

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE LAS MARIAS**

**AUDITORIA 2005-2006**

**30 DE JUNIO DE 2006**

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DE LAS MUNICIPALIDADES  
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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**

Independent Auditors' Report  
  
Financial Statements and  
Supplemental Schedules  
  
Year Ended June 30, 2006

**MUNICIPALITY OF LAS MARIAS**  
**COMMONWEALTH OF PUERTO RICO**  
FINANCIAL STATEMENTS AND SUPPLEMENTAL SCHEDULES  
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 Las Marías  
Las Marías, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Las Marías of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

In accordance with Government Audit Standards, we have also issued our report dated December 19, 2006 on my consideration of the Government's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Audit Standards and should be read in conjunction with this reporting in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the general purposes financial statements taken as a whole. The accompanying schedule of expenditure of federal awards is presented for purpose of additional analysis as required by US Office of Management and Budget Circular A- 133, Audit of States, Local Governments, and Non- Profit Organizations, and is not required part of the general purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

The accompanying Management's Discussion and Analysis and the Budgetary Comparison Schedule are not required parts of the basic financial statements referred to above, but are supplementary information required by GASB. 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.

  
Juan Rivera, CPA  
License# 2214



December 19, 2006  
Toa Baja, Puerto Rico

Stamp No. 2195598 of the Puerto Rico Society of Certified Public Accountants was affixed to the record copy of this report.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management of the Municipality of Las Marias of the Commonwealth of Puerto Rico (the "Municipality") provides this *Management's Discussion and Analysis* of the Municipality's basic financial statements as an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2006, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, issued by the Governmental Accounting Standards Board (commonly known as "GASB 34"). According to this statement, significant required changes in content and structure have been made in the accompanying Municipality's basic financial statements as of and for the fiscal year ended June 30, 2006, which make the accompanying basic financial statements not easily comparable to the Municipality's general purpose financial statements issued in prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the Municipality's financial position and results of operations.

This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of GASB 34, and it has been designed accordingly with the following goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget), and;
- e) Identify individual fund issues or concerns.

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the accompanying basic financial statements.

### **FINANCIAL HIGHLIGHTS**

- The Municipality's has reported assets and net assets amounting to \$17,204,117 and \$7,567,730, respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to \$15,487,440 (90 percent of total Municipality's assets).
- The Municipality has reported total liabilities amounting to \$9,636,387 in the accompanying statement of net assets, of which the most significant liabilities are: (1) account payables and accrued liabilities (\$685,171), (2) bonds and notes payable (\$6,972,484) and (3) intergovernmental (\$958,825). These liabilities account for 89 percent of the Municipality's total liabilities at June 30, 2006.
- The Municipality has reported total revenues amounting to \$7,733,539 in the accompanying statement of activities, of which: (1) other revenues (\$694,647), (2) restricted capital and operating grants (\$1,248,106), (3) property taxes (\$562,838) and (4) intergovernmental contributions (\$5,044,383) were the most significant revenues amounting to \$7,549,871 (98 percent of total revenues).

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**MUNICIPALITY OF LAS MARIAS**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

- The Municipality has reported a net change in net assets (excess of expenses over revenues) amounting to (\$399,079) in the accompanying statement of activities.
- The Municipality's governmental funds reported combined ending fund balances of (\$491,068) of which (\$835,356) represent the fund balances of the general fund, the CDBG fund and the debt service fund combined (jointly known as the Municipality's major funds).
- The Municipality has reported unreserved fund balance for the general fund (deficit) amounting to (\$1,007,686)
- The Municipality has reported an excess of expenditures and other financing uses over revenues and other financing sources amounting to \$ 720,086 in the governmental funds.

**USING THIS ANNUAL REPORT**

This annual report consists of a series of new financial statements with a change in the focus from the previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

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

**Government-Wide Financial Statements**

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance 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 the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2006 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

**Statement of Net Assets**

The statement of net *assets* presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

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**MUNICIPALITY OF LAS MARIAS**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Statement of Activities**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2006. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

**Fund Financial Statements**

The Municipality's fund financial statements, which consist of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

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.

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year (June 30, 2006). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar

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information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has three major funds: (1) the general fund, (2) the CDBG fund and (3) the debt service fund.

**Notes to the Basic Financial Statements**

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the basic financial statements.

**Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

**INFRASTRUCTURE ASSETS**

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (modified approach), which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

As of July 1, 2003, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$7,567,730 at June 30, 2006.

The largest portions of the Municipality's net assets are invested in capital assets net of their related debt (\$13,989,357). The Municipality's net assets are also composed of net assets amounting to \$516,617 that are restricted for (1) future debt service payments and (2) the future acquisition or construction of capital assets. In addition, the Municipality's net assets are reported net of an unrestricted deficit of \$6,938,244.

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MANAGEMENT'S DISCUSSION AND ANALYSIS**

The unrestricted deficit is the consequence of previous budgets, which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets, are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

**Condensed Statement of Net Assets:**

Current and other assets	\$ 791,790
Noncurrent and other assets	<u>16,412,327</u>
Total assets	<u>17,204,117</u>
Long-term liabilities outstanding	7,043,601
Other liabilities	<u>2,592,786</u>
Total liabilities	<u>9,636,387</u>
Net assets/(liabilities):	
Invested in capital assets, net of related debt	13,989,357
Restricted	516,617
Unrestricted	<u>(6,938,244)</u>
Total net assets	<u>\$ 7,567,730</u>

**Changes in Net Assets**

The Municipality's net assets decreased by \$399,079 during the year. Approximately 65 percent of the Municipality's total revenues came from intergovernmental contributions, while 16 percent resulted from restricted capital and operating grants. The Municipality's expenses cover a range of services. The largest expenses were for general government (36 percent) and urban and economic development (29 percent).

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MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

**Condensed Statement of Activities:**

Revenues:	
Program revenues:	
Operating grants and contributions	\$ 389,914
Capital grants and contributions	858,192
General revenues:	
Property taxes	562,838
Municipal license taxes	86,403
Construction excise taxes	84,457
Intergovernmental contributions	5,044,383
Other	707,352
Total revenues	<u>7,733,539</u>
Expenses:	
General government	2,911,164
Urban and economic development	2,358,462
Public safety	633,535
Health and sanitation	638,997
Culture, recreation and education	521,812
Public housing and welfare	659,659
Interest	408,989
Total expenses	<u>8,132,618</u>
Net increase in net assets	(399,079)
Net assets - at beginning of year	<u>7,966,809</u>
Net assets - at end of year	<u>\$ 7,567,730</u>

**FINANCIAL ANALYSIS OF THE MUNICIPALITY'S GOVERNMENTAL FUNDS**

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF LAS MARIAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

**Condensed Balance Sheet - Governmental funds:**

Total Assets - Major Funds	\$	1,027,425
Total Assets - Nonmajor Funds		656,987
Total assets		1,684,412
Total Liabilities - Major Funds		1,862,781
Total Liabilities - Nonmajor Funds		312,699
Total liabilities		2,175,480
Fund Balances - Major Funds		(835,356)
Fund Balances - Nonmajor Funds		344,288
Total fund balance	\$	(491,068)

**Condensed Statement of Operations - Governmental funds:**

Total Revenues - Major Funds	\$	6,574,704
Total Revenues - Nonmajor Funds		1,158,832
Total revenues		7,733,536
Total expenditures - Major Funds		7,198,074
Total expenditures - Nonmajor Funds		1,255,548
Total expenditures		8,453,622
Revenues Over Expenses - Major		(623,370)
Revenues Over Expenses - Nonmajor		(96,716)
Total fund balance	\$	(720,086)

**GENERAL FUND BUDGETARY HIGHLIGHTS**

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

The accompanying Budgetary Comparison Schedule shows a total negative variance between budgeted revenues and actual revenue results of (\$514,180), which was mainly caused by a negative variance of (\$1,011,708) in construction excise tax.

In addition, the accompanying Budgetary Comparison Schedule shows a total positive variance between budgeted expenditures and actual expenditures results of \$489,797.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
MANAGEMENT'S DISCUSSION AND ANALYSIS

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$20,720,101 of which \$6,292,853 represents infrastructure assets at June 30, 2006. The related accumulated depreciation and amortization of capital assets amounted to \$5,232,661, of which \$2,301,634 is related to infrastructure assets at June 30, 2006. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$2,656,354 for the year ended June 30, 2006. Depreciation and amortization charges for the year totaled \$585,240.

The Municipality finances a significant portion of its construction activities through bond issuances and 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.

**Debt Administration**

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

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

The Municipality is required under applicable laws and regulations to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax Levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

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MANAGEMENT'S DISCUSSION AND ANALYSIS**

**ECONOMIC FACTORS AND NEXT BUDGETS AND RATES**

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

Those factors were considered when preparing the Municipality's budget for the 2006-2007 fiscal years. There were no significant changes between the budget for fiscal year 2005-2006 and the one for fiscal year 2006-2007.

**FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's' accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mr. Mario A. Jorge Quintana, at PO Box 366, Las Marías, Puerto Rico, 00670-0366.

**MUNICIPALITY OF LAS MARIAS**

Statement of Net Assets

June 30, 2005

**ASSETS**

**Current Assets:**

Cash and cash equivalents (notes 1g and 3)		\$ 51,825
Receivables, net of allowance for doubtful accounts (note 1h):		
Taxes:		
Property taxes (note 5)	\$ 159,317	
Municipal license taxes (note 4)	8,588	
Total taxes receivable	<u>167,905</u>	
Intergovernmental (note 1h)	571,536	
Other	<u>524</u>	
Total receivables		<u>739,965</u>
Total current assets		<u>791,790</u>

**Noncurrent Assets:**

Temporarily restricted cash and cash equivalents (notes 1j and 3)		892,622
Deferred charges, net of accumulated amortization (notes 1k)		32,265
Capital assets, net of accumulated depreciation and amortization (notes 1m and 7)		<u>15,487,440</u>
Total noncurrent assets		<u>16,412,327</u>
Total assets		<u>\$ 17,204,117</u>

**LIABILITIES**

**Current liabilities:**

Bank overdraft		\$ 262,047
Accounts payable and other accrued liabilities (notes 1h)		685,171
Intergovernmental (note 1h and 8)		958,825
Deferred revenues (notes 1n, 4 and 5)		269,437
Accrued compensated absences, excluding long-term portion (note 1o)		175,181
Bonds and notes payable (notes 1q and 9)		<u>242,125</u>
Total current liabilities		2,592,786

**Noncurrent liabilities:**

Accrued compensated absences, excluding current portion (notes 1o)		313,242
Bonds and notes payable, excluding current portion (notes 1q and 9)		<u>6,730,359</u>
Total noncurrent liabilities		<u>7,043,601</u>
Total liabilities		<u>9,636,387</u>

**NET ASSETS (DEFICIT)**

Invested in capital assets, net of related debt		13,989,357
Restricted for (1j):		
Debt service	172,330	
Capital projects	<u>344,287</u>	
Total restricted net assets		<u>516,617</u>
Unrestricted net deficit		<u>(6,938,244)</u>
Total net assets		<u>7,567,730</u>
Total Liabilities and Net Assets		<u>\$ 17,204,117</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**LAS MARIAS**  
Statement of Activities  
Year Ended June 30, 2006

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>		<u>Net Expenses and Changes in Net Assets</u>
		<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
Governmental activities:				
General government	\$ 2,911,164	\$ 186	\$ -	\$ (2,910,978)
Urban and economic development	2,358,462		848,249	(1,510,213)
Public safety	633,535		9,943	(623,592)
Health and sanitation	638,997			(638,997)
Culture, recreation and education	521,812	66,004		(455,808)
Public housing and welfare	659,659	323,724		(335,935)
Interest on bonds, notes, capital lease obligations and long-term debt (notes 9 and 10)	408,989			(408,989)
<b>Total governmental activities</b>	<b>\$ 8,132,618</b>	<b>\$ 389,914</b>	<b>\$ 858,192</b>	<b>\$ (6,884,511)</b>
General revenues:				
Taxes:				
Property taxes (note 5)				\$ 562,838
Municipal license taxes (note 4)				86,403
Construction excise taxes				84,457
Total taxes				733,698
Intergovernmental contributions and reimbursements				5,044,383
Unrestricted interests, fines and penalties				12,805
Other revenues				694,547
Total general revenues				6,485,433
Net change in net assets				(399,079)
Net assets-beginning of fiscal year, as restated (note 12)				7,966,809
Net assets-end of fiscal year				<b>\$ 7,567,730</b>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
Balance Sheet  
Governmental Funds  
June 30, 2006

	<b>Major Funds</b>			<b>Other Governmental Funds</b>	<b>Total Governmental Funds</b>
	<b>General Fund</b>	<b>Debt Service Fund</b>	<b>CDBG Fund</b>		
<b>ASSETS</b>					
Unrestricted cash and cash equivalents (note 1g and 3)	\$ 51,825	\$ -	\$ -	\$ -	\$ 51,825
Receivables, net of allowance for doubtful accounts:					
Taxes:					
Property taxes (note 5)	134,043	25,274	-	-	159,317
Municipal license tax (note 4)	8,588	-	-	-	8,588
Construction excise tax	-	-	-	-	-
Other	-	-	-	524	524
Total taxes receivable	142,631	25,274	-	524	168,429
Intergovernmental, principally from the governments of the Commonwealth of Puerto Rico and United States of America	479,602	-	34,676	57,258	571,536
Total receivables, net	622,233	25,274	34,676	57,782	739,965
Total current assets	674,058	25,274	34,676	57,782	791,790
Temporarily restricted cash and cash equivalents (note 1g and 3)	44,715	147,056	101,646	599,205	892,622
Total assets	<u>\$ 718,773</u>	<u>\$ 172,330</u>	<u>\$ 136,322</u>	<u>\$ 656,987</u>	<u>\$ 1,684,412</u>
<b>LIABILITIES</b>					
Bank overdraft	\$ 262,047	\$ -	\$ -	\$ -	\$ 262,047
Account payable and accrued liabilities (notes 1h)	430,901	-	136,322	117,948	685,171
Intergovernmental	958,825	-	-	-	958,825
Deferred revenues (notes 1n, 4 and 5)	74,686	-	-	194,751	269,437
Total liabilities	1,726,459	-	136,322	312,699	2,175,480
<b>FUND BALANCES</b>					
Capital assets	-	-	-	344,288	344,288
Debt service	-	172,330	-	-	172,330
Unreserved	(1,007,686)	-	-	-	(1,007,686)
Total fund balances (note 12)	(1,007,686)	172,330	-	344,288	(491,068)
Total liabilities and fund balances	<u>\$ 718,773</u>	<u>\$ 172,330</u>	<u>\$ 136,322</u>	<u>\$ 656,987</u>	<u>\$ 1,684,412</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
 Statement of Revenues, Expenditures and  
 Changes in Fund Balances - Governmental Funds  
 Year Ended June 30, 2006

	<u>Major Funds</u>			<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
	<u>General Fund</u>	<u>Debt Service Fund</u>	<u>CDBG Fund</u>		
<b>REVENUES:</b>					
Taxes					
Property taxes (note 5)	\$ 463,570	\$ 99,268	\$ -	\$ -	\$ 562,838
Municipal license taxes (note 4)	86,403				86,403
Construction excise taxes	84,457	-	-	-	84,457
Total taxes	634,430	99,268	-	-	733,698
Intergovernmental					
Grants and contributions:					
Federal grants and contributions			704,130	543,973	1,248,103
State contributions	4,431,224			613,159	5,044,383
Interest, fines, and penalties	7,205	3,900	-	1,700	12,805
Other revenues	694,547	-	-	-	694,547
Total revenues	5,767,406	103,168	704,130	1,158,832	7,733,536
<b>EXPENDITURES:</b>					
Current					
General government	2,494,191			432,910	2,927,101
Public safety	620,233			9,943	630,176
Urban development	1,500,554		704,130	144,119	2,348,803
Health and sanitation	639,090				639,090
Culture and education	234,387			66,004	300,391
Public housing and welfare	354,375			323,724	678,099
Capital outlays	-			278,849	278,849
Debt service:					
Principal (notes 1r and 10)		242,125			242,125
Interest on bonds and notes (notes 10 and 11)	-	408,989	-	-	408,989
Total expenditures	5,842,830	651,114	704,130	1,255,549	8,453,623
Deficiency of revenues under expenditures	(75,424)	(547,946)	-	(96,716)	(720,086)
<b>OTHER FINANCING SOURCES (USES):</b>					
Operating transfer-in from other funds (note 6)	3,662	516,090	-	-	519,752
Operating transfer-out to other funds (note 6)	(516,090)	(3,662)	-	-	(519,752)
Total other financing sources (uses)	(512,428)	512,428	-	-	-
<b>EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES AND OTHER FINANCING USES</b>					
	(587,852)	(35,518)	-	(96,716)	(720,086)
<b>FUND BALANCES AT BEGINNING OF YEAR, AS RESTATED (NOTE 12)</b>					
	(419,834)	207,848	-	441,004	229,018
<b>FUND BALANCES AT END OF YEAR</b>					
	\$ (1,007,686)	\$ 172,330	\$ -	\$ 344,288	\$ (491,068)

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

*OK- [Signature]*  
 15/03/2007

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
 Reconciliation of Statement of Revenues,  
 Expenditures and Changes in Fund Balances  
 Governmental Funds to the Statement of Activities  
 Year Ended June 30, 2006

Amounts reported for governmental activities in the accompanying statement are different because:

Net change in fund balances as reported in the accompanying statement of revenues, expenditures and changes in fund balances - governmental funds	\$ (720,086)
Governmental funds report capital outlays as expenditures. However, in the accompanying statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense.	535,086
Depreciation expenses	(585,240)
Repayment of bond and notes principal is recorded as expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. Also, governmental funds report the effect of issuance costs, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of the two differences.	239,710
Expenditures recorded for government-wide and not for governmental funds	<u>131,451</u>
Net change in net assets as reported in the accompanying statement of activities	<u>\$ (399,079)</u>

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

**COMMONWEALTH OF PUERTO RICO**  
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NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2006

**1. GOVERNMENTAL ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Government Background Information**

The Municipality of Las Marias of the Commonwealth of Puerto Rico (the "Municipality") is a local government constituted in 1871 with full legislative, fiscal and administrative powers to operate as a government. The Municipality assumes responsibility for public safety, health and sanitation, public housing and welfare, culture and education, urban and development and many other general and administrative duties.

The laws and regulations of the Commonwealth of Puerto Rico (the "Commonwealth") provide for separation of powers of the executive, legislative and judicial branches of the Commonwealth's and the Municipality's governments. The executive power of the Municipality is exercised by a Mayor, who is elected every four years and is assisted by the Administrative Cabinet, which is appointed by the Mayor. The legislative power is exercised by the Municipal Legislature, which is 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.

**B. Financial Reporting Entity**

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

According to GAAP, the financial reporting entity for the Municipality consists of: (1) the primary government, which is composed of all municipal departments and units under the legal and administrative control of the Mayor and the Municipal Legislature, and (2) all component units.

In evaluating how to define the Municipality for financial reporting purposes, the Municipality's management has addressed all potential entities and organizations that may be considered component units according to the criteria set forth by Statement No. 14, *The Financial Reporting Entity*, as amended by Statement No. 39, *Determining Whether Certain Organizations are Component Units*, both issued by the Governmental Accounting Standards Board.

GAAP defines component units as those entities that: (1) are legally separate organizations for which the Municipality's elected officials are financially accountable, and (2) other organizations for which the nature and significance of their relationship with the Municipality are such that exclusion of their financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete. Financial accountability exists if the Municipality appoints a voting majority of the organization's governing body, and if either one of the following conditions exist: (1) the Municipality can

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impose its will on the organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

GASB Statement No. 39, which was early adopted by the Municipality on July 1, 2003, amended the provisions of GASB Statement No. 14 to provide additional guidance to determine whether certain organizations for which the Municipality is not financially accountable should be reported as component units based on the nature and significance of their relationship with the Municipality. Generally, GASB Statement No. 39 requires reporting, as a discretely presented component unit, an organization that raises and holds economic resources for the direct benefit of a governmental entity. Such organizations are legally separate, tax-exempt entities that meet all of the three specific criteria that address benefit, entitlement or access, and significance.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations considered component units of the Municipality according to GAAP as of June 30, 2004 nor for the year then ended.

**C. New Financial Reporting Model**

On July 1, 2003, the Municipality adopted the provisions of Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (commonly known as "GASB 34"), issued by the Governmental Accounting Standards Board (GASB). This statement, as amended, established a new financial reporting model for state and local governments.

In addition, on July 1, 2001 the Municipality also adopted the following required statements issued by GASB and the Financial Accounting Standards Board ("FASB"):

- i. **GASB Statement No. 33** – *Accounting and Financial Reporting for Nonexchange Transactions;*
- ii. **GASB Statement No. 36** – *Recipient Reporting for Certain Shared Nonexchange Revenues;*
- iii. **GASB Statement No. 37** – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus;*
- iv. **GASB Statement No. 39** – *Determining Whether Certain Organizations are Component Units;*
- v. **GASB Interpretation No. 6** – *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements;*

Simultaneously to the adoption of GASB Statement No. 34, the Municipality adopted certain pronouncements issued by FASB and all of its predecessor bodies, such as the Accounting Principles Board (APB), for its governmental activities. In this respect, the Municipality adopted the pronouncements issued by these entities that were issued on or before November 30, 1989, and that do not conflict with GASB pronouncements. Accordingly, on July 1, 2003 the Municipality adopted the provisions of APB Opinion No. 21, *Interest on Receivables and*

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*Payables*, to account for non-interest bearing receivables and payables reported in the accompanying basic financial statements.

The effects of implementing the aforementioned pronouncements have been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the cumulative effects of such transactions have been reported retroactively as restatements of fund balances at July 1, 2003.

According to the new financial reporting model established by GASB 34, as amended, the minimum required presentation for financial reporting purposes of the Municipality is composed of the following elements:

1. **Management's Discussion and Analysis ("MD&A")** – MD&A is a required supplementary information used to introduce the basic financial statements and provide an analytical overview of the Municipality's financial activities for the year ended June 30, 2004 based on the Municipality's management knowledge of the transactions, events and conditions reflected in the basic financial statements and the fiscal policies that control the Municipality's operations.
2. **Government-Wide Financial Statements ("GWFS")** – GWFS is a set of financial statements composed of: (1) a statement of net assets and (2) a statement of activities.

The government-wide financial statements are aimed at presenting a broad overview of the Municipality's finances by focusing on operational accountability through reporting the financial position and results of operations of the Municipality as a whole using methods that are similar to those used by most private businesses.

The statement of net assets provides short-term and long-term information about the Municipality's financial position, which assist management to determine the Municipality's economic condition at June 30, 2006 by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Net assets are reported in the following three categories:

- **Invested in Capital Assets, Net of Related Debt** – This consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted Net Assets** – These result when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the Municipality's policy to use restricted resources first, and then unrestricted resources as they are needed.

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- **Unrestricted Net Assets** – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designed, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

The statement of activities presents financial information showing how the Municipality's net assets changed during the year ended June 30, 2006. The statement of activities demonstrates the degree to which direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. Program revenues include charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function, segment or operational unit. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. The Municipality does not allocate general government (indirect) expenses to other functions.

Under the provisions of GASB 34, all activities carried out by the Municipality are considered governmental in nature for financial reporting purposes. As a result, no business-type activities are reported in the accompanying basic financial statements.

3. **Fund Financial Statements ("FFS")** – FFS is a set of financial statements composed of: (1) a balance sheet (financial position) and (2) a statement of revenues, expenditures and changes in fund balances (deficits) of the Municipality's governmental funds (results of operations).

The fund financial statements focus on: (1) financial accountability, (2) individual parts of the Municipality's government and (3) reporting the Municipality's operations in more detail than the government-wide financial statements.

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. The minimum number of funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its funds within the following governmental fund categories:

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**General Fund** – The general fund is the chief operating fund used to account for all financial resources and governmental activities of the Municipality, except for financial resources required to be accounted for in another fund type. It is presumed that the Municipality's 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 fund other than the general fund.

**Special Revenue Funds** – The special revenue funds are used to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes.

**Debt Service Fund**– The debt service fund is used to account for the accumulation of resources for, and the payment of, principal and interest for: (1) general long-term debt for which debt service payments are legally mandated to be accounted for in a debt service fund, and/or (2) 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 (such bonds payable and notes payable).

General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as capital leases, compensated absences, claims and judgments, advances from CRIM, and landfill closure and post closure maintenance costs) are accounted for in the general fund.

Long-term debt's principal and accrued interest due on July 1 of the following fiscal year are accounted for as liabilities in the debt service fund at June 30, if resources are available at June 30 for its payment.

**Capital Projects Funds** – Capital projects funds are used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The use of the capital projects funds has been reserved for major capital acquisitions or construction activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities.

The routine purchase of capitalizable assets (such as vehicles and other minor capital assets) has been reported in the general fund.

The Municipality has no significant operations or activities that: (1) are financed and operated primarily in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges, or (2) are fiduciary in nature. As a result, the Municipality does not report

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proprietary nor fiduciary funds in the accompanying fund financial statements. All Municipalities' funds are classified as governmental for financial reporting purposes.

4. *Notes to the Basic Financial Statements* – A set of notes that provide information that is essential to a user's understanding of the basic financial statements.
5. *Required Supplementary Information (other than MD&A)* – A set of reports and information reported along with, but separate from, the basic financial statements of the Municipality, such as: (1) Budgetary Comparison Schedule – General Fund, (2) the Notes to Budgetary Comparison Schedule and (3) the Schedule of Funding Progress - Employees' Retirement System of the Commonwealth of Puerto Rico and Its Instrumentalities.

**D. Measurement Focus and Basis of Accounting**

The term measurement focus refers to what is being expressed in reporting financial position and performance, that is, which resources are being measured in the accompanying basic financial statements. Two different measurement focuses have been applied in the accompanying basic financial statements: (1) the flow of current financial resources and (2) the flow of economic resources. Basis of accounting refers to when transactions have been recognized in the accompanying basic financial statements. GAAP provides for the use of two different bases of accounting, which have been used in the accompanying basic financial statements: (1) the accrual basis and (2) the modified accrual basis.

The accompanying government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenues are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund activities have been eliminated from these government-wide financial statements.

The accompanying fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available (that is, earned and collected or expected to be collected within the next 90 days following the fiscal year-end) to pay liabilities of the current period, except property tax revenues, for which the availability period is 60 days.

In applying the susceptible to accrual concept to intergovernmental revenue in the accompanying fund financial statements, there are essentially two types of revenue. For the majority of grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, generally recognized as expenditures are incurred. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are

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generally reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met.

In the accompanying fund financial statements, expenditures and related liabilities are generally recorded in the accounting period in which the liability is incurred, except for: (1) principal payment and interest on long-term obligations, which are recorded when due, except for principal and interest due in July 1 of the following fiscal year which are recorded when resources are available in the debt service funds (generally June 30); and (2) vacation leave, sick leave, christmas bonuses, obligations under capital leases, amounts subject to judgments under litigation, and other long-term obligations, which are recorded under the accrual basis of accounting in the accompanying government-wide financial statements.

In December 1998, the Governmental Accounting Standards Board issued Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* ("GASB 33"), effective for financial statement for periods after June 15, 2000, which the Municipality adopted on July 1, 2003. This statement established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, a government 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. The statement groups nonexchange transactions of governments into four classes, based on their principal characteristics: (a) derived tax revenue; (b) imposed nonexchange revenue; (c) government mandated nonexchange transactions; and (d) voluntary nonexchange transactions. The adoption of this statement altered significantly the basis of accounting used by the Municipality for the recognition of revenue and expenditures and related assets and liabilities, as described above. The effect of the adoption of this pronouncement has been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the cumulate effects of such transactions have been reported retroactively as restatements of fund balances at July 1, 2003.

**E. Major and Nonmajor Funds**

Under the provisions of GASB 34, the Municipality is required to segregate funds among major and nonmajor categories within the fund financial statements. Major individual governmental funds are reported as separate columns in the accompanying fund financial statements, while data from all nonmajor governmental funds are aggregated into a single column, regardless of fund type. At minimum a fund is considered major if: (1) it is the primary operating fund of the Municipality (i.e. the general fund) or; (2) meets both of the following criteria:

- (a) Total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding total for all funds of that category or type; and,

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- (b) Total assets, liabilities, revenues, or expenditures of the individual governmental fund are at least 5 percent of the corresponding total for all governmental funds combined.

Based on the above-mentioned criteria, the Municipality's general fund, the CDBG fund and the debt service fund are the only three funds that qualify as major funds for the fiscal year ended June 30, 2006, and accordingly, have been reported as major funds in the accompanying fund financial statements. All other governmental funds of the Municipality are considered nonmajor for financial reporting purposes.

**F. Statutory (Budgetary) Accounting**

The Municipality's budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with GAAP. Revenue is generally recognized when cash is received.

Expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one 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.

Under the statutory basis of accounting, 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.

The accompanying budgetary comparison schedule – general fund, only presents the information for the general fund, which is the only Municipality's fund with a legally adopted budget, as required by GAAP. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of differences in the deficiency of revenues and other financing sources under expenditures and other uses of financial sources for the year ended June 30, 2004 was presented for the general fund as part of the accompanying budgetary comparison schedule.

**G. Cash and Cash Equivalents**

The Municipality's cash and cash equivalents are composed of cash on hand, demand deposits, and short-term investments in certificates of deposit with original maturities of three months or less from the date of acquisition.

The Municipality follows the practice of pooling cash and cash equivalents. The balance in the pooled cash accounts is available to meet current operating requirements and any excess is invested in various interest-bearing deposits with private commercial banks.

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Cash with fiscal agent in the debt service fund represents additional property tax collections retained by the Municipal Revenue Collection Center ("CRIM", by its Spanish Acronyms), a municipal corporation (not a component unit of the Commonwealth nor of the Municipality). Such cash balances are restricted for the payment of the Municipality's debt service, as established by law.

**H. Receivables and Payables**

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans).

Tax receivables in the general fund represent amounts owed by taxpayers principally for individual and corporate property taxes, municipal license taxes and construction excise taxes. A portion of these tax receivables is recognized when they become measurable and available based on actual collections during the 90 days (60 days for property taxes) following the fiscal year-end related to tax returns due before year-end. Tax receivables also include amounts owed by taxpayers from taxable years prior to June 30, 2006, estimated to be collectible but not currently available, as a result of the adoption of GASB 33.

Accounts receivables are stated net of estimated allowances for doubtful accounts, which are determined based upon past collection experience and current economic conditions. Intergovernmental receivables mainly represent amounts owed to the Municipality by the Commonwealth and the federal government of the United States of America for: (1) intergovernmental charges, and (2) for reimbursement of expenditures incurred pursuant to federally funded programs, respectively.

In the accompanying government-wide financial statements, receivables consist principally of all revenues earned at year-end and not yet received. Allowances for doubtful accounts are based upon historical trends and the periodic aging of accounts receivable. Major receivable balances for the governmental activities include municipal license taxes, property taxes and construction excise taxes, among others.

Nonexchange transactions collectible but not available are deferred in the accompanying fund financial statements in accordance with the modified accrual basis of accounting, but not deferred in the accompanying government-wide financial statements in accordance with the accrual basis of accounting. Interest income is recorded when earned only if collected within 90 days after year-end since they would be considered both measurable and available. Allowances for uncollectible accounts receivable are based upon historical trends and the periodic aging of accounts receivable.

**I. Inventories and Prepaid Expenses**

Inventories consist of materials and supplies held for consumption. Generally, inventories and prepaid expenses are valued at cost and predominantly on the first-in, first-out basis.

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Governmental fund inventories and prepaid expenses are recorded as expenditures consumption method) when purchased rather than capitalized as an asset. Only significant amounts of inventory and prepaid expenses at the end of the year would be capitalized, if any, in the governmental funds. However, inventories are always capitalized (purchase method) in the statement of net assets.

**J. Temporarily Restricted Assets**

Certain cash and cash equivalents set aside by the general fund, the capital projects fund and the special revenue fund are classified as temporarily restricted assets since their use is limited for: (a) the compliance with debt service requirements of bonds and notes payable as established in the respective debt agreements, (b) the funding of construction and permanent improvement projects, and (c) the funding of federal and state sponsored programs. Temporarily restricted cash and cash equivalents amounted to \$892,622 (note 3) at June 30, 2006.

**K. Deferred Charges**

Deferred charges in the accompanying statement of net assets consist of debt bond issuance costs, which are amortized over the term of the related debt using the straight-line method. In the fund financial statements, bond issuance costs are recognized in the current period as expenditure, whether or not withheld from the actual debt proceeds received.

**L. Interfund Transactions**

Permanent reallocations of resources between the Municipality's funds are classified as interfund transfers. The Municipality has the following types of transactions recorded among funds in the accompanying fund financial statements:

- *Operating Transfers* – Legally required transfers that are reported when incurred as “operating transfers-in” by the recipient fund and as “operating transfer-out” by the disbursing fund.
- *Interfund Payments (Quasi-external Transactions)* – Charges or collections for services rendered by one fund to another that are recorded as revenue of the recipient fund and as expenditure of the disbursing fund.

For the purposes of the accompanying government-wide statement of activities, all interfund transfers between individual governmental funds have been eliminated.

**M. Capital Assets**

The accounting and reporting treatment applied to the capital assets associated with a fund are determined by its measurement focus. General capital assets are long-lived assets of the Municipality as a whole, such as land, land improvements, easements, buildings, building improvements, vehicles, machinery, equipment, works, infrastructure and all other intangible assets that are used in the operations of the Municipality and that have initial useful lives

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extending beyond a single reporting period (fiscal year). Infrastructure assets are generally immovable in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets. In the accompanying government-wide statement of net assets, all individual capital assets over the threshold amount of \$500 have been capitalized and depreciated.

In the accompanying government-wide statement of net assets, all capital assets are valued at their historical cost or estimated historical cost if actual is unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical cost was used to value the majority of the assets acquired prior to June 30, 2006. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

All capitalized assets are depreciated over their estimated useful lives under the straight-line method. All individual capital assets under the above mentioned capitalization threshold are charged directly to expense in the accompanying government-wide statement of activities. The estimated useful lives of major capital asset categories are:

Land improvements	20 years
Buildings and building improvements	50 years
Infrastructure	20 to 50 years
Motor vehicles	7 to 10 years
Furniture and fixtures	5 to 20 years
Machinery and equipment	5 to 20 years

Equipment held under capital leases is depreciated under the shorter of its estimated useful life of the assets or the lease term. Capital assets are recorded as capital outlays expenditures in the acquiring fund for the purposes of the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds.

**N. Deferred Revenues**

The Municipality reports deferred revenue on its basic financial statements. Deferred revenue arises when potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. Available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. Deferred revenues also arise when the Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized. Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

Deferred revenues at June 30, 2006 amounted to \$269,437 in the accompanying government-wide statement of net assets and balance sheet – governmental funds, respectively.

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**O. Compensated Absences**

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by the Governmental Accounting Standards Board (GASB 16).

Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. According to GASB 16, the liability for compensated absences recorded in the accompanying government-wide statement of net assets is strictly 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 (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences, include 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, Medicare taxes, employer contributions to retirement system and others).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year). Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed. Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave days is not paid to the employee. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employees at any time. At June 30, 2006, the Municipality has recorded a liability for compensated absences amounting to \$488,423 in the accompanying government-wide statement of net assets.

**P. Claims and Judgments**

The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.

**Q. Long-Term Debt**

All long-term debt to be repaid from governmental resources is reported as liabilities in the government-wide statement of net assets, except for principal and interest payment on long-term obligations due in July 1 of the following fiscal year, which is recorded in the fund financial statements when resources are available in the debt service fund (generally at June 30). Bonds

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and notes premiums and discounts, as well as, issuance costs, are deferred and amortized over the life of the debt in the accompanying government-wide financial statements.

Long-term debt for governmental funds is generally not reported as liabilities in the fund financial statements. In the governmental fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts are reported as other financing uses.

**R. Reservations of Fund Balances**

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

- *Encumbrances* – Represent future expenditures under purchase orders and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- *Capital Assets* - Represents net assets available to finance future acquisitions of capital assets.
- *Debt Service* – Represents fund balances available to finance future debt service payments.
- *Advances and Other Specified Purposes* – Represent the reservation of moneys set aside principally for long-term commitments related to federally-funded programs.

**S. Risk Financing**

The Municipality purchases commercial insurance covering casualty, theft, tort claims, and other losses. The Commonwealth, through its Department of Treasury, pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments. The current insurance policies have not been canceled or terminated. For workers' compensation and disability insurance, the Municipality obtains insurance coverage through the State Insurance Fund Corporation (a component unit of the Commonwealth) and the Occupational Disability Fund (which is a trust fund administered by the Department of Labor and Human Resources of the Commonwealth).

**T. Total Columns**

Total columns on the fund financial statements are presented only to facilitate financial analysis. Data in these columns does not present consolidated financial position or results of operations in

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conformity with GAAP. Such data is not comparable to a consolidation since interfund eliminations have not been made in the accompanying fund financial statements.

**U. Use of Estimates**

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires the Municipality's management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

**2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY**

The Municipality's general fund is the only governmental fund for which an annual budget is legally adopted. The Municipality's elected Mayor is legally required to prepare and submit to the elected Municipal Legislature an annual balanced budget for the ensuing fiscal year. The annual budget is prepared by the Municipality's Department of Finance, and takes into consideration the advice provided by all municipal departments and divisions. The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year, unless the imposition of taxes sufficient to cover said appropriations is provided by law.

The annual budget, which is developed utilizing elements of performance-based program budgeting and zero-based budgeting, includes an estimate of revenues and other financing resources of the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) municipal legislative measures proposed by the Mayor and submitted with the proposed budget, as well as the Mayor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year governmental plan adopted by the Municipality.

The Municipal Legislature may amend the budget 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. Upon approval by the Municipal Legislature, the budget is referred to the Mayor who may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Mayor may also veto the budget in its entirety and return it to the Municipal Legislature with his objections. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve a new budget. This permits the Municipality to continue making payments for its operations and other purposes until the new budget is approved.

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP. Accordingly, for budgetary purposes the Municipality uses encumbrance accounting. The encumbrances (principally purchase orders and contracts) are considered expenditures when a commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of budgetary appropriations and GAAP fund balances and do

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not constitute expenditures or liabilities on a GAAP basis because the commitments will be honored during the subsequent year. The encumbered balance of any appropriation of the general fund at the end of the fiscal year will lapse to the following fiscal year. In addition, the Municipal Legislature may direct that certain revenues be retained and made available for spending within a specific appropriation account.

Generally, expenditures may not exceed the level of spending authorized for an individual department or division of the Municipality. However, the Municipality is statutorily required to satisfy the debt service requirements, regardless of whether such amounts are appropriated or not.

Appropriations are enacted for certain departments and divisions. Appropriations for capital projects are made for each bond/note issue and the authorization continues for the expected construction period.

The Municipality's Finance Department has the responsibility to ensure that budgetary spending control is maintained on an individual department/division basis. The Finance Department may transfer part or all of any encumbered balance within a department to another department subject to approval. Budgetary control is exercised through the Municipality's accounting system. This system ensures that encumbrances or expenditures are not processed if they exceed the department/division's total available spending authorization, which is considered its budget. The legal level of budgetary control is at the individual department level for the general fund expenditures, principal and interest due for the year for the debt service fund, and by bond/note authorization for capital expenditures.

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

**3. DEPOSITS**

The Municipality maintains its deposits of cash in the Government Development Bank for Puerto Rico ("GDB") (a governmental bank and component unit of the Commonwealth) who serves as fiscal agent of the Municipality; and in various commercial banks located in Puerto Rico. The balances deposited in GDB are uninsured and uncollateralized. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation ("FDIC") up to a maximum of \$100,000 per depositor. However, under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance provided by the FDIC. All securities pledged as collateral are held by an agent of the Secretary of the Treasury of the Commonwealth in the name of the Municipality.

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Cash, cash equivalents and investments at June 30, 2006 consist of the following:

	<u>Included in General Fund</u>	<u>Included in Debt Service Fund</u>	<u>Included in CDBG Fund</u>	<u>Included in Other Governmental Funds</u>	<u>Total</u>
Unrestricted cash and cash equivalents in commercial bank	\$ 51,825	\$ -	\$ -	\$ -	\$ 51,825
Temporarily restricted cash and cash equivalents	44,715	147,056	101,646	599,205	892,622
<b>Total</b>	<u>\$ 96,540</u>	<u>147,056</u>	<u>101,646</u>	<u>599,205</u>	<u>\$ 944,447</u>

The Municipality's bank balance of deposits and investments with financial institutions are categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2006. Risk categories are described as follows:

- Category 1:** Insured or collateralized with securities held by the Secretary of the Treasury's agents in the Municipality's name.
- Category 2:** Collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.
- Category 3:** Uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

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The carrying amount (book balance) and the bank balance of deposits and investments with financial institutions of the Municipality at June 30, 2006 consist of the following:

	<b>Carrying Amount</b>	<b>Bank Balance</b>
Deposits in commercial banks	\$ 246,004	\$ 426,290
Deposits in governmental banks	234,747	234,747
Total	\$ 480,751	\$ 661,037
Bank balances of deposits and investments:		
Category 1		\$ 426,290
Category 2		
Category 3		234,747
Total bank balances		\$ 661,037

**4. MUNICIPAL LICENSE TAXES**

The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$ 1 million or more must include rates are established by the Municipality. At June 30, 2006, the municipal tax rates imposed by the Municipality were 1.50 percent for financing institutions and 0.30 percent for any other taxpayers. Any taxpayers, who have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth, ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return every April 15 based on the actual volume of business generated in the preceding calendar year. The tax can be paid by the taxpayer in two equal installments: (1) the first payment due at the filing date of the return (generally April 15), and (2) January 15 subsequent to the filing of the declaration. The first installment of the tax covers the taxable period (six months) ended December 31 subsequent to the filing date of the declaration, while the second installment of the tax covers the taxable period (six months) 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 (April 15), a 5 percent discount is granted automatically on the tax amount due.

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Any municipal license taxes collected in advance (that is, prior to June 30 but pertaining to the next fiscal year) are recorded as deferred revenues. As of June 30, 2006, the total municipal license tax receivable (net of the allowance for estimated uncollectible amounts) and the respective deferred revenues amounted to \$8,588 and \$74,686, respectively, in the accompanying government-wide financial statements.

**5. PROPERTY TAXES**

The Municipality is authorized by law to impose and collect personal and real property taxes. Personal property taxes can be imposed to any natural or legal person engaged in trade or business that at January 1 of each year is owner of personal property used in trade or business.

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 and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. At June 30, 2006, the total personal property tax rate in force was 6.38 percent (of which taxpayers pay 6.18 percent and .20 percent is reimbursed by the Department of Treasury of the Commonwealth. 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 at 1957 market prices. At June 30, 2006, the total real property tax rate in force was 8.38 percent (of which 8.18 percent is paid by taxpayers).

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury of the Commonwealth assumes payment of the basic tax (4.00 and 6.00 percent for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the general fund when collections are received from the CRIM.

CRIM is required to remit 1.03 percent of the personal and real property tax collected to the Municipality to be used for the partial funding of the debt service requirements on general obligations and notes payable of the Municipality. In addition, 1.35 percent of the total personal and real property taxes collected by CRIM is restricted for debt service requirements of the Municipality and is retained by GDB for such purposes. Accordingly, such amount is recorded as revenues in the debt service fund when collected and reported by the CRIM.

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

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth of which a maximum of \$26 million, on an annual basis, is distributed to the

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Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.

- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35 percent corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriation from the municipalities' Puerto Rico Health Reform is covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

Total property tax receivable, net of allowance for uncollectible accounts of \$399,954 amounted to \$159,317 at June 30, 2006. The composition of the property tax receivable and the related allowance for doubtful accounts as follows:

	General Fund	Debt Service Fund	Total
Property tax receivable	\$ 305,248	\$ 94,706	\$ 399,954
Allowance for doubtful account	(171,205)	(69,432)	(240,637)
Net property tax receivable	<u>\$ 134,043</u>	<u>\$ 25,274</u>	<u>\$ 159,317</u>

**6. INTERFUND BALANCES**

On July 1, 2001 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures*, issued by the Governmental Accounting Standards Board. This statement requires the disclosure of the flow of resources between funds and to assess the collectibles of interfund balances. Interfund balances at June 30, 2006 consisted of the following:

<u>Operating Transfers to:</u>	General Fund	Debt Service Fund	Total
Major funds:			
General fund	\$ -	\$ 516,090	\$ 516,090
Debt service fund	<u>3.662</u>	<u>-</u>	<u>3.662</u>
<b>Total</b>	<u>\$ 3.662</u>	<u>\$ 516,090</u>	<u>\$ 519,752</u>

At June 30, 2006 all amounts due to among funds are considered collectible by the Municipality's management.

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**7. CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2006, was as follows:

	Balance at June 30, 2005,	Additions	Reclassifications	Balance at June 30, 2006
<b>ST BASIS:</b>				
Cost basis of capital assets, not subject to depreciation and amortization:				
Infrastructure land	\$ 5,261,063		\$ -	\$ 5,261,063
Construction in progress	883,231	522,551	(55,400)	1,350,382
Total cost basis of capital assets, not subject to depreciation and amortization	<u>6,144,294</u>	<u>522,551</u>	<u>(55,400)</u>	<u>6,611,445</u>
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	2,656,354			2,656,354
Infrastructure	6,292,853			6,292,852
Land Improvements	3,542,911		55,400	3,598,311
Licensed vehicles	719,663			719,663
Machinery and equipment	828,940	12,535		841,475
Total cost basis of capital assets subject to depreciation and amortization	<u>14,040,721</u>	<u>12,535</u>	<u>55,400</u>	<u>14,108,656</u>
Total cost basis of capital assets	<u>20,185,015</u>	<u>535,086</u>	<u>-</u>	<u>20,720,101</u>
<b>CUMULATED DEPRECIATION AND AMORTIZATION:</b>				
Buildings, structures and building improvements	319,476	55,224		374,700
Infrastructure	2,002,453	299,181		2,301,634
Land Improvements	1,420,576	90,969		1,511,545
Licensed vehicles	288,460	82,066		370,526
Machinery and equipment	616,456	57,800		674,256
Total accumulated depreciation and amortization	<u>4,647,421</u>	<u>585,240</u>	<u>-</u>	<u>5,232,661</u>
<b>PITAL ASSETS, NET</b>	<u>\$ 15,537,594</u>	<u>\$ -50,154</u>	<u>\$ -</u>	<u>\$ 15,487,440</u>

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

General government	\$ 11,829
Public safety	30,572
Public housing and welfare	10,180
Health and sanitation	7,442
Culture, recreation and education	230,355
Urban and economic development	294,862
Total depreciation and amortization expense	<u>\$ 585,240</u>

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**8. EMPLOYEES RETIREMENT SYSTEM**

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the "System"). The System is the administrator of a multi-employer cost-sharing (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The System was created under Act. No. 447 approved on May 15, 1951, as amended, and became effective on January 1, 1952. The System covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

The System is independent, thus assets may not be transferred to another system or used for any purpose other than to benefit each system's participants. The System issues publicly available financial reports that include its basic financial statements and required supplementary information for each of them, including required six-year trend information. Those reports may be obtained by writing to the administrator of the System.

The System provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after 10 years of plan participation.

Retirement benefits are determined by the application of 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 plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75 percent of the average compensation.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension system ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, are the only required becoming members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth nor the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275 percent of the employees' salary which is applicable to the Municipality) will be used to fund the current plan.

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

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**Funding Policy:**

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600
	8.275 % of gross salary over \$6,600
Hired on or after April 1, 1990	8.275% of gross salary

During the fiscal year ended June 30, 2006 the employer's contributions paid by the Municipality to both retirement systems amounted to \$141,923. On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years of services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, the Commonwealth will assume any actuarial deficiency that may exist or arise related to the Municipality's participating employees since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

**9. LONG-TERM DEBT**

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such 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 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 to be repaid with the proceeds of property taxes restricted for debt service.

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In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2006, the Municipality is in compliance with the debt limitation requirements.

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

	<u>Balance at June 30, 2005</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Other net changes</u>	<u>Balance at June 30, 2006</u>	<u>Due Within One Year</u>
Bonds payables	\$ 3,822,000	\$ -	\$ (187,000)	\$ -	\$ 3,635,000	\$ 187,000
Notes payable to the Puerto Rico Treasury Department	32,563	-	(6,513)	1	26,050	6,513
Notes payable to the Government Development Bank	3,360,056	-	(48,622)	-	3,311,434	48,612
Compensated absences	464,196	-	-	(24,227)	488,423	175,181
<b>Total</b>	<u>\$ 7,678,815</u>	<u>\$ -</u>	<u>\$ (242,135)</u>	<u>\$ (24,226)</u>	<u>\$ 7,460,907</u>	<u>\$ 417,306</u>

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Long-term debt at June 30, 2006 is composed of the following debts:

**General Obligation Bonds:**

	<u>Outstanding Amount</u>
1992 serial bonds due in annual principal installments ranging from \$7,000 to \$22,000; plus interest due in annual installments at 5.625% through January, 1, 2017	\$ 188,000
1997 serial bonds due in annual principal installments ranging from \$1,000 to \$3,000; plus interest due in annual installments at 4.50% through January, 1, 2022	38,000
1999 serial bonds due in annual principal installments ranging from \$5,000 to \$35,000; plus interest due in semiannual installments at variable rates (2.70% to 2.80% at June 30, 2004) through July, 1, 2020	280,000
1999 serial bonds due in annual principal installments ranging from \$10,000 to \$65,000; plus interest due in semiannual installments at 5.00% through July 1, 2024	720,000
2001 serial bonds due in annual principal installments ranging from \$5,000 to \$45,000; plus interest due in semiannual installments at 8.00% through July, 1, 2025	420,000
2002 serial bonds due in annual principal installments ranging from \$20,000 to \$30,000; plus interest due in semiannually installments at variable rates (2.70% to 2.80% at June 30, 2004) through July 1, 2009	110,000
2002 serial bonds due in annual principal installments ranging from \$15,000 to \$60,000; plus interest due in semiannual installments at 6.00% through July, 1, 2028	760,000

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2006

2004 serial bonds due in annual principal installments ranging from \$14,000 to \$27,000, plus interest due in semiannual installments at variable rates (5.00% to 6.00%) through July 1, 2019.	289,000
2006 serial bonds due in annual principal installments ranging from \$25,000 to \$70,000, plus interest in semiannual installments at 5.00% through July 1, 2024.	830,000
	\$ 3,635,000

**Notes payable to the Puerto Rico Treasury Department:**

2002 operating loan with GDB due in monthly principal installments of \$22,915; which includes implicit interest due in monthly installments at 6.159% through July 1, 2032	3,311,434
Payment plan with Treasury Department, agreed to be payable in monthly installments of \$543 through June 30, 2010	26,050
Provision for accrued compensated absences	488,423
Total long-term debt	\$ 7,460,907

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

<u>Year Ended</u> <u>June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	193,179	422,420	615,599
2008	202,426	411,666	614,091
2009	216,876	400,189	617,065
2010	232,543	387,798	620,341
2011	206,928	375,142	582,070
2012-2016	1,196,845	1,711,579	2,908,424
2017-2021	1,536,559	1,251,121	2,787,680
2022-2026	1,586,694	754,302	2,340,996
2027-2031	1,126,129	333,193	1,459,322
2032	474,306	37,243	511,549
Totals	6,972,484	6,084,653	13,057,137

As described in Note 5, the Municipality levies an annual additional special tax of 1.35% of the assessed value of personal and real property. The proceeds of this additional special tax are required to be credited to the debt service fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected by CRIM as agent of the Municipality (see note 5).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2006

**10. COMMITMENTS AND CONTINGENCIES**

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 authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in 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 not reported liabilities for awarded and anticipated unfavorable judgments as of June 30, 2006.

The Municipality had several outstanding or planned construction projects as of June 30, 2006. These projects are evidenced by contractual commitment with contractors. The construction projects of the Municipality are commitments of the Capital Projects' funds that amount to \$460,966.

**11. ACCOUNTING CHANGES AND RESTATEMENTS**

During current year, the Municipality implemented several new accounting standards and pronouncements issued by GASB.

GASB Statement No. 34, as amended by GASB 37, establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state and local governments, including statement formats and changes in fund types and elimination of account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the 2003 financial statements were required.

GASB Statement No. 38 requires certain note disclosures. The provisions of these new standards have been incorporated into the basic financial statements and notes.

GASB Interpretation No. 6 clarifies the application of existing standards for distinguishing the respective portions of certain types of liabilities that should be reported as (1) governmental fund liabilities and (2) general long-term liabilities of the Municipality. The provisions of this interpretation have been incorporated into the basic financial statements and notes.

These new accounting standards caused most of the accounting changes and restatements described on the ensuing discussions below. Changes and restatements for reasons other than the adoption of the above pronouncements are also explained below.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF LAS MARIAS  
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND  
YEAR ENDED JUNE 30, 2006**

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis) (See Note 1)</u>	<u>Variance with Final Budget - Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
<b>Revenues:</b>				
Property taxes	\$ 473,450	\$ 473,450	\$ 473,450	\$ -
Municipal license taxes	80,000	80,000	86,403	6,403
Construction excise taxes	1,096,165	1,096,165	84,457	(1,011,708)
Intergovernmental contributions and reimbursements	4,630,773	4,430,913	4,431,224	311
Interest, fines and penalties	1,050	1,050	10,867	9,817
Other	213,550	213,550	694,547	480,997
	<u>\$ 6,494,988</u>	<u>\$ 6,295,128</u>	<u>\$ 5,780,948</u>	<u>\$ (514,180)</u>
<b>Expenditures:</b>				
General government	\$ 3,179,601	\$ 3,137,821	\$ 2,780,579	\$ 357,242
Urban and economic development	1,567,757	1,484,724	1,492,161	(7,437)
Public safety	676,833	639,217	617,156	22,061
Public housing and welfare	428,946	377,447	354,376	23,072
Culture, recreation and education	237,210	245,527	219,703	25,824
Health and sanitation	404,641	410,392	341,357	69,035
	<u>\$ 6,494,988</u>	<u>\$ 6,295,128</u>	<u>\$ 5,805,331</u>	<u>\$ 489,797</u>

**Explanation of Differences:**

**Sources/inflows of financial resources:**

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 5,780,948
Differences - budget basis to GAAP:	
Property tax receivable recorded in prior year for financial reporting	(9,880)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	<u>(3,662)</u>
Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds	<u>\$ 5,767,406</u>

**Uses/outflows of financial resources:**

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 5,805,331
Differences - budget basis to GAAP:	
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(516,090)
Resources considered expenditures for financial reporting purposes but are not expenditures for budgetary purposes	<u>553,589</u>
Total expenditures as reported on the statement of revenues, expenditure and changes in fund balances - governmental funds	<u>\$ 5,842,830</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
NOTE TO BUDGETARY COMPARISON SCHEDULE  
FOR THE YEAR ENDED JUNE 30, 2006

**NOTE 1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

**A. Budgetary Control**

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

The Municipality prepares its annual budget including the operations of the general fund.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**

FEDERAL GRANTOR / PASS THROUGH GRANTOR	<b>FEDERAL CFDA</b>		
<u>PROGRAM TITLE</u>	<u>NUMBER</u>		<u>EXPENDITURES</u>
<b>US DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>			
Direct Programs:			
Section 8 Vouchers and Portability	14.871	MP	\$ 144,780
Indirect Program:			
Passed through PR Office of Municipalities Affairs			
State Block Grant Program (SBGP)	14.228	MP	704,130
Housekeeper	14.228	MP	2,760,119
Total SBGP			<u>706,890</u>
			<u>1,106,596</u>
<b>US DEPARTMENT OF AGRICULTURE</b>			
Direct Programs:			
Rural Development Grant	10.769		<u>984,326</u>
<b>US DEPARTMENT OF HEALTH AND HUMAN SERVICES</b>			
Indirect Program:			
Passed through PR Family Department (ACUDEN)			
Child Care and Development Block Grant	93.575		<u>63,142</u>
Passed through the Elderly Commission Office			
Title III, Part C-Nutrition Services	93.045		14,266
Title III, Part B- Grants for Supportive Services and Seniors Centers	93.44		<u>159,936</u>
			<u>174,202</u>
<b>US DEPARTMENT OF HOMELAND SECURITY</b>			
Direct Programs:			
Public Disaster Assistance	97.036		<u>134,493</u>
<b>US DEPARTMENT OF JUSTICE</b>			
Direct Program:			
Local Law Enforcement Block Grant	16.592		<u>9,943</u>
TOTAL FEDERAL FINANCIAL ASSISTANCE			<u>\$ 2,217,776</u>

MP = Major Program

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006

**NOTE 1. GENERAL**

The accompanying Schedule of Expenditures of Federal Awards presents balance expended of all Federal Financial Assistance Programs of the Municipality of Las Marías, Puerto Rico. The reporting entity is defined in Note 1 to the general-purpose financial statements.

**NOTE 2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Federal financial assistance revenues and expenditures are reported in the Municipality's general-purpose financial statements as other governmental funds and capital project fund.

**NOTE 3. FEDERAL CFDA NUMBER**

The CFDA number included in this schedule were determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalog of Federal Domestic Assistance.

  
**JUAN A. RIVERA, CPA**  
**CERTIFIED PUBLIC ACCOUNTANT**

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

To the Honorable Mayor and  
the Municipal Assembly  
Municipality of Las Marías  
Las Marías, Puerto Rico

We have audited the financial statements of the Municipality of Las Marías as of and for the year ended June 30, 2006, and have issued our report thereon dated December 19, 2006. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the Municipality of Las Marías financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing and opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such as an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards and which are described in the accompanying schedule of findings and questioned costs Section II.

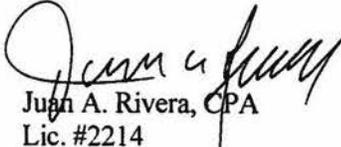
**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Municipality of Las Marías internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance 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 of Las Marías ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions in federal award are described in the accompanying schedule of findings and questioned costs Section II and also we have reported to the management of Municipality of Las Marías those reportable condition that affect the internal control of the Municipality operations in a separate letter.

A material weakness is a 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 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 weakness. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended for the information of the audit committee, the Municipality's management, the Department of Housing and Urban Development (Cognizant Agency), and federal awarding agencies and pass-through entities and not is intended to be and should not be used by anyone other than these specified parties.

  
Juan A. Rivera, CPA  
Lic. #2214

December 19, 2006  
Toa Baja, Puerto Rico



Stamp NO. 2195599 of the Puerto Rico Society of Certified Public Accountants was affixed to the original report.

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

To the Honorable Mayor and  
the Municipal Assembly  
Municipality of Las Marías  
Las Marías, Puerto Rico

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

**Compliance**

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

As described in item Section II in the accompanying schedule of findings and questioned costs, the Municipality of Las Marías did not comply with requirements regarding administrative requirements that are applicable to its SBGP Program. Compliance with such requirement is necessary for the Municipality of Las Marías to comply with the federal regulations. Also we want to emphasize that this requirement has not been complied in prior years.

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

**Internal Control Over Compliance**

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

Our noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality of Las Marías 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 in Section II.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants 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, we believe that none of the reportable conditions described above is a material weakness. This report is intended for the information of the audit committee, the Municipality's management, the Department of Housing and Urban Development (Cognizant Agency), and federal awarding agencies and pass-through entities. However, this report is not intended to be and should not be used by anyone other than these specified parties.

*Juan A. Rivera*  
Juan A. Rivera, CPA  
Lic. #2214

December 19, 2006  
Toa Baja, Puerto Rico



Stamp No 2195600 of the Puerto Rico State Society of Certified Public Accountants was affixed to the original report.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2006**

**I. Summary of Auditors' Result**

Financial Statements

Type of auditor's report issued: unqualified opinion

Internal Control over financial reporting:

Material weakness (es) identified?  Yes  No

Reportable condition (s) identified that are not considered to be material weakness?  Yes  No

Noncompliance material to financial statements noted?  Yes  No

Federal Awards

Internal Control over major programs:

Material weakness (es) identified?  Yes  No

Reportable condition (s) identified that are not Considered to be material weakness?  Yes  No

Type of auditor's report issued on compliance for major programs: qualified

Any audit findings disclosed that are required to be reported in accordance with section 510 (a) of Circular A-133?  Yes  No

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
14.228	State Block Grant Program

Dollar threshold used to distinguish between type A and type B programs: \$500,000

Auditee qualified as low-risk auditee?  Yes  No

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2006**

**II. Federal Awards Findings and Questioned Costs**

My examination of compliance with federal requirements of the Municipality of Las Marias, for the year ended June 30, 2006 disclosed that grants funds were generally administered in a satisfactory manner, except for the following situations:

SBGP  
CFDA No. 14.228

**Condition 06-1**

The SBGP program should to minimize the time elapsing between transfers the federal funds from agency (OCAM) and disbursement to suppliers.

**Criteria**

As required by Code of federal regulation (30 CFR part 205) OCAM, the Pass-through entity, established procedures to comply with requirements for cash management. OCAM establish the federal funds should be used into three to five labor days in order to maintain less than \$5,000 on the bank account and the bank account balance has as of June 30, 2006 \$101,645.

**Cause**

The Municipality does not make the disbursement into the three to five labor days required. The money transfer petition was in excess of its obligations.

**Effect**

The Municipality is not in compliance with federal regulations mentioned above.

**Recommendation**

The Municipality should establish procedures in conjunction with finance department in order to make the disbursement into the time required; for excess of cash in bank, the finance director must analyzed the latest fund petitions in order to determine the origination of transfer petition, if after the analysis the cash balance remain the future cash petition will be adjusted as required.

**Auditee Response**

The Municipality Finance Area accepts the recommendation in order to avoid this in the future.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF LAS MARIAS**  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006

<b>Program</b>	<b>Finding/ Compliance</b>	<b>Status</b>
SBGP CFDA No. 14.228	Condition 99-2, 00-1, 01-1, 02-11, 03-1, 04-1 The program does not minimizing the time elapsed between the receipt and final disbursement of funds.	Condition still prevails