow procedures to minimize the time elapsing between the receipt and the disbursement of such funds.

When advances are made by letter of credit or electronic transfer of funds, the Municipality must make drawdowns as close as possible to the time of making disbursements. Disbursements of funds received should be made within three (3) days of the date of deposit of funds for grant advances greater than $5,000.

31 CFR 205.6 established that the zero balance accounting is a method of transferring federal funds to the Municipality based on the actual amount of funds that are paid out by the Municipality. The funding technique must be auditable for internal control purposes. Auditable means the sources of data and information for a calculation are readily available, fully documented, and verifiable, such that the calculation can be replicated and proven to comply with all pertinent standards.

Cause and Effect:

These conditions occurred because the Municipality does not have adequate internal controls and procedures designed to appropriately ascertain compliance with these federal requirements.

The continued occurrence of this situation will result in future instances noncompliance with federal regulations related to cash management. In addition, the Municipality will not be able to reconcile the disbursements with their corresponding checks for accounting purposes in a timely manner.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to establish the necessary internal controls and procedures to ascertain that the drawdown of federal funds is only made for immediate program needs. In addition, the Municipality must establish and implement adequate procedures to forecast the transfer of funds from the grantor to the program. Any interest earned on advances in excess of $100 must be returned to the grantor.

06-29 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Davis-Bacon Act

Statement of Condition

As part of our testing of compliance with the Davis-Bacon Act for the program, we examined the contracts of five construction projects of the Community Development Block Grants Program. For each of those projects, we also examined one payroll report of the fiscal year ended June 30, 2006. Based on our review of such documents, we noted the following conditions:

- For each of the five projects, the Community Development Block Grants Program did not include a clause in the contract with the contractor by which the contractor: (1) certifies that it will comply with the provisions of the Davis-Bacon Act, (2) agrees and discloses the prevailing wage rates for its employees, and (3) commits to submit certified payroll reports on a weekly basis.

- For one construction project, the pre-conference minutes were not present in the project file.

- For one construction project, the certifications of the payroll reports was not present in the file.

- For three construction projects, the information about the complete address of thirteen (13) employees was not present in the file nor the payroll reports.

- For one construction project, the interview documents were not present in the file nor the payroll reports.

In addition, as part of our disbursements test we examined the contracts of three disbursements associated to two contractors, noting that their respective contracts did not include a clause in the contract with the contractor by which the contractor: (1) certifies that it will comply with the provisions of the Davis-Bacon Act, (2) agrees and discloses the prevailing wage rates for its employees, and (3) commits to submit certified payroll reports on a weekly basis.

Criteria

The A-102 Common Rule and 29 CFR 5.5 and 5.6 state that for all construction contracts in excess of $2,000 financed with federal funds, the Municipality shall include in its construction contract a requirement that the contractor or subcontractor complies with the requirements of the Davis-Bacon Act and the regulations of the U.S. Department of Labor. This includes the use of a contractual clause in the contract where the prevailing wage rate is agreed and disclosed. This also includes a requirement for the contractor or subcontractor to submit to the Municipality weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls). This reporting is often done using Optional Form WH-347, which includes the required statement of compliance (OMB No. 1215-0149).

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the requirements of the Davis-Bacon Act applicable to federal programs, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with this federal requirement.

The continued occurrence of this situation will result in future instances of noncompliance with the Davis-Bacon Act.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of the Davis-Bacon Act. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-30 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Procurement, Suspension and Debarment

Statement of Condition

As part of our procurement tests of the Community Development Block Grants Program, we examined the construction contracts of three construction projects for examination of the contractual clauses. Based on our examination of these contracts, we noted the three of them did not include several contractual clauses required by the procurement standards established by 24 CFR 85.36, known as *Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments.*

The construction contracts examined did not include the contractual clauses described in the "Criteria" section below.

Criteria

24 CFR 85.36 requires that all grantee's and sub-grantee's contracts must contain the following provisions :

1. Compliance with Executive Order 11246 of September 24, 1965, entitled "Equal Employment Opportunity", as amended by Executive Order 11375 of October 13, 1967, and as supplemented in Department of Labor regulations (41 CFR chapter 60). (All construction contracts awarded in excess of $10,000 by grantees and their contractors or sub-grantees).

2. Compliance with Sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327A 330) as supplemented by Department of Labor regulations (29 CFR part 5). (Construction contracts awarded by grantees and sub-grantees in excess of $2,000, and in excess of $2,500 for other contracts which involve the employment of mechanics or laborers).

3. Notice of awarding agency requirements and regulations pertaining to reporting.

4. Notice of awarding agency requirements and regulations pertaining to patent rights with respect to any discovery or invention which arises or is developed in the course of or under such contract.

5. Access by the grantee, the sub-grantee, the federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives to any books,

documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions.

6. Compliance with all applicable standards, orders, or requirements issued under section 306 of the Clean Air Act (42 U.S.C. 1857 (h)), section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and Environmental Protection Agency regulations (40 CFR part 15). (Contracts, subcontracts, and sub-grants of amounts in excess of $100,000).

7. Mandatory standards and policies relating to energy efficiency which are contained in the state energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94A 163, 89 Stat. 871).

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the procurement requirements applicable to federal programs, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with this federal requirement.

The continued occurrence of this situation will result in future instances of noncompliance with the federal procurement requirements.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of the federal procurement standards of 24 CFR 85.36. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-31 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Special Tests and Provisions – Rehabilitation Projects

Statement of Condition

As part of our special tests and provisions of the Community Development Block Grants Program, we selected a sample of ten (10) housing rehabilitation projects amounting to $49,872 or 73% of the total housing rehabilitation costs for the fiscal year ended June 30, 2006. Based on our examination of the project files, we noted the following conditions:

- For two (2) project files examined, the actual project costs disbursed exceed the approved amounts by $567 (questioned cost).

- For one (1) project file examined, the file was incomplete since the following documents were not included in the file: (a) the pre-rehabilitation inspection report describing the deficiencies in the structure to be rehabilitated, (b) the final inspection of rehabilitation work completed as contracted, and (c) the low income verification data to determine the applicant's eligibility. In addition, for such file, the deficiencies in the structure to be rehabilitated could not be traced to the housing rehabilitation contract with the applicant because the project file was incomplete.

- For two (2) project files examined, the property deeds of the residential structure to be rehabilitated was not included in the file.

- For one (1) project file examined, the OCAM Forms RV-04-000 (Certification Form), RV-04-001 (Application Form), RV-04-003-A (Certification for Applicant's File), RV-04-004 (Criteria to Determine Eligibility), RV-04-005 (Municipality Official Use Form), RV-04-005-A (Interview Evaluation Results), RV-04-008 (Owner Certification Form), RV-04-010 (Follow-up Visit Form) and RV-04-012 (Control Expense Register Form) were not included in the file.

- For one (1) project file examined, the OCAM Form RV-04-002 (General Authorization to Release Information) was not included in the file.

- For seven (7) project files examined, the OCAM Form RV-04-003 (Verification from Third Party) was not included in the file.

- For one (1) project file examined, the income limits table was not included in the file.

- For one (1) project file examined, the OCAM Form RV-04006 (Preliminary Visit Form) was not included in the file.

- For one (1) project file examined, the OCAM Form RV-04-002 (General Authorization to Release Information) was not included in the file.

- For two (2) project files examined, the OCAM Form RV-04-007 (Participant's Contract Form) was not included in the file, therefore, we could not ascertain that the actual disbursed amounts of $6,392 agreed with the project approved amount (questioned cost $6,392).

- For two (2) project files examined, the OCAM Form RV-04-009 (Materials Receipt Form) was not included in the file.

- For two (2) project files examined, the OCAM Form RV-04-013 (Final Certification Case Form) was not included in the file.

In addition to the above conditions, we noted that the Community Development Block Grants Program incorrectly used "Adjusted Annual Income" instead of "Gross Annual Income" to determine the eligibility of applicants to the housing rehabilitation services. The "Adjusted Annual Income" calculation is not applicable and not required for housing rehabilitation projects. The total disbursements for housing rehabilitation projects amounted to $68,151 for the fiscal year ended June 30, 2006 (questioned cost - $68,151).

Furthermore, we noted that the Community Development Block Grants Program does not have complete and adequate records to demonstrate compliance with the federal requirements for housing rehabilitation projects. The following additional conditions were noted about the housing rehabilitation project files examined:

- The files do not have sufficient information about the dates when applications were submitted by the citizens requesting the services. Therefore, we could not determine if the families that applied for assistance first were served in the same order.

- The waiting list of applicants was incomplete and was not updated.

- The Program does not assign a consecutive number to each application to determine the status of the requests for rehabilitation projects from citizens.

- The files did not have sufficient information with respect to: (a) applicants who do not qualify for assistance or reasons for denied services, (b) applicants who are currently submitting the required information to qualify for the services, and (c) the status of the applicants that have completed the application and are waiting for a written response about the status of their application.

- The Housing Rehabilitation Guide needs to be revised and updated. The Guide must be expanded to provide more clear descriptions of procedures established to maximize participation under the Program.

Criteria

24 CFR 570.506 and 508 state that each recipient shall establish and maintain sufficient records to enable the Secretary of Housing and Urban Development of the United States of America to determine whether the recipient has met the federal requirements of the Community Development Block Grants Program. At a minimum, the following records are required by law:

- Records providing a full description of each activity assisted (or being assisted) with CDBG funds, including its location, the amount of funds budgeted, obligated and expended for the activity, and the provision of law under which it is eligible.

- For residential rehabilitation projects determined to aid in the prevention or elimination of slums or blight in a slum or blighted area, the Municipality must have records of: (a) the local definition of ``substandard", (b) a pre-rehabilitation inspection report describing the deficiencies in each structure to be rehabilitated; and (c) details and scope of CDBG assisted rehabilitation, by structure.

The Subpart F, Section 8, 24 CFR 5.609 establishes that eligibility of applicants to the housing rehabilitation services must be based on the Annual Low/Moderate Household Income, which is defined as the gross amount of income of all adult household members that is anticipated to be received during the coming twelve (12) month period.

Cause and Effect

These conditions occurred because of the lack of adequate internal controls and procedures designed to appropriately ascertain compliance with these federal requirements. The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned federal requirements.

Questioned Costs: $68,151

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of housing rehabilitation standards of 24 CFR 570.506, 508 and 609. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-32 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Equipment and Real Property Management

Statement of Condition

The Community Development Block Grants Program has not complied with the property management requirements. Although a physical inventory of capital assets acquired with CDBG funds was made during the fiscal year ended June 30, 2006, the results of the physical inventory were not reconciled with the Uniform Accounting System (UAS) nor the subsidiary ledger of capital assets recorded in the basic financial statements of the Municipality.

The Community Development Block Grants Program has a subsidiary ledger of equipment acquired with federal funds, however, such subsidiary ledger does not comply with federal requirements because it does not: (1) have information needed to calculate the federal share of the cost of the equipment, (2) have information about the identification number of the asset, such as the manufacturer's serial numbers, (3) identify the grant under which the program acquired the equipment, (4) have information about the location, use and condition of the equipment and the date the information was obtained, (5) have all pertinent information on the ultimate transfer, replacement, or disposal of the equipment, and (6) have information about each asset's book value and accumulated depreciation.

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

Criteria

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

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

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

Cause and Effect

This situation occurred because the Municipality's property division is not performing physical inventories of the property, nor requiring the accurate completion and documentation of the inventory lists.

This situation allows for the unauthorized disposition of assets because there is no reconciliation with a permanent property subsidiary to ensure that the assets acquired by the Municipality and charged to this federal program still exist. Furthermore, there is no official taking responsibility for the existence of such assets, thus this record may be altered or modified without the authorization of an authorized officer.

Questioned Costs: None

Independent Auditors' Recommendation

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

06-33 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Matching, Level of Effort, Earmarking

Statement of Condition

The Community Development Block Grants Program has not complied with the earmarking requirements established by federal regulations. At June 30, 2006, the CDBG funds obligated during the program year, amounting to $285,400, exceeded the limitation of $272,140 (15% of the grant amounts received for that year).

Criteria

24 CFR 570.201 states that the amount of CDBG funds obligated during the program year for public services must not exceed fifteen percent (15%) of the grant amount received for that year plus 15% of the program income it received during the preceding program year.

Cause and Effect

This condition occurred because of the lack of adequate internal controls and procedures designed to appropriately ascertain compliance with this federal requirement. The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned federal requirements. This situation allows for the unauthorized obligations of CDBG funds.

Questioned Costs: $13,260

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the earmarking provisions of 24 CFR 570.201. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-34 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Reporting

Statement of Condition

The Community Development Block Grant Program has not complied with the reporting requirements established by federal regulations. The following conditions were noted:

The Federal Cash Transaction Reports (SF-272), the Activity Summary Report (CO4PRO3) and the CDBG Financial Summary Report (CO4PR26) submitted through the Integrated Disbursement and Information System (IDIS) were prepared with accounting records kept by the Community Development Block Grants Program, which were not reconciled with the general ledger of the Uniform Accounting System (UAS). In addition, such reports were not prepared following the Accounting Principles Generally Accepted in the United States of America (GAAP).

The following Federal Cash Transaction Reports required by the grant agreement were filed after the respective deadlines as follows:

Federal Cash Transaction Report for Quarter Ended	Deadline for Filing	Actual Filing Date
September 30, 2005	October 30, 2005	July 20, 2006
December 31, 2005	January 30, 2006	July 20, 2006
March 31, 2006	April 30, 2006	July 20, 2006
June 30, 2006	July 31, 2006	July 20, 2006

Criteria

OMB No. 2506-0077, states that the Community Development Block Grants Program must prepare reports generated by IDIS as part of their annual performance and evaluation report that must be submitted for the CDBG Entitlement Program ninety (90) days after the end of the Municipality's fiscal year.

24 CFR 85.41 states that Federal Cash Transaction Reports should be filed no later than thirty (30) days following the end of the quarter reported.

Cause and Effect

This situation occurred because the Community Development Block Grants Program has not adequate internal controls in place to ensure the accurate and timely preparation of reports required by federal regulations. This situation increases the possibility of increased oversight procedures from the U.S. Department of Housing and Urban Development.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to establish adequate internal controls and procedures to ensure that the required IDIS reports are prepared in a timely manner using financial data in agreement and reconciled with the Uniform Accounting System (UAS) and following the Accounting Principles Generally Accepted in the United States of America (GAAP). Adequate training should be given to the employees assigned to the preparation of these reports.

06-35 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control - Conflict of Interests Regulations

Statement of Condition

The Community Development Block Grant Program has not complied with the Conflict of Interest regulations. A written code of conduct or manual of policies and procedures governing the "Conflict of Interest" regulation for the Program has not been established by the Municipality.

Statement of Condition

24 CFR 570.611 states that no persons who exercise or have exercised any functions or responsibilities with respect to CDBG activities, or who are in a position to participate in a decision-making process or gain inside information with regard to such activities, may obtain a financial interest or benefit from a CDBG-assisted activity, or have a financial interest in any contract, subcontract, or agreement with respect to a CDBG-assisted activity, or with respect to the proceeds of the CDBG-assisted activity, either for themselves or those with whom they have business or immediate family ties, during their tenure or for one year thereafter.

The conflict of interest provisions apply to any person who is an employee, agent, consultant, officer, or elected official or appointed official of the recipient, or of any designated public agencies, or of subrecipients that are receiving funds. Upon the written request of the recipient, HUD may grant an exception to the provisions on a case-by-case basis when it has satisfactorily met certain threshold requirements.

Cause and Effect

These conditions resulted from the lack of awareness of the Conflict of Interest regulations by the Program employees. The lack of a written code of conduct may result in additional unexpected violations to the Conflict of Interest regulations.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to adopt a written code of standards of conduct that includes the provisions of the Conflict of Interest regulations. Appropriate training should be given to the employees to ensure the general awareness of these regulations.

06-36 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles
Procurement, Suspension and Debarment

Statement of Condition

As part of our testing of compliance with activities allowed and allowable costs for the program, we examined twenty (20) non-payroll disbursements totaling $965,079. The following exceptions were noted in the items examined:

- For the sixteen (16) disbursements amounting to $342,687, the Municipality did not verify that the supplier was not suspended or debarred or otherwise excluded. The Municipality did not check the Excluded Parties List System (EPLS) maintained by the General Services Administration, nor obtained a certification from the supplier and did not add a clause in the supplier's contract with the Municipality.

- For two (2) architectural and engineering service disbursements of one supplier, amounting to $67,878, the Community Development Block Grants Program did not comply with the procurement transactions established by 24 CFR 85.36. Although the professional services contract of this supplier exceeded the $100,000 threshold, there was no evidence of a bidding process and the supplier selection processes. There was no evidence of full and open competition, no evidence of invitation for bid, no documentation as to the analysis performed by the Municipality for the procurement actions taken, and no approval from the U.S. Department of Housing and Urban Development was obtained by the Municipality. In addition, the Community Development Block Grants Program did not obtain price estimates from three (3) suppliers (questioned cost $67,878).

- For one (1) consulting service disbursement of one supplier amounting to $12,319, the Municipality did not comply with the small purchase procurement transactions established by 24 CFR 85.36, known as *Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments.* There was no evidence to ensure that services were obtained at the most advantageous terms and in a manner providing full and open competition in accordance with the requirements established by the U.S. Department of Housing and Urban Development. The Community Development Block Grants Program did not obtain price estimates from three (3) suppliers (questioned cost $12,319).

- For ten (10) disbursements amounting to $510,582, the payments could not be traced to the general ledger since were unrecorded at June 30, 2006.

- For sixteen (16) disbursements, the disbursement documents were not stamped as paid.

Criteria

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

According to 40 CFR 12.76(d)(2) and (3), if a project is estimated to cost $100,000 or more, the sealed bid process or the "competitive proposals" procedure should be used for contracting services. Under the sealed bid process, bids are publicly solicited and the contract is awarded to the lowest responsible bidder. The sealed bid process is the preferred federal method for procuring construction. Under the "competitive proposals" procedure, a municipality must publicly notice the project (for services), and solicit an adequate number of bids. The bidders' qualifications are evaluated and the most qualified competitor is selected, subject to negotiations of a fair and reasonable prices. The "competitive proposals" procedure, where price is not used as a selection factor, may only be used in the procurement of architectural or engineering services.

If a project is estimated to cost $100,000 or less the Program must follow the small purchase procedures. Small purchase procedures are those relatively simple and informal procurement methods for securing services, supplies, or other property that do not cost more than the simplified acquisition threshold fixed at 41 U.S.C. 403(11) (currently set at $100,000). If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources (generally three sources).

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

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

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

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of certain procurement, suspension and debarment regulations applicable to federal programs, as well as, the lack of internal controls and procedures designed to appropriately review payment vouchers prior to the issuance of a payment.

The continued occurrence of this situation will result in possible unsupported disbursements and payments to suspended or debarred suppliers, as well as accounting errors or omissions.

Questioned Costs: $80,197

Independent Auditors' Recommendation

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

The Municipality should enforce strict compliance with the procurement procedures prescribed by 40 CFR 12.76(d)(2) and (3) for contracting services in excess of $100,000.

Furthermore, the Municipality must ascertain that all transactions are recorded in the general ledger of the Uniform Accounting System.

06-37 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Community Development Block Grants – Entitlement Grants - CFDA No. 14.218
Community Development Block Grants – State-Administered Small Cities Program - CFDA No. 14.228
Internal Control - Block Grant National Objectives

Statement of Condition

The Community Development Block Grants Program has not established adequate internal controls and procedures to ensure that the activities undertaken by the Program meet one of the block grant national objectives or benefiting low and moderate income persons.

The Community Development Block Grants Program has not adopted formal policies and procedures to document compliance with the block grant national objectives and record-keeping. The project files of the Community Development Block Grants Program do not include sufficient information about census track numbers, census block information, maps demonstrating census track or any other relevant information needed to compare the boundaries of census divisions (tracks, block groups, etc.) with the boundaries of the service areas for the purpose of reporting activities and calculating the percentages of low-moderate income persons residing in specific areas.

Criteria

24 CFR 570.506 and 508 state that each recipient shall establish and maintain sufficient records to enable the Secretary of Housing and Urban Development of the United States of America to determine whether the recipient has met the federal requirements of the Community Development Block Grants Program. At a minimum, the following records are required by law: records providing a full description of each activity assisted (or being assisted) with CDBG funds, including its location, the amount of funds budgeted, obligated and expended for the activity, and the provision of law under which it is eligible.

Cause and Effect

These conditions occurred because the municipal employees had no complete knowledge of the record-keeping requirements established by 24 CFR 570.506. The continued occurrence of this situation will result in possible future unallowable costs.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Community Development Block Grants Program to establish the necessary internal controls and procedures to ensure adequate documentation of the Program's compliance with the block grant national objectives.

06-38 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Reporting

Statement of Condition

The un-audited and audited Financial Data Schedules (FDS) for the fiscal year ended June 30, 2005 were not prepared by the Section 8 Housing Choice Voucher Program and submitted to REAC and HUD on or before the August 30, 2005 deadline. In addition, the reports referred to above were prepared from accounting records that were not reconciled with the Uniform Accounting System (UAS) of the Municipality.

Criteria

24 CFR, Subpart H, Section 5.801, known as *The Uniform Financial Reporting Standards* (UFRS), require that Public Housing Authorities (PHAs) that administer Housing Choice Voucher Programs (HCV) submit FDS to REAC and HUD on an annual basis. FDS must comply with the following standards:

- Must consist of balance sheets and statements of revenues, expenditures and changes in fund balances (or a statement of operations) as of and for the fiscal year ended June 30.

- FDS should be prepared in accordance with Generally Accepted Accounting Principles as instructed in Appendix D, *Questions and Answers*, of the HUD PHA GAAP Conversion Guide.

- Un-audited FDS must be submitted electronically to REAC and HUD through the Internet no later than 60 days after the end of the fiscal year of the reporting period (August 30 in the case of the Municipality). Subsequently, audited FDS must be submitted electronically to REAC and HUD through the Internet no later than 9 months after the end of the fiscal year of the reporting period.

Cause and Effect

The management of the Section 8 Housing Choice Voucher Program administered by the Municipality were not aware of all reporting requirements established by UFRS until HUD informed them about the noncompliance situations referred to previously.

In addition, the UAS and the accounting records of the Municipality are currently maintained on the cash basis and the budgetary bases of accounting, which significantly differ from Accounting Principles Generally Accepted in the United States of America (GAAP). Accordingly, the preparation of FDS requires significant efforts to convert the Municipality's financial data to GAAP. Generally such procedures extend beyond sixty days after June 30 of each fiscal year.

Failure to comply with the aforementioned reporting requirements may result in a ten (10%) percent penalty against the Municipality's monthly administrative fees related to its Section 8 Housing Choice Voucher Program for failure to file the required reports in accordance with UFRS.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 8 Housing Choice Voucher Program to ascertain that all employees performing tasks related to federal programs, be continuously trained and educated with all laws and regulations applicable to federal programs administered by the Municipality.

In addition, on an annual basis, the Section 8 Housing Choice Voucher Program must submit an un-audited FDS to REAC and HUD electronically no later than two (2) months following each June 30. In addition, the Municipality must submit an audited FDS no later than March 31 subsequent to each fiscal year end. To achieve these objectives, the Municipality must maintain its accounting records according to GAAP throughout the year and minimize the conversion efforts at the end of each fiscal year.

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06-39 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Special Tests and Provisions – Selection from Waiting List

Statement of Condition

As part of our special tests, we examined the waiting list of the Section 8 Housing Choice Voucher Program and selected all of the twenty-one (21) applicants that became new participants during the fiscal year ended June 30, 2006. We noted the following conditions:

- The application numbers between one hundred twenty-six (126) and one hundred and fifty (150) are currently duplicated in the waiting list. Therefore, there are fifty (50) applicants in the waiting list sharing twenty five (25) consecutive positions in the list.

- The Section 8 Housing Choice Voucher Program did not comply with Chapter 4 of the Program's Administrative Plan titled: *"Establishing Preferences and Managing the Waiting List"*. For fourteen (14) applicants, the Municipality did not follow the sequential order of the waiting list to select the applicants that became new participants during the fiscal year ended June 30, 2006. The waiting list does not provide sufficient information to corroborate that a correct sequential order was followed (considering special admission applicants) and does not provide sufficient information to determine the rationale of the selection process of new participants in the waiting list.

Criteria:

24 CFR 5.410, 982.54(d) and 982.201 through 982.207 state that the Section 8 Housing Choice Voucher Program must have written policies in its administrative plan for selecting applicants from the waiting list and documentation must be kept to corroborate that these policies were followed when selecting applicants for admission from the waiting list. Except as provided in 24 CFR 982.203 (special admission non-waiting list), all families admitted to the program must be selected from the waiting list. The selection from the waiting list must generally be made when the Section 8 Housing Choice Voucher Program notifies a family whose name reaches the top of the waiting list to come in to verify eligibility for admission.

Cause and Effect

These conditions occurred because the Section 8 Housing Choice Voucher Program has not adopted adequate internal controls and procedures to ensure compliance with the Program's administrative plan and the provisions of 24 CFR 5.410, 982.54(d) and 982.201 through 982.207.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 8 Housing Choice Voucher Program to ascertain that all employees performing tasks related to federal programs, be continuously trained and educated with all laws and regulations applicable to federal programs administered by the Municipality. We also recommend the Section 8 Housing Choice Voucher Program to adopt adequate internal controls and procedures to ensure compliance with the aforementioned regulations and policies.

06-40 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Special Tests and Provisions – Housing Quality Standards Inspections

Statement of Condition

As part of our housing quality standards test, we selected a sample of sixty (60) participants to determine if annual inspections and/or quality control re-inspections, as applicable, were made. We noted that for one (1) of the participants evaluated, the inspection/re-inspection report was not available for our examination and was not included in the participant's file.

In addition, we selected for examination a sample of ten (10) leased units for which quality control deficiencies were identified by the Program as part of the inspection/re-inspection process. We noted that for the ten (10) units examined, the quality housing deficiencies were not corrected within twenty-four (24) hours or thirty (30) days statutory deadline, as applicable. For those ten (10) leased units, the Program did not stop the housing assistance payments and did not terminate the housing assistance payment contract.

Criteria:

CFR 982.158(d) and 982.405(b) state that the Program must inspect the unit leased to a family at least annually to determine if the unit meets the housing quality standards, and must conduct quality control re-inspections. The Program must prepare a unit inspection report.

24 CFR 982.158(d) and 982.404 state that for units under housing assistance payment contracts that fail to meet the housing quality standards, the Section 8 Housing Choice Voucher Program must require the owner to correct any life threatening housing quality standards deficiency within twenty-four (24) hours after the inspection and all other deficiencies within thirty (30) calendar days or within a specified extension approved by the Program. If the owner does not correct the cited deficiencies within the specified correction period, the Program must stop (abate) the housing assistance payments beginning no later than the first day of the month following the specified correction period, or must terminate the housing assistance payment contract. The owner is not responsible for a breach of housing quality standards as a result of the family's failure to pay for utilities for which the family is responsible under the lease or for tenant damage. For family-caused defects, if the family does not correct the cited deficiencies within the specified correction period, the Program must take prompt and vigorous action to enforce the family obligations.

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Cause and Effect

These conditions occurred because the Section 8 Housing Choice Voucher Program has not adopted adequate internal controls and procedures to ensure compliance with the provisions of 24 CFR 982.158(d), 982.404 and 982.405(b).

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 8 Housing Choice Voucher Program to ascertain that all employees performing tasks related to federal programs, be continuously trained and educated with all laws and regulations applicable to federal programs administered by the Municipality. We also recommend the Section 8 Housing Choice Voucher Program to adopt adequate internal controls and procedures to ensure compliance with the aforementioned regulations and policies.

06-41 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Special Tests and Provisions – Housing Assistance Payments

Statement of Condition

As part of our housing assistance payments test, we selected a sample of sixty (60) participants to examine the housing assistance payments on leased properties. For two (2) of the participants examined, the housing assistance payments reflected in the housing assistance payment contract did not agree with the respective payment reflected in line 12u of the HUD-50058 as shown as follows:

Case/Contract Number	Monthly HAP per HUD-50058	Monthly HAP per Contract
2006-000616	$289	$314
2006-000975	$307	$300

In addition to the above conditions, we noted that various housing assistance payments were not made on a monthly basis. There were instances were a housing assistance payment were made late and included more than one monthly amount to cover past due housing assistance payments.

Criteria:

24 CFR 982.158 states that the Section 8 Housing Choice Voucher Program must pay a monthly housing assistance payment on behalf of the family that corresponds with the amount on line 12u of the HUD-50058. This housing assistance payment must be reflected on the housing assistance payment contract and the housing assistance payment register.

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Cause and Effect

These conditions occurred because the Section 8 Housing Choice Voucher Program has not adopted adequate internal controls and procedures to ensure compliance with the provisions of 24 CFR 982.158.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 8 Housing Choice Voucher Program to ascertain that all employees performing tasks related to federal programs, be continuously trained and educated with all laws and regulations applicable to federal programs administered by the Municipality. We also recommend the Section 8 Housing Choice Voucher Program to adopt adequate internal controls and procedures to ensure compliance with the aforementioned regulations and policies.

06-42 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles

Statement of Condition

As part of our tests of allowable costs of the Section 8 Housing Choice Voucher Program, we examined a sample of thirty-seven (37) non-payroll disbursements amounting to $152,001. The following exceptions were noted for the items examined:

- For seven (7) disbursements, their respective amounts could not be traced to the general ledger.
- For twenty-four (24) disbursements, the payment voucher and the related documents were not stamped as paid.
- For one (1) disbursement, the payment voucher and the related documents did not include the budgetary item number to which the disbursement should have been charged.

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

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

reconciliations, adjustments, closing entries, reports, and all other necessary documentation to support the basic financial statements.

Cause and Effect

These conditions occurred because of the lack of adequate internal controls and procedures designed to appropriately review payment vouchers prior to the issuance of a payment. The continued occurrence of this situation will result in possible unsupported disbursements.

Questioned Costs: None

Independent Auditors' Recommendation

The Municipality must ascertain that all transactions are recorded in the general ledger of the Uniform Accounting System and all disbursements documents are stamped as paid.

06-43 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles

Statement of Condition

As part of our tests of allowable costs of the Section 8 Housing Choice Voucher Program, we examined a sample of twenty-two (22) payroll disbursements of five employees totaling $9,376, and the respective human resources' files of the corresponding employees. The following exceptions were noted for the items examined:

Exceptions related to the payroll disbursements:

- For eight (9) vacations, sick leave or compensatory time disbursements, the time and attendance sheets were not updated and we could not ascertain if the employee had sufficient accumulated balance to cover the disbursement.

- For seven (7) disbursements of one employee, the employee's human resources file did not include a description of the position of assigned duties of the employee in the Section 8 Housing Choice Voucher Program, therefore, we could not ascertain that the employee works only in the Section 8 Housing Choice Voucher Program.

- For five (5) disbursements on one employee, the payroll disbursement did not agree with the approved wage rate documented in the employee's human resources file. The Section 8 Housing Choice Voucher Program has been paying a salary of $1,982 per month while the approved salary documented in the human resources file is $2,082 per month.

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Exceptions related to the human resources files of the employees for which payroll disbursements were examined:

- For three (3) employees, the Form I-9 of the Service of Naturalization and Immigration included in the human resources files were not completed in all the required parts of the form or was not included in the file.

- For three (3) employees, the employee's property tax debt certification from the Municipal Revenue Collection Center (CRIM, by its Spanish acronym) were not included in the employees' human resources files.

- For one (1) employee, the human resources files did not include the Form ASM-5, *Report of New Employees*, required by the Puerto Rico Child Support Administration (ASUME, by its Spanish acronym).

- For one (1) employee, the employee's income tax debt certification from the Puerto Rico Treasury Department was not included in the employee's human resources file.

- For one (1) employee, the health certificate was not included in the employees' human resources files.

- For three (3) employees, the drug test results documents were not included in the employees' human resources files.

- For one (1) employee, the labor or professional history report was not included in the employee's human resources file.
- For one (1) employee, the human resources files did not include the hiring notice signed by the Mayor or authorized representative.

- For two (2) employees, the human resources files did not include the designation of beneficiaries.

- For two (2) employees, the human resources files did not include the employee's performance evaluations.

- For one (1) employee, the human resources files did not include the certification of services rendered by the employee to the government.

- For five (5) employees, the human resources files did not include updated records of vacations, sick leave, compensatory time, licenses without pay, and any other types of licenses and records.

Criteria:

OMB Circular A 102, Subpart C, Section 20 (2), states that 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 the grant or sub-grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Accounting records must be supported by such source documentation as cancelled invoices, pre-audited invoices, paid bills, payrolls, time and attendance records, etc. Except as otherwise provided, records must be retained for three years.

Article 11.023 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that each municipality must maintain a complete human resources file for each of its employees. Those files must include the historical information of each employee from the original hiring date through the termination or retirement date of the employee, including the employee's human resources information from his or her previous public employers.

Cause and Effect

These conditions occurred because the Section 8 Housing Choice Voucher Program does not update the human resources files of its employees periodically, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with these federal and state requirements.

The continued occurrence of this situation will result in future instances of unsupported or incorrect payroll payments and other instances of noncompliance with federal and state regulations related to human resources management.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 8 Housing Choice Voucher Program to update all human resources files as soon as possible and ascertain that all employee-related documents required by law are maintained in the human resources file of each employee. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal and state requirements, including continued professional education and training to the employees assigned to human resources duties.

06-44 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Cash Management

Statement of Condition

In testing compliance with the Cash Management compliance requirements, we examined the monthly cash balances of the Section 8 Housing Choice Voucher Program and evaluated the procedures implemented to minimize the time elapsed between the transfer of federal funds and the payment of funds for program purposes.

The Section 8 Housing Choice Voucher Program had a monthly average ending cash balance of $119,545 during the fiscal year ended June 30, 2006. The ending monthly cash balances in bank ranged between $97,904 and $153,870 during the fiscal year ended June 30, 2006. These high cash balances arose principally because of a cash balance of $134,417 carried over from the fiscal year ended June 30, 2005.

In addition to the above test, we selected one (1) drawdown for examination and noted that the time elapsed between the drawdown date and the last subsequent disbursement date exceeded three days as follows:

Drawdown Date	Drawdown Amount	Last Subsequent Disbursement Date	Number of days that elapsed
July 1, 2005	$61,720	August 2005	More than 30 days

Criteria:

OMB Circular A-102 and the Treasury Regulations at 31 CFR 205, state that drawdown of federal funds should be made only for immediate needs. In addition, when grant award funds are advanced to the Section 8 Housing Choice Voucher Program, the Municipality must follow procedures to minimize the time elapsing between the receipt and the disbursement of such funds.

When advances are made by letter of credit or electronic transfer of funds, the Municipality must make drawdowns as close as possible to the time of making disbursements. Disbursements of funds received should be made within three (3) days of the date of deposit of funds for grant advances greater than $5,000.

31 CFR 205.6 established that the zero balance accounting is a method of transferring federal funds to the Section 8 Housing Choice Voucher Program based on the actual amount of funds that are paid out by the Municipality. The funding technique must be auditable for internal control purposes. Auditable means the sources of data and information for a calculation are readily available, fully documented, and verifiable, such that the calculation can be replicated and proven to comply with all pertinent standards.

Cause and Effect:

These conditions occurred because the Section 8 Housing Choice Voucher Program does not have adequate internal controls and procedures designed to appropriately ascertain compliance with these federal requirements.

The continued occurrence of this situation will result in future instances noncompliance with federal regulations related to cash management. In addition, the Municipality will not be able to reconcile the disbursements with their corresponding checks for accounting purposes in a timely manner.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Section 8 Housing Choice Voucher Program to establish the necessary internal controls and procedures to ascertain that the drawdown of federal funds is only made for immediate program needs. In addition, the Municipality must establish and implement adequate procedures to forecast the transfer of funds from the grantor to the program. Any interest earned on advances in excess of $100 must be returned to the grantor.

06-45 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Equipment and Real Property Management

Statement of Condition

The Section 8 Housing Choice Voucher Program has not complied with the property management requirements. Although a physical inventory of capital assets acquired with program funds was made during the fiscal year ended June 30, 2006, the property records of the program have not been reconciled with the Uniform Accounting System (UAS) and the amounts recorded in the basic financial statements of the Municipality.

The Section 8 Housing Choice Voucher Program has a subsidiary ledger of property and equipment acquired with federal funds, however, such subsidiary ledger does not comply with federal requirements because it does not: (1) have information needed to calculate the federal share of the cost of the equipment, (2) have information about the identification number of the asset, such as the manufacturer's serial numbers, (3) identify the grant under which the program acquired the equipment, (4) have information about the location, use and condition of the equipment and the date the information was obtained, (5) have all pertinent information on the ultimate transfer, replacement, or disposal of the equipment, and (6) have information about each asset's book value and accumulated depreciation.

Furthermore, there is no evidence that the total amount of capital expenditures and the composition of capital assets incurred of the Section 8 Housing Choice Voucher Program have been reconciled with the general ledger or other control account to enhance the controls to prevent unauthorized disposition of assets.

Criteria

29 CFR 97.32(d)(2) establishes that the Section 8 Housing Choice Voucher Program should take the physical inventory and reconcile the results with the property records. In addition, section (d)(3) establishes that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property.

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

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

Cause and Effect

This situation occurred because the Municipality's property division is not performing physical inventories of the property, nor requiring the accurate completion and documentation of the inventory lists.

This situation allows for the unauthorized disposition of assets because there is no reconciliation with a permanent property subsidiary to ensure that the assets acquired by the Municipality and charged to this federal program still exist. Furthermore, there is no officer taking responsibility for the existence of such assets, thus this record may be altered or modified without the authorization of an authorized officer.

Questioned Costs: None

Independent Auditors' Recommendation

A physical inventory of the Section 8 Housing Choice Voucher Program's capital assets should be taken as soon as possible. Physical inventory amounts should be reconciled with the property recorded on the subsidiary ledgers. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions. Dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance Director.

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06-46 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Section 8 Housing Choice Voucher - CFDA No. 14.871
Internal Control / Compliance
Eligibility

Statement of Condition

As part of our eligibility tests of the Section 8 Housing Choice Voucher Program, we selected a sample of sixty (60) participant families for examination of their eligibility files for the fiscal year ended June 30, 2006. Based on our examination of the project files, we noted the following conditions:

- Forty-eight (48) participant families were not included in the waiting list of participants.
- For twenty-two (22) participant families, their application form was not available for our examination and was not included in the participant's file.
- For two (2) participant families, the birth certificates of all family members over six years old were not available for our examination and were not included in the participant's file.
- For three (3) participant families, the social security numbers of all family members were not included in the participant's file and were not available for our examination.

Criteria

24 CFR 982.201(b) states that an applicant may eligible to obtain Section 8 Housing Choice Voucher benefits if he or she: (1) is income eligible, (2) is part of a family group in accordance with the definition of family prescribed by HUD, (3) furnishes the social security numbers for all family members age six or older, and (4) is a head of household or part of an elderly or disabled family.

To be eligible for assistance, an applicant family must have an annual income at the time of admission that does not exceed the very low income limits for occupancy as established by HUD for the Ponce Metropolitan Statistical Area (PMSA), which is the area where the Municipality of Juana Díaz is located. To be income eligible, the applicant family must meet the very low income criteria which defines the family as one whose income does not exceed fifty percent (50%) of the area median income.

Cause and Effect

These conditions occurred because of the lack of adequate internal controls and procedures designed to safeguard eligibility files. The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned federal requirements.

Questioned Costs: None

06-47 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Cash Management

Statement of Condition

In testing compliance with the Cash Management compliance requirements, we examined the monthly cash balances of the Head Start Program and evaluated the procedures implemented to minimize the time elapsed between the transfer of federal funds and the payment of funds for program purposes.

The Head Start Program had a monthly average ending cash balance of $238,886 during the fiscal year ended June 30, 2006. The ending monthly cash balances in bank ranged between $69,436 and $557,446 during the fiscal year ended June 30, 2006.

Criteria:

OMB Circular A-102 and the Treasury Regulations at 31 CFR 205, state that drawdown of federal funds should be made only for immediate needs. In addition, when grant award funds are advanced to the Head Start Program, the Municipality must follow procedures to minimize the time elapsing between the receipt and the disbursement of such funds. When advances are made by letter of credit or electronic transfer of funds, the Municipality must make drawdowns as close as possible to the time of making disbursements. Disbursements of funds received should be made within three (3) days of the date of deposit of funds for grant advances greater than $5,000.

31 CFR 205.6 established that the zero balance accounting is a method of transferring federal funds to the Head Start Program based on the actual amount of funds that are paid out by the Municipality. The funding technique must be auditable for internal control purposes. Auditable means the sources of data and information for a calculation are readily available, fully documented, and verifiable, such that the calculation can be replicated and proven to comply with all pertinent standards.

Cause and Effect:

These conditions occurred because the Head Start Program does not have adequate internal controls and procedures designed to appropriately ascertain compliance with these federal requirements.

The continued occurrence of this situation will result in future instances noncompliance with federal regulations related to cash management. In addition, the Municipality will not be able to reconcile the disbursements with their corresponding checks for accounting purposes in a timely manner.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Head Start Program to establish the necessary internal controls and procedures to ascertain that the drawdown of federal funds is only made for immediate program needs. In addition, the Municipality must establish and implement adequate procedures to forecast the transfer of funds from the grantor to the program. Any interest earned on advances in excess of $100 must be returned to the grantor.

06-48 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Equipment and Real Property Management

Statement of Condition

The Head Start Program has not complied with the property management requirements. A physical inventory of capital assets acquired with program funds was not made during the fiscal year ended June 30, 2006 and the property records of the program have not been with the Uniform Accounting System (UAS).

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

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

Criteria

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

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

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

Cause and Effect

This situation occurred because the Municipality's property division is not performing physical inventories of the property, nor requiring the accurate completion and documentation of the inventory lists.

This situation allows for the unauthorized disposition of assets because there is no reconciliation with a permanent property subsidiary to ensure that the assets acquired by the Municipality and charged to this federal program still exist. Furthermore, there is no officer taking responsibility for the existence of such assets, thus this record may be altered or modified without the authorization of an authorized officer.

Questioned Costs: None

Independent Auditors' Recommendation

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

06-49 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Procurement, Suspension and Debarment

Statement of Condition

As part of our procurement tests of the Head Start Program, we performed an examination of the contractual clauses of the contracts with two (2) suppliers. One of the suppliers provided electric repair services and the other supplier provided supplies. Based on our examination of these contracts, we noted the two (2) of them did not include several contractual clauses required by the procurement standards established by 24 CFR 85.36, known as *Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments.*

The contracts examined did not include the contractual clauses described in the "Criteria" section below.

Criteria

24 CFR 85.36 requires that all grantee's and sub-grantee's contracts must contain the following provisions :

8. Compliance with Sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327A 330) as supplemented by Department of Labor regulations (29 CFR part 5). (Contracts which involve the employment of mechanics or laborers).

9. Notice of awarding agency requirements and regulations pertaining to reporting.

10. Notice of awarding agency requirements and regulations pertaining to patent rights with respect to any discovery or invention which arises or is developed in the course of or under such contract.

11. Access by the grantee, the sub-grantee, the federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions.

12. Mandatory standards and policies relating to energy efficiency which are contained in the state energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94A 163, 89 Stat. 871).

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of all of the procurement requirements applicable to federal programs, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with this federal requirement.

The continued occurrence of this situation will result in future instances of noncompliance with the federal procurement requirements.

Questioned Costs: None

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Independent Auditors' Recommendation

We recommend the Head Start Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of the federal procurement standards of 24 CFR 85.36. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-50 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles
Procurement, Suspension and Debarment

Statement of Condition

As part of our testing of compliance with activities allowed and allowable costs for the program, we examined one hundred and seven (107) non-payroll disbursements totaling $4,075,835. The following exceptions were noted in the items examined:

- One (1) disbursement amounting to $5,654 was duplicated (paid two times). The disbursement was for the concept of mileage and travel expenses reimbursements (questioned cost $5,654).

- For six (6) professional services and two (2) miscellaneous services disbursements, amounting to $14,930, the Head Start Program did not comply with the small purchase procurement transactions established by 24 CFR 85.36, known as *Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments.* There was no evidence to ensure that services were obtained at the most advantageous terms and in a manner providing full and open competition in accordance with the requirements established by the U.S. Department of Health and Human Services. The Head Start Program did not obtain price estimates from three (3) suppliers for each disbursement questioned (questioned cost $14,930).

- For eighty-six (86) disbursements, the disbursement documents were not market as paid.

- For four (4) disbursements amounting to $33,948, the canceled checks was not available for our examination (questioned cost $33,948).

Criteria

According to 40 CFR 12.76(d)(2) and (3), if a project is estimated to cost $100,000 or more, the sealed bid process or the "competitive proposals" procedure should be used for contracting services. Under the sealed bid process, bids are publicly solicited and the contract is awarded to the lowest responsible bidder. The sealed bid process is the preferred federal method for procuring construction. Under the "competitive proposals" procedure, a municipality must publicly notice the project (for services), and solicit an adequate number of bids. The bidders' qualifications are evaluated and the most qualified competitor is selected, subject to negotiations of a fair and reasonable prices. The "competitive proposals" procedure, where price is not used as a selection factor, may only be used in the procurement of architectural or engineering services.

If a project is estimated to cost $100,000 or less the Program must follow the small purchase procedures. Small purchase procedures are those relatively simple and informal procurement methods for securing services, supplies, or other property that do not cost more than the simplified acquisition threshold fixed at 41 U.S.C. 403(11) (currently set at $100,000). If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources (generally three sources).

Furthermore, Section 5 of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico*, which were created pursuant to Article 19.011 of Law No. 81 and approved by the Office of the Commissioner of Municipal Affairs, state that the accounting system of the Municipality should include fiscal procedures for the system's operations, establishing proper internal controls and the prevention of irregularities. These procedures should provide for the timely and accurate performance of operations. It should include the necessary records, files, reconciliations, adjustments, closing entries, reports, and all other necessary documentation to support the basic financial statements.

Cause and Effect

These conditions occurred because the municipal employees had no previous knowledge of certain procurement regulations applicable to federal programs, as well as, the lack of internal controls and procedures designed to appropriately review payment vouchers prior to the issuance of a payment.

The continued occurrence of this situation will result in possible unsupported disbursements and payments to suspended or debarred suppliers, as well as accounting errors or omissions.

Questioned Costs: $54,532

Independent Auditors' Recommendation

The Head Start Program should enforce strict compliance with the procurement procedures established by 40 CFR 12.76.

06-51 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Activities Allowed / Allowable Costs / Cost Principles

Statement of Condition

As part of our tests of allowable costs of the Head Start Program, we examined a sample of twenty-five (25) payroll disbursements of twenty-four employees totaling $13,614, and the respective human resources' files of the corresponding employees. The following exceptions were noted for the items examined:

Exceptions related to the payroll disbursements:

- For two (2) disbursements of two employees, the payroll disbursement did not agree with the approved wage rate documented in the employee's human resources file.

Exceptions related to the human resources files of the employees for which payroll disbursements were examined:

- For eleven (11) employees, the Form I-9 of the Service of Naturalization and Immigration included in the human resources files were not completed in all the required parts of the form or was not included in the file.

- For six (6) employees, the human resources files did not include the Form ASM-5, *Report of New Employees*, required by the Puerto Rico Child Support Administration (ASUME, by its Spanish acronym).

- For two (2) employees, the required identification card with photo was not included in the employees' human resources files.

- For twenty-four (24) employees, the unopened drug test results were not included in the employees' human resources files.

- For nine (9) employees, the medical report was not included in the employees' human resources files.

- For four (4) employees, the labor or professional history report was not included in the employee's human resources file.

- For one (1) employee, the human resources files did not include the employee's original birth certificate.

- For eighteen (18) employees, the human resources files did not include updated records of approved withholdings and marginal benefits.

- For one (1) employee, the human resources files did not include the hiring notice signed by the Mayor or authorized representative.

Criteria:

OMB Circular A 102, Subpart C, Section 20 (2), states that 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 the grant or sub-grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Accounting records must be supported by such source documentation as cancelled invoices, pre-audited invoices, paid bills, payrolls, time and attendance records, etc. Except as otherwise provided, records must be retained for three years.

Article 11.023 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that each municipality must maintain a complete human resources file for each of its employees. Those files must include the historical information of each employee from the original hiring date through the termination or retirement date of the employee, including the employee's human resources information from his or her previous public employers.

Cause and Effect

These conditions occurred because the Head Start Program does not update the human resources files of its employees periodically, as well as, the lack of internal controls and procedures designed to appropriately ascertain compliance with these federal and state requirements.

The continued occurrence of this situation will result in future instances of unsupported or incorrect payroll payments and other instances of noncompliance with federal and state regulations related to human resources management.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Head Start Program to update all human resources files as soon as possible and ascertain that all employee-related documents required by law are maintained in the human resources file of each employee. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal and state requirements, including continued professional education and training to the employees assigned to human resources duties.

06-52 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Eligibility

Statement of Condition

As part of our eligibility tests of the Head Start Program, we selected a sample of sixty (60) children for examination of their eligibility files for the fiscal year ended June 30, 2006. Based on our examination of the project files, we noted that the eligibility file of one child was not provided to us for examination within a reasonable period of time after requested.

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Criteria

45 CFR 1305 states that to be eligible for Head Start services, a child must be at least three years old by the date used to determine eligibility for public school in the community in which the Head Start Program is located, except in cases where the Head Start Program's approved grant provides specific authority to serve younger children. At least 90 percent of the children who are enrolled in each Head Start Program must be from low-income families and up to ten percent of the children who are enrolled may be children from families that exceed the low-income guidelines but who meet the criteria that the program has established for selecting such children and who would benefit from Head Start services.

Cause and Effect

These conditions occurred because of the lack of adequate internal controls and procedures designed to safeguard eligibility files. The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned federal requirements.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Head Start Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of eligibility standards of 45 CFR 1305. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements.

06-53 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Matching, Level of Effort, Earmarking

Statement of Condition

The Head Start Program has not complied with the matching requirements established by 45 CFR 74.23. The Head Start Program did not have adequate internal controls and procedures to ensure compliance with the required level of matching contributions and the adequate documentation of it. Based on our examination of the monthly In-Kind Contributions Certifications submitted by the Head Start Program to the Administration for Integral Care and Development of Children (ACUDEN, by its Spanish Acronym) (the pass-through entity of the grant) for the fiscal year ended June 30, 2006, we noted the following in-kind matching contributions for which no adequate documentation was available to support their allowability:

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Type of In-Kind Contribution	Contribution Amount
Professional and consulting services	$211,237
Materials and supplies	111,822
Rent	10,606
Other costs, including payroll costs of municipal employees	494,840
Total unsupported in-kind contributions	$828,505

On August 20, 2004, a firm of independent Certified Public Accountants, in representation of the Administration for Integral Care and Development of Children (ACUDEN, by its Spanish Acronym and pass-through entity of the Head Start funds) completed a program audit of the Head Start Program as of and for the fiscal year ended February 29, 2004. The program audit report includes an audit finding indicating that for such fiscal year, there were unsupported in-kind contributions for which a questioned cost of $1,164,792 was reported.

On June 30, 2006, a firm of independent Certified Public Accountants, in representation of ACUDEN, completed a program audit of the Head Start Program as of and for the fiscal year ended February 28, 2005. The preliminary draft of the program audit report includes an audit finding indicating that for such fiscal year, there were unsupported in-kind contributions for which a questioned cost of $482,493 was reported. At the date of our audit report, such program audit report is tentative and subject to changes based on the discussion of its contents with the management of the Municipality.

Criteria

45 CFR 1301 states that grantees are required to contribute at least twenty percent (20%) of the costs of the program through cash or in-kind contributions, unless a lesser amount has been approved by the Administration for Children and Families of the Department of Health and Human Services. 45 CFR 74.23 states that to be accepted, all cost sharing or matching contributions, including cash and third party in-kind, shall meet all of the following criteria:

- Are verifiable from the recipient's records.
- Are not included as contributions for any other federally-assisted project or program.
- Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
- Are allowable under the applicable cost principles.
- Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.
- Are provided for in the approved budget.

- Unrecovered indirect costs may be included as part of cost sharing or matching.

- Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles. If the awarding agency authorizes recipients to donate buildings or land for construction/facilities acquisition projects or long-term use, the value of the donated property for cost sharing or matching shall be the lesser of: (1) the certified value of the remaining life of the property recorded in the recipient's accounting records at the time of donation; or (2) the current fair market value.

- Volunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program. Rates for volunteer services shall be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient's organization, rates shall be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved. In either case, fringe benefits consistent with those paid that are reasonable, allowable, and allocable may be included in the valuation.

- When an employer other than the recipient furnishes the services of an employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overhead costs), provided these services are in the same skill for which the employee is normally paid.

- Donated supplies may include such items as expendable property, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation.

- Volunteer services shall be documented and, to the extent feasible, supported by the same methods used by the recipient for its own employees, including time records.

- The basis for determining the valuation for personal service, material, equipment, buildings and land shall be documented.

Cause and Effect

These conditions occurred because of the lack of adequate internal controls and procedures designed to ascertain compliance with the required level of matching contributions and the adequate documentation of it. The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned federal requirements and future questioned costs.

Questioned Costs: $4,142,525 ($828,505 divided by 20% matching requirement for 2005-2006 = $4,142,525)

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Independent Auditors' Recommendation

We recommend the Head Start Program to ascertain that employees working with federal financially assisted programs be oriented and trained with the provisions of matching requirements of 45 CFR 1301. We also recommend that the Municipality adopt the necessary internal controls and procedures designed to ascertain compliance with these federal requirements, including adopting the necessary procedures to ensure adequate documentation of the in-kind contributions made to this federal financially assisted program.

06-54 U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
Head Start - CFDA No. 93.600
Internal Control / Compliance
Reporting

Statement of Condition

The Head Start Program did not comply with the reporting requirements required by law and the grant agreement with the Administration for Integral Care and Development of Children (ACUDEN, by its Spanish Acronym). All of the reports and related documents for the following months were submitted after the deadlines agreed with the ACUDEN:

Reports and Related Documents for the Month Ended	Deadline for Filing	Actual Filing Date
August 31, 2005	September 7, 2005	September 9, 2005
September 30, 2005	October 7, 2005	October 11, 2005

In addition to the above conditions, the Head Start Program could not provide us evidence to ascertain that the reports and the related documents for the month of November 2005 were submitted to ACUDEN.
Furthermore, the Head Start Program could not provide us evidence to ascertain that monthly subsidiary ledger of capital assets was submitted to ACUDEN.

The reports submitted to ACUDEN by the Head Start Program were prepared with accounting records kept by the Program, which were not reconciled with the general ledger of the Uniform Accounting System (UAS). In addition, such reports were not prepared following the Accounting Principles Generally Accepted in the United States of America (GAAP).

Criteria

The grant agreement with ACUDEN states that the Head Start Program must submit a monthly expense report no later than five (5) working days after the month reported. Such report shall include the following documents:

- Report of accumulated expenses and claim of funds
- Report of project costs

- List of outstanding encumbrances
- Financial Report
- Certified payroll of the previous month
- Bank account reconciliations of the previous month
- Report of administrative costs
- Trial balance at the close of business of the previous month
- Report of Liquidation of Funds at the close of business of the previous month
- Any other programmatic report required by ACUDEN

Cause and Effect

This situation occurred because the Municipality has not adequate internal controls in place to ensure the accurate and timely preparation of reports required by federal regulations. This situation increases the possibility of increased oversight procedures from ACUDEN and the U.S. Department of Health and Human Services.

Questioned Costs: None

Independent Auditors' Recommendation

We recommend the Head Start Program to establish adequate internal controls and procedures to ensure that the required reports are prepared in a timely manner using financial data in agreement and reconciled with the Uniform Accounting System (UAS) and following the Accounting Principles Generally Accepted in the United States of America (GAAP). Adequate training should be given to the employees assigned to the preparation of these reports.

Total Questioned Costs for all major programs **$4,447,418**

In compliance with Government Auditing Standards, 2003 Revision, Chapter 8, Item 8.32, *Reporting Views of Responsible Officials*, the independent auditors discussed all of the financial statements and federal awards findings and questioned costs reported in the accompanying schedule of findings and questioned costs with the respective municipal officials responsible for the financial statements and each of the Municipality's major programs, prior to the issuance of the Single Audit Report. The findings and questioned costs were also discussed with the Mayor and other members of the senior management of the Municipality. The independent auditors also received verbally, from each of the responsible municipal officials, their views, conclusions, preliminary recommendations and preliminary planned corrective actions, as applicable, on each of the financial statements and federal awards findings and questioned costs reported.

In summary, the management of the Municipality evaluated and verbally concurred with each of the findings and questioned costs referred to above prior to the issuance of the Single Audit Report, and is currently in the process of preparing the formal written responses for each of the audit findings and questioned costs as part of the preparation of the corrective action plan, which is expected to be completed on or before March 31, 2007. The independent auditors were informed by the management of the Municipality that they are aware of the deadlines and other requirements related to the written responses to the findings and the corrective action plan. The management of the Municipality is responsible of submitting the written responses and the corrective action plan to the Federal Audit Clearinghouse on or before the statutory deadline.

The independent auditors obtained a written representation letter from the municipal responsible officials, dated December 22, 2006, in which those officials confirmed that the evaluation and the discussion process of the findings and questioned was properly performed prior to the issuance of the Single Audit Report. The representation letter was signed by: (1) Hon. Ramón A. Hernández, Mayor, (2) Mr. Francisco Torres, Director of Finance and Budget, (3) Mrs. Ramonita Rentas, Director of Federal Programs Office, the Section 108 Loan Guarantee Program, the Community Development Block Grants – Entitlement Grants Program and the Community Development Block Grants – State-Administered Small Cities Program, (4) Mrs. María M. Boglio, Director of Section 8 Housing Choice Voucher Program, (5) Mrs. Eva Cintrón, Director of Head Start Program, (6) Mrs. Elsa Martínez, Director of Child and Adult Care Food Program, and (7) Mr. Reinaldo Meléndez, CPA, Financial Counselor.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF JUANA DÍAZ
Summary Schedule of Prior Audit Findings
Fiscal Year Ended June 30, 2006

The following schedule contains the original number and title of each of the findings of federal awards included in the *Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133* and the Schedule of Prior Years' Audit Findings for the Fiscal Year ended June 30, 2005. The following legend indicates the current status of the prior years' audit findings:

FR - Fully resolved (indicating the corrective action plan was fully implemented).

PR - Partially resolved (indicating the corrective action plan was partially implemented).

NR - Not resolved yet. Finding pending for final resolution from grantor.

Original Finding Number	Title	Action Taken
05-03	Allowable Activities-Housekeeper Activities	NR
05-04	Allowable Activities-Housing Rehabilitation Activities	NR
05-05	Cash Management	NR
05-06	Equipment and Real Property Management	NR
05-07	Reporting	NR
05-08	Davis-Bacon Act	NR
05-09	Cash Management	NR
05-10	Eligibility	NR
05-11	Special Test – Selection from the Section 8 Waiting List	NR
05-12	Special Test – Reasonable Rent	FR
05-13	Special Test – Utility Allowance Schedule	FR
05-14	Special Test – Housing Quality Standards Inspections	NR
05-15	Cash Management	NR
05-16	Davis-Bacon Act	FR
05-17	Reporting	NR
05-18	Reporting	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF JUANA DÍAZ
Summary Schedule of Prior Audit Findings
Fiscal Year Ended June 30, 2006

Original Finding Number	Title	Action Taken
04-05	Cash Management	NR
04-06	Reporting	NR
04-07	Allowable Activities- Housing Rehabilitation Activities	NR
04-09	Eligibility of Individuals	NR
04-11	Special Test – Selection from the Section 8 Waiting List	NR
04-13	Special Test – Utility Allowance Schedule	FR
04-14	Special Test – Housing Quality Standards Inspections	NR
04-17	Reporting	NR
04-18	Cash Management	NR
03-07	Cash Management	NR
03-11	Allowable Activities-Housing Rehabilitation Activities	NR
03-13	Eligibility	NR
03-14	Special Test – Selection from the Section 8 Waiting List	NR
03-15	Special Test – Reasonable Rent	FR
03-16	Special Test – Utility Allowance Schedule	FR
03-18	Cash Management	NR
03-21	Matching	NR

The above summary schedule of prior audit findings do not include: (1) federal awards findings for which two fiscal years have passed since the audit report in which the finding occurred was submitted to the federal clearinghouse, (2) findings for which the federal agency or pass-through entity is not currently following up with the auditee on the audit finding; and (3) findings for which a management decision was not issued.