OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE LOIZA
AUDITORIA 2005-2006

30 DE JUNIO DE 2006

07-0181-PF

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA

BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2006

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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MUNICIPALITY OF LOÍZA
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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Members:
American Institute of Certified Public Accountants (AICPA)
Puerto Rico Board of Certified Public Accountants
Management Consulting Services Division

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Municipal Legislature
Municipality of Loíza
Loíza, 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 Loíza, as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Brisas de Loíza Project, as of June 30, 2006. Those financial statements were audited by other auditors whose report thereon has been furnished to, and our opinion, insofar as it relates to the amounts included for Brisas de Loíza Project, is based on the report of the other auditors.

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

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, discretely presented component unit, each major fund and the aggregate remaining fund information of the Municipality of Loíza as of June 30, 2006, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 3, 2006 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements. The schedule of expenditures of federal awards has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Ortiz, Rodriguez, Rivera & C.

San Juan, Puerto Rico
November 3, 2006

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the ***Municipality of Loiza*** 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.

FINANCIAL HIGHLIGHTS

- The Municipality's in the Govermental Activities has reported assets and net assets amounting to **$11,298,335** and **($9,070,466)** respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to **$8,024,362** ***(71 percent of total Municipality's assets)***.

- The Municiaplity in the same activities has reported total liabilities amounting to **$20,368,801** in the accompanying statement of net assets, of which the most significant liabilities are bonds, notes and other long-term debt amounting to **$10,364,023** ***(51 percent of total liabilities)***.

- The Municipality has reported total revenues amounting to **$10,370,841** in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds, for the Fiscal Year Ended **June 30, 2006**. The most significant revenues amounting in this statement are property taxes and municipal licenses taxes and, licenses and permits were to **$921,866** ***(9 percent of total revenues)*** and **$1,022,913** ***(10 percent of total revenues)***, respectively.

- The Municipality has reported a net change in net assets ***deficiency*** of revenues over expenditures amounting to **($2,760,053)** in the accompanying statement of activities.

- The Municipality's governmental funds reported combined ending fund balances of **($6,669,642)** which represent the fund balances of the general fund, capital proyects funds and debt service fund combined (all known as the Municipality's major funds).

- The Municipality has reported a deficit for the general fund amounting to **($9,578,938)**.

- The Municipality has reported a deficiency of revenues and other financing sources over expenditures and other financing uses amounting to **($2,222,890)** in the governmental funds. Such amount correspond to the general fund. As a significant fact, the Municipality's outlays for capital proyects during the year amounted **$567,691** while to the disponible funds provine of the fund balance available at beginning of the fiscal year.

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)**.

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.

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 spendable resources. They also focus on the balances of spendable 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 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 four major funds: **(1)** the general fund **(2)** the debt service fund **(3)** the Housing and Urban Development Programs and and **(4)** the Capital Projects 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.

Government-wide Financial Statements Summary

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, liabilities exceeded assets by **($9,070,466)** at **June 30, 2006**.

As previously discussed, by far the largest portion of the Municipality's net assets reflect its investment in capital assets **(e.g., land, buildings, machinery, equipment and all other property)**, less any related debt used to acquire those assets that is still outstanding. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. The following is a condensed presentation of the Municipality's financial position and results of operations, as reported in the government-wide financial statements including its component unit, Brisas de Loiza Proyect:

Condensed Statement of Net Assets:

	June 30, 2006
Current assets	$ 3,640,255
Capital assets	$ 9,581,079
Total assets	**$13,221,334**
Current liabilities	$10,032,369
Non-current liabilities	$12,427,562
Total liabilities	**$22,459,931**
Net assets/(liabilities):	
Invested in capital assets, net of related debt	$ 3,045,362
Restricted	$ 3,050,420
Unrestricted	$(15,166,248)
Total net assets	**($ 9,238,597)**

An additional portion of the Municipality's net assets **(30 percent)** represents resources that are subject to restrictions on how they may be used. At the end of the current fiscal year, the Municipality has reported positive balances in two categories of net assets.

Condensed Statement of Activities:

	June 30, 2006
Revenues:	
Program revenues:	
Charges for services	$ 752,284
Operating grants and contributions	$ 703,464
Capital grants and contributions	$ -0-
General revenues:	
Property taxes	$ 921,866
Municipal license taxes	$ 631,350
Grants and contributions	$ 7,362,499
Interest, fines and penalties	$ 71,216
Miscellaneous	$ 266,552
Total revenues	**$10,709,231**
Expenses:	
General government	$ 7,735,285
Public safety	$ 974,011
Public works	$ 2,732,429
Recreation	$ 488,672
Health and welfare	$ 840,497
Depreciation expense	$ 304,037
Interest on long-term debt	$ 320,048

Brisas de Loiza Project	$ 390,058
Total expenses	**$13,785,037**
Change in net assets	$ (3,075,806)
Net assets – at beginning of year	**$ (6,162,791)**
Net assets – at end of year	**$ (9,238,597)**

Fund Financial Statements Summary

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 *spendable resources.* Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

Condensed Balance Sheet – Governmental funds:

	June 30, 2006
Total Assets – Major Funds	$ 4,201,967
Total Assets – Nonmajor Funds	$ 134,883
Total assets	**$ 4,336,850**
Total Liabilities – Major Funds	$10,812,770
Total Liabilities – Nonmajor Funds	$ 193,722
Total liabilities	**$11,006,492**
Fund Balances – Major Funds	$ (6,669,642)
Fund Balances – Nonmajor Funds	$ ------0------
Total Fund Balance	**$ (6,669,642)**

Condensed Statement of Operations – Governmental funds:

Total Revenues – Major Funds	$ 9,694,690
Total Revenues – Nonmajor Funds	$ 676,151
Total revenues	**$10,370,841**
Total expenditures – Major Funds	$12,736,541
Total expenditures – Nonmajor Funds	$ 628,715
Total expenditures	**$13,365,256**
Other financing sources (uses) Major	$ 234,362
Other financing sources (uses) Nonmajor	$ -0-
Revenues Over Expenses – Major	$(2,760,053)
Revenues Over Expenses – Nonmajor	$ -0-
Total Fund Balance	**$(2,760,053)**

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 to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer on the 2nd. floor of the **Loiza City Hall, Loiza, Puerto Rico**.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF NET ASSETS
JUNE 30, 2006

Assets	**Governmental Activities**	**Brisas de Loíza Project**
Cash in bank **(Note 2)**	$ 249,378	$ 64,664
Cash with fiscal agent **(Note 2)**	2,207,726	
Accounts receivable		13,854
Due from other agencies **(Note 8)**	816,869	
Restricted deposits		278,183
Inventories		9,581
Capital assets, net **(Note 10)**	8,024,362	1,556,717
Total assets	$ 11,298,335	$ 1,922,999
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued liabilities	$ 6,933,819	$ 15,108
Deposits payable		12,483
Due to other agencies **(Note 11)**	2,567,010	
Accrued interest	33,742	
Deferred revenues **(Note 12)**:		
Municipal license tax	367,390	
Federal government	152,841	
Noncurrent liabilities **(Note 14)**:		
Due within one year	845,954	20,000
Due in more than one year	9,518,069	2,043,539
Total liabilities	20,418,825	2,091,130
Net Assets		
Investment in capital assets, net of related debt	3,045,362	
Restricted for:		
Debt service	1,296,336	
Capital projects	1,754,084	
Unrestricted	(15,216,272)	(168,131)
Total net assets	(9,120,490)	(168,131)
Total liabilities and net assets	$ 11,298,335	$ 1,922,999

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets	
					Primary Government	Component Unit
Functions/Programs	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Brisas de Loiza Project
Primary Government:						
General government	$ 7,735,285	$ 417,354	$ -	$ -	$ (7,317,931)	$ -
Public safety	974,011				(974,011)	
Public works	2,778,276				(2,778,276)	
Recreation	488,672				(488,672)	
Health and welfare	844,674		703,464		(141,210)	
Depreciation expense	304,037				(304,037)	
Interest on long-term debt	320,048				(320,048)	
Total primary government	$ 13,445,003	$ 417,354	$ 703,464	$ -	(12,324,185)	
Component Unit:						
Brisas de Loiza Project	$ 390,058	$ 334,930	$ -	$ -		(55,128)
General revenues:						
Property taxes					921,866	
Municipal license tax					631,350	
Grants and contributions not restricted to specific programs					7,362,499	
Interest, fines and penalties					69,754	1,462
Miscellaneous					264,554	1,998
Total general revenues					9,250,023	3,460
Change in net assets					(3,074,162)	(51,668)
Net assets at beginning of year, as restated **(Note 20)**					(6,046,328)	(116,463)
Net assets at end of year					$ (9,120,490)	$ (168,131)

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2006

Assets	General	Housing and Urban Development Programs	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
Cash and cash equivalents **(Note 2)**	$ -	$ 17,668	$ -	$ 96,827	$ 134,883	$ 249,378
Cash with fiscal agent **(Note 2)**	66,443		1,296,336	844,947		2,207,726
Due from other agencies **(Note 8)**	816,869					816,869
Due from other funds **(Note 9)**	76,549	7,925		978,403		1,062,877
Total assets	$ 959,861	$ 25,593	$ 1,296,336	$ 1,920,177	$ 134,883	$ 4,336,850

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2006

Liabilities and Fund Balance (Deficit)	General	Housing and Urban Development Programs	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
Liabilities						
Accounts payable and accrued liabilities	$ 6,625,996	$ 107,446	$ -	$ 118,168	$ 54,788	$ 6,906,398
Due to other agencies **(Note 11)**	2,567,010					2,567,010
Due to other funds **(Note 9)**	978,403	22,289		47,925	14,260	1,062,877
Deferred revenues **(Note 12)**:						
Municipal license tax	367,390					367,390
Federal government		23,990			128,851	152,841
Total liabilities	10,538,799	153,725	-	166,093	197,899	11,056,516
Fund Balances (Deficit)						
Reserved for:						
Encumbrances	500,602					500,602
Debt service			1,296,336			1,296,336
Capital projects				1,754,084		1,754,084
Fund balance (deficit)	(10,079,540)	(128,132)			(63,016)	(10,270,688)
Total fund balance (deficit)	(9,578,938)	(128,132)	1,296,336	1,754,084	(63,016)	(6,719,666)
Total liabilities and fund balance (deficit)	$ 959,861	$ 25,593	$ 1,296,336	$ 1,920,177	$ 134,883	$ 4,336,850

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2006

Total fund balances - governmental funds	$(6,719,666)
Amounts reported for governmental activities in the statement of net assets are different because:	
• Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet	8,024,362
• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. **(Note 4)**	(10,425,186)
Net assets of governmental activities	$(9,120,490)

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) -GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	General	Housing and Urban Development Programs	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
REVENUES						
Property taxes (Note 6)	$ 599,112	$ -	$ 322,754	$ -	$ -	$ 921,866
Municipal license taxes (Note 7)	631,350					631,350
Licenses and permits	391,563					391,563
Charges for service and rents	25,791					25,791
Intergovernmental revenues (Note 13):						
Federal grants and contributions		703,464			676,151	1,379,615
State contributions	6,686,348					6,686,348
Interest, fines, and penalties	26,394		43,360			69,754
Other revenues	264,554					264,554
Total revenues	8,625,112	703,464	366,114	-	676,151	10,370,841
EXPENDITURES						
Current:						
General government	5,162,400				334,384	5,496,784
Public safety	974,011					974,011
Public works	3,501,641	739,185				4,240,826
Recreation	488,672					488,672
Health and welfare	453,755	92,411			298,508	844,674
Capital outlays				567,691		567,691
Debt service:						
Principal retirement			516,316			516,316
Interest and other			286,306			286,306
Total expenditures	10,580,479	831,596	802,622	567,691	632,892	13,415,280
Excess (deficiency) of revenues over (under) expenditures	(1,955,367)	(128,132)	(436,508)	(567,691)	43,259	(3,044,439)
OTHER FINANCING SOURCES (USES)						
Bond issuance	34,362			200,000		234,362
Transfers in	107,057		408,942			515,999
Transfers out	(408,942)		(107,057)			(515,999)
Total other financing sources (uses)	(267,523)	-	301,885	200,000	-	234,362
Excess (deficiency) of revenues and other sources over expenditures and other uses	(2,222,890)	(128,132)	(134,623)	(367,691)	43,259	(2,810,077)
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR	(7,356,048)		1,430,959	2,121,775	(106,275)	(3,909,589)
FUND BALANCE (DEFICIT) AT END OF YEAR	$ (9,578,938)	$ (128,132)	$ 1,296,336	$ 1,754,084	$ (63,016)	$ (6,719,666)

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Net change in fund balances - total governmental funds	$(2,810,077)
Amounts reported for governmental activities in the statement of activities are different because:	
• Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.	2,030,241
• Depreciation expense on capital assets is reported in the statement of activities, but do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds.	(304,037)
• Governmental funds report issuance of long-term debt as other financial sources because provides current financial resources.	(234,362)
• Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities.	516,316
• Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds.	(2,272,243)
Changes in net assets of governmental activities	$(3,074,162)

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL-GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	General Fund				Debt Service Fund			
	Budgeted Amounts			Variance with Final Budget-Positive	Budgeted Amounts			Variance with Final Budget-Positive
	Original	Final	Actual	(Negative)	Original	Final	Actual	(Negative)
REVENUES								
Property taxes	$ 425,854	$ 425,854	$ 425,854	$ -	$280,568	$280,568	$ 322,754	$ 42,186
Municipal license taxes	725,771	725,771	631,350	(94,421)				
Licenses and permits	1,876,215	1,876,215	391,563	(1,484,652)				
Charges for services and rent	18,000	18,000	25,791	7,791				
Intergovernmental revenues:								
State contributions	7,059,444	7,059,444	6,640,094	(419,350)				
Interest, fines and penalties	45,000	45,000	26,394	(18,606)				-
Other revenues	215,000	215,000	217,590	2,590				
Total revenues	10,365,284	10,365,284	8,358,636	(2,006,648)	280,568	280,568	322,754	42,186
EXPENDITURES								
Current:								
General government	5,454,643	5,454,643	6,516,484	(1,061,841)				
Public safety	1,266,264	1,266,264	1,194,952	71,312				
Public works	2,623,181	2,623,181	3,479,159	(855,978)				
Recreation	524,618	524,618	564,355	(39,737)				
Health and welfare	496,578	496,578	453,755	42,823				
Debt service:								
Principal					104,722	104,722	516,316	411,594
Interest					175,846	175,846	286,306	110,460
Total expenditures	10,365,284	10,365,284	12,208,705	(1,843,421)	280,568	280,568	802,622	522,054
Excess of expenditures over revenues	$ -	$ -	$ (3,850,069)	$ (3,850,069)	$ -	$ -	$ (479,868)	$ (479,868)

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

1. ORGANIZATION

The Municipality of Loíza, Puerto Rico (Municipality) was founded in 1719. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession existence and legal identity, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including: public safety, public works, culture, recreation, health and welfare, education and other miscellaneous services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial information of the Municipality is presented in this report as follows:

- Management's Discussion and Analysis - Introduces the basic financial statements and provides and analytical overview of the Municipality's financial activities.

- Government - Wide Financial Statements - The reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).

- Statement of Net Assets - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure.

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The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.

- Statement of Program Activities - The government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.

- Budgetary comparison schedules - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

a. Reporting Entity

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

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The Brisas de Loíza Project is included in the basic financial statements as a discretely component unit because of the nature of the services they provide and the Municipality's ability to impose its will

Brisas de Loíza Project is a 70-unit multi-family housing project owned by the Municipality as authorized transfer from the Special Trustee for the Liquidation of the Accounts of the Puerto Rico Urban Renewal and Housing Corporation. The Project is operated under Section 221(d)(3) of USDA, Rural Development (USDA-RD) and regulated by the U. S. Department of Housing and Urban Development (HUD) with respect to rental charges and operating methods. The project is also subject to Section 8 Housing Assistance Payments agreements with HUD, and a significant portion of the Project's rental income is received from HUD. Also, the Project is financed by a Mortgage of Section 221 (d)(3) Direct Loan.

Separate financial statements of the individual component unit can be obtained from the respective administrative office.

Administrative office:
García de la Noceda Street
Loíza, Puerto Rico 00772

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) 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.

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

c. Measurement Focus, Basis of Accounting and Financial Statement Presentation

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

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting.* Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

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The Municipality reports the following major governmental funds:

- General Fund

  This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

- Housing and Urban Development Programs (HUD Programs)

  This fund account for revenue sources for the development of viable urban communities, decent housing, suitable living environment, rental assistance to help very low-income families afford decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low-income family.

- Debt Service Fund

  This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

- Capital Projects Fund

  This fund is used to account for the financial resources used for the acquisition and construction of major capital facilities, financed with the proceeds of general obligation bonds.

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, licenses, permits, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions,

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including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

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

d. Cash and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

Cash with fiscal agent in the capital projects fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

e. Interfund Receivables and Payables

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

f. Capital Assets

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly

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extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	Useful Life
Infrastructure	25-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-10 years
Vehicles and equipment	5-20 years

g. Reservation of Fund Balance

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

- Encumbrances

  Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

- Debt Service

  Represents net assets available to finance future debt service payments.

- Capital Projects Fund

  Represents the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. The committed amounts generally will become liabilities in future periods as the projects are completed.

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury

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Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2006 amounted to approximately $122,000. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately $235,000 for workers' compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

j. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

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k. Future Adoption of Accounting Pronouncements

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

Statement Number	Statement Name	Adoption Required in Fiscal Year
45	Accounting and Financial Reporting for Employers for Post-employment Benefits Other than Pensions	2007-08
48	Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues	2006-07

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

3. 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 and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The

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amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

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.

b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. 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 entity and timing differences in the excess of revenues over expenditures for the year ended June 30, 2006 is presented below for the general fund:

	General	Debt Service
Excess of expenditures over revenues - budgetary basis	($3,850,069)	($479,868)
Entity differences:		
Non-budgeted revenues	58,060	43,360
Non-budgeted transfers	301,885	301,885

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	General	Debt Service
Timing differences:		
Prior year encumbrances recorded as current year expenditures for GAAP basis	($ 426,032)	$ -
Current year encumbrances recorded as expenditures for budgetary purposes	500,602	-
Basis of accounting differences:		
Net change in receivables	219,512	-
Net change in payables	1,576,964	-
Excess of expenditures over revenues - GAAP basis	($2,222,890)	($134,623)

c. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures; and principal and interest due for the debt service fund.

4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the

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current period and therefore are not reported in the funds. The details of the approximately $8.3 million difference are as follows:

Bonds payable	$4,979,000
Compensated absences	1,550,215
Note payable to CRIM	856,876
Due to Puerto Rico Health Insurance Administration	182,962
Due to Puerto Rico Treasury Department	158,345
Due to Puerto Rico Labor Department	28,891
Due to Federal Emergency Management Agency	252,386
CRIM - Repayment Plan	131,029
Due to Puerto Rico Aqueduct and Sewer Authority	14,000
Due to Municipal Revenues Collection Center	62,204
Accrued interest	33,742
Accounts payable	27,421
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	$8,277,071

5. DEPOSITS - CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral is held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The deposits at GDB of approximately $845,000 that are restricted principally for capital projects, and the $1.3 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its investments in one (1) bank located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $100,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

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6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.08% for real property and 6.83% for personal property. The composition is as follows:

	Real	Personal
Basic property	6.00%	4.00%
Additional special property - state	1.03%	1.78%
Additional special property - municipal	1.25%	1.25%
Discounts made by state to tax payer	<.20%>	<.20%>
	8.08%	6.83%

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first $15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the

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Municipality, except for property assessed at less than $3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of $50,000 is granted to merchants with an annual volume of net sales less than $150,000.

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuring fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year ends. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2005-06, but not the final settlement as the six months period after fiscal year ends, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the final settlement already received, during the year ended June 30, 2006, the amount collected by CRIM exceeded the amount received from CRIM for the same period by approximately $173,000. Such amount is presented as due from CRIM in the basic financial statements. (Refer to Note 8)

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2006. The annual Municipal License Tax is determined based on the gross

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income of all commerce and industrial organizations who have operations in the Municipality of Loíza, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality of Loíza, are as follows:

Savings and loans associations	=1.00%
Financial institutions	=1.50%
Other organization	= .50%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately $367,000, corresponding to the next fiscal year municipal license.

8. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local agencies:

Puerto Rico Electric Power of Authority	$643,611
Municipal Revenues Collection Center	173,258
Total	$816,869

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9. INTERFUND TRANSACTIONS

a. Due from/to Other Funds

The due from and due to other funds balance as of June 30, 2006 are as follows:

Receivable Fund	Payable Fund	Amount
Capital Projects	General	$ 978,403
General	Capital Project	40,000
General	HUD Programs	22,289
General	Other Governmental Funds	14,260
HUD Programs	Capital Project	7,925
Total		$1,062,877

Interfund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures.

b. Interfund Transfers

Interfund transfers for the year ended June 30, 2006 consisted of the following:

Transfer In	Transfer Out	Amount
Debt Service	General	$408,942
General	Debt Service	107,057
Total		$515,999

The transfer from the General fund to the Debt Service fund represents receipts restricted as debt service payments become due. Transfer from the Debt Service fund to the General fund represents interest income generated by the bank account with GDB, which is remitted to the General fund for working capital purposes.

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10. CAPITAL ASSETS

a. Primary Government

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

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Governmental Activities:				
Capital assets, not being depreciated:				
Land	$ 1,628,017	$ -	$ -	$ 1,628,017
Total capital assets, not being depreciated	1,628,017	-	-	1,628,017
Capital assets, being depreciated:				
Buildings and building improvements	5,153,180	1,671,185		6,824,365
Furniture and fixtures	335,477	11,517		346,994
Vehicles and equipment	1,671,407	165,990		1,837,397
Infrastructure	1,538,717	181,549		1,720,266
Total capital assets, being depreciated	8,698,781	2,030,241	-	10,729,022
Less accumulated depreciation for:				
Buildings and building improvements	2,131,137	147,058		2,278,195
Furnitures and fixtures	284,220	23,490		307,710
Vehicles and equipment	1,400,764	99,084		1,499,848
Infrastructure	212,519	34,405		246,924
Total accumulated depreciation	4,028,640	304,037	-	4,332,677
Total capital assets, being depreciated, net	4,670,141	1,726,204	-	6,396,345
Governmental activities capital assets, net	$ 6,298,158	$ 1,726,204	$ -	$ 8,024,362

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b. Discretely Presented Component Unit

Activity for Brisas de Loíza Project for the fiscal year ended June 30, 2006 was as follows:

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Capital assets, not being depreciated:				
Land	$ 109,735	$ -	$ -	$ 109,735
Total capital assets, not being depreciated	109,735	-	-	109,735
Capital assets, being depreciated:				
Land improvements	198,276			198,276
Buildings and building improvements	2,639,075			2,639,075
Building equipment	179,887	10,450		190,337
Furniture and fixtures	46,639	22,462		69,101
Equipment	43,393	8,267		51,660
Total capital assets, being depreciated	3,107,270	41,179	-	3,148,449
Less accumulated depreciation for:				
Land improvements	139,918	4,957		144,875
Buildings and building improvements	1,274,639	92,340		1,366,979
Building equipment	117,089	7,700		124,789
Furnitures and fixtures	24,252	4,664		28,916
Equipment	34,208	1,700		35,908
Total accumulated depreciation	1,590,106	111,361	-	1,701,467
Total capital assets, being depreciated, net	1,517,164	(70,182)	-	1,446,982
Brisas de Loíza Project capital assets, net	$ 1,626,899	$ (70,182)	$ -	$ 1,556,717

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11. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2006 are as follows:

Puerto Rico Electric Power Authority	$ 851,205
Puerto Rico Treasury Department	255,935
Retirement System Administration	1,114,804
Internal Revenue Services	252,719
Municipal Affairs Commissioner's Office	32,500
General Services Administration	30,264
Puerto Rico Water and Sewer Authority	29,583
Total	$2,567,010

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of approximately $367,000 municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.

b. Federal Government

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant. These were related to the following federal programs/grants:

Program/Grant Description	
Urban Development Action Grant (HUD)	$ 23,990
Other governmental funds	128,851
Total	$152,841

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13. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, payments in lieu of taxes from the Puerto Rico Electric Power Authority and federal financial assistance received from the federal government.

14. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2006 are as follows:

a. Bonds

$451,000 series of 1993, payable in annual installments of $10,000 to $32,000 until January 1, 2016, interest at 5%.	$ 260,000
$100,000 series of 1996, payable in annual installments of $3,000 to $8,000 until January 1, 2015, interest at 4.5%.	58,000
$385,000 series of 1999, payable in annual installments of $40,000 to $70,000 until July 1, 2007, interest ranging from 7.81% to 8%.	135,000
$1,685,000 series of 1999, payable in annual installments of $30,000 to $150,000 until July 1, 2023, interest ranging from 5.88% to 8%.	1,520,000
$655,000 series of 2002, payable in annual installments of $5,000 to $20,000 until July 1, 2026, interest ranging from 5% to 8%.	620,000
$870,000 series of 1987, payable in annual installments of $15,000 to $90,000 until July 1, 2006, interest at 8.5%.	90,000
$400,000 series of 1997, payable in annual installments of $10,000 to $40,000 until July 1, 2016, interest at 6.75%.	285,000

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$130,000 series of 2004, payable in annual installments of $5,000 to $10,000 until July 1, 2028, interest ranging from 5.0% to 6.5%.	$ 120,000
$340,000 series of 2004, payable in annual installments of $40,000 to $60,000 until July 1, 2010, interest ranging from 5.0% to 6.5%.	260,000
$95,000 series of 2004, payable in annual installments of $2,000 to $7,000 until July 1, 2028, interest ranging from 5.0% to 6%.	91,000
$455,000 series of 2004, payable in annual installments of $5,000 to $35,000 until July 1, 2028, interest ranging from 5.0% to 6.5%.	445,000
$925,000 series of 2005, payable in annual installments of $30,000 to $70,000 until July 1, 2024, interest ranging from 4.37% to 5%.	895,000
$200,000 series of 2006, payable in annual installments of $25,000 to $65,000 until July 1, 2013, interest ranging from 4.23% to 4.73%.	200,000
Total bonds payable	$4,979,000

b. Note Payable

Note payable of $856,876 represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in semmi-annual aggregate principal installments of $33,347 including an interest rate of 6.187%.

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The annual debt service requirements for the bonds payable and note payable at June 30, 2006, are as follows:

	Bonds		Note Payable	
	Principal	Interest	Principal	Interest
2007	$ 368,000	$ 267,240	$ 13,890	$ 52,808
2008	300,000	253,063	14,763	51,935
2009	231,000	237,729	15,691	51,007
2010	252,000	225,798	16,676	50,022
2011	268,000	206,422	17,760	48,974
2012-2016	1,154,000	875,910	106,788	226,698
2017-2021	1,119,000	557,401	144,827	188,660
2022-2026	1,092,000	206,979	196,414	137,071
2027-2031	195,000	15,894	266,378	67,109
2032-2036	-	-	63,689	2,973
	$4,979,000	$2,846,436	$856,876	$877,257

c. Other Long-Term Liabilities

- Due to Puerto Rico Health Insurance Administration

  Due to Puerto Rico Health Insurance Administration represents the municipal contributions related to the Health Care Reform corresponding to the period from December 1, 1995 through June 30, 1997. This balance will be paid through amounts withheld by the CRIM from the participation in the Municipal Equalization Fund of the Additional Lottery System.

- Due to Puerto Rico Treasury Department

  Due to Puerto Rico Treasury Department represents property tax advances, payable in monthly installments of $2,639 until 2009.

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As described in Note 6, the Municipality levies an annual special tax of 1.25% of the assessed value of real property. The proceeds of this 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 and retained by the CRIM.

Primary Government	Beginning Balance	Additions	Payments	Ending Balance	Due within One Year
Governmental Activities:					
Bonds payable	$ 5,091,000	$ 200,000	$ 312,000	$ 4,979,000	$ 368,000
Note payable	869,945		13,069	856,876	13,890
Total governmental activities	5,960,945	200,000	325,069	5,835,876	381,890
Other long-term liabilities:					
Due to Puerto Rico Health Insurance Administration	182,962			182,962	
Due to Puerto Rico Treasury Department	190,014		31,669	158,345	31,668
Due to Puerto Rico Labor Department	47,555		18,664	28,891	18,660
Due to CRIM	62,204			62,204	
Due to Puerto Rico Aqueduct and Sewer Authority	-	34,362	20,362	14,000	14,000
CRIM Repayment Plan	150,637		19,608	131,029	20,792
Federal Emergency Management Administration	353,330		100,944	252,386	100,944
Compensated absences	1,459,829	171,588	81,202	1,550,215	93,000
Legal settlement	-	2,148,115	-	2,148,115	185,000
Total other long-term liabilities	2,446,531	2,354,065	272,449	4,528,147	464,064
Total noncurrent liabilities, governmental activities	$ 8,407,476	$ 2,554,065	$ 597,518	$ 10,364,023	$ 845,954
Component Unit:					
Brisas de Loíza Project mortgage payable	$ 2,082,795	$ -	$ 19,256	$ 2,063,539	$ 20,000

The beginning balance of long-term debt has been restated to included a payable to CRIM Repayment Plan amounting to $150,637.

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15. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. ERS was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

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

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity will be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than $200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five

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(55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

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

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

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to $6,600 plus 8.275% of gross salary in excess of $6,600. The Municipality's contributions are 9.275% of gross salary. Contributions'

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requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2006 was approximately $243,000. The Municipality's payroll for employees covered by ERS was approximately $2.6 million. The Municipality total payroll for all employees was approximately $6.2 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2006, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

16. RISK MANAGEMENT

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

17. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

a. The Municipality leases spaces in the Transportation Center under operating lease agreements with terms ranging from one to five years.

b. Total income from leases during the year ended June 30, 2006 was approximately $25,800.

c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

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Leasing arrangements with the Municipality as lessee:

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

18. CONTINGENCIES

a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.

b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

19. COMMITMENTS

The Municipality of Loíza had several outstanding or planned construction projects as of June 30, 2006. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately $942,000.

20. RESTATEMENT

The beginning balance of net assets has been restated to include a payable to CRIM Department Plan amounting to $150,637. (Refer to Note 14).

21. SUBSEQUENT EVENTS

a. In October 2006, the Carolina Superior Court of Puerto Rico, Court of First Instance, entered judgement against the Municipality. Through this judgement, the Court ordered the Municipality to pay $2,148,115 to settle the collection of money case through a payment plan. The payment plan consists of an initial payment of $150,000 and the remaining balance payable in monthly installments of $5,000.

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b. Effective on November 15, 2006, the Municipality imposed a sales tax of 1.5% to be applicable over all direct sales to consumers, including certain services as approved by the Municipal Legislature.

   Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained in Subtitle BB of the Code. The Municipal Sales Tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Sales Tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within Municipal limits.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Federal Grantor/Program Title	Federal CFDA Number	Federal Disbursements/ Expenditures
U.S. Department of Housing and Urban Development (HUD)		
Direct program:		
Section 8 Housing Choice Vouchers	14.871	$ 33,530
Pass-through State -Commissioner Office of Municipal Affairs - Community Development State Block Grant Program - SBGP	14.228	617,375
Pass-through Municipality of San Juan Housing Opportunities for Persons with AIDS (HOPWA)	14.241	58,881
Subtotal U.S. Department of HUD		709,786
U.S. Department of Health and Human Services (HHS)		
Pass-through Puerto Rico Family Department Child Care and Development Block Grant	93.575	214,032
Subtotal U.S. Department of HHS		214,032
U.S. Department of Agriculture		
Pass-through Puerto Rico Education Department - Child and Adult Care Food Program	10.558	14,430
Subtotal U.S. Department of Agriculture		14,430
TOTAL		$ 938,248

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards is a summary of the activity of the Loíza's federal award programs presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

2. RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

Expenditures per basic financial statements:

Housing and Urban Development programs	$709,786
Federal expenditures included within the other nonmajor governmental funds	228,462
Expenditures per Schedule of Expenditures of Federal Awards	$938,248

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Management Consulting Services Division

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

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Loíza as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated November 3, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Municipality of Loíza's 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 Loíza's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items a and b.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk

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that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items a and b to be material weaknesses.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Municipality of Loíza in a separate letter dated November 3, 2006.

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

Ortiz, Rodriguez, Rivera & Co.

San Juan, Puerto Rico
November 3, 2006

The stamp 2190936 was affixed to the original of this report.

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INDEPENDENT AUDITOR'S 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 Municipal Legislature
Municipality of Loíza
Loíza, Puerto Rico

Compliance

We have audited the compliance of Municipality of Loíza 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. Municipality of Loíza's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Loíza's management. Our responsibility is to express and opinion on Municipality of Loíza's compliance based on our audit.

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

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In our opinion, Municipality of Loíza complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 06-1 and 06-2.

Internal Control over Compliance

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

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components do not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

Ortiz, Rodriguez, Rivera & Co.

San Juan, Puerto Rico
November 3, 2006

The stamp 2190937 was affixed
to the original of this report.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

1. SUMMARY OF AUDIT RESULTS

a. The auditors' report expresses an unqualified opinion on the financial statements of the Municipality of Loíza.

b. There were reportable conditions on internal controls some of which are considered to be material weaknesses.

c. Instances of noncompliance material to the financial statements of Municipality of Loíza were disclosed during the audit.

d. There were no reportable conditions on internal controls over major programs.

e. The auditor's report on compliance for the major federal award programs for Municipality of Loíza express an unqualified opinion.

f. Audit findings' relation to the major federal award programs for Municipality of Loíza are reported in number 3 of this schedule.

g. The programs tested as major programs included:

Community Development Block Grants/States Program SBGP - CFDA No. 14.228

h. The threshold for distinguishing types A and B programs was $300,000.

i. Municipality of Loíza was determined to be a high-risk auditee.

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2. FINDINGS - FINANCIAL STATEMENTS AUDIT

a. General Ledger

The Municipality does not have the accounting practices, policies or internal controls in place to provide for the preparation of financial statements, on a timely basis, in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). The accounting system does not provide for a self balancing set of accounts for each fund operated by the Municipality, recording cash and other financial resources, together with all related assets, liabilities, revenues, expenditures and changes in fund balances. Therefore, the financial statements must be prepared using financial information obtained from various departments and accounting records. The records are not integrated, and do not follow a double entry system (debits and credits). As a result, the records required significant adjustments in order to present the financial position and results of operations of the Municipality in conformity with accounting principles generally accepted in the United States of America.

The continued failure to have an adequate accounting system prevents the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions when plans and objectives are not being met.

Recommendation

The Municipality should adopt and implement a plan to convert its accounting system to an integrated system that would allow for the monthly closing of the general ledger, as well as the preparation of year-end financial statements in accordance with accounting principles generally accepted in the United States of America.

This plan should provide for:

- Assessment of the financial accounting and reporting needs in order to take the necessary steps to meet the financial reporting requirements of GASB Statement No. 34.

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- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for the federal funds.

- The preparation of periodic financial reports to be submitted to the Finance Director and all other interested entities.

- Adequate training of all accounting personnel to improve the understanding of the system and to promote operational efficiency.

- Reconciliation of financial records with the reports prepared and submitted to the federal government.

b. Budget

The Municipality's system of internal control relating to the Budgeting function does not adequately prevent operating management from incurring expenditures in excess of the level of funds appropriated and available. The Municipality closed its fiscal year ended June 30, 2006 with an unreserved fund balance deficiency in the general fund approximately $8.6 million.

This occurs because the budgeting system does not reflect actual available revenues and therefore cannot prevent the obligation of expenditures for which current resource will not be available.

Article 8.004 (b) o the Municipalities Law establishes that the Municipality cannot obligate or spend funds in excess of the appropriations or the ensuing fiscal year. In addition, according to Chapter IV, Section 17, of the Basic Standards, the responsibility of oversight to prevent deficits in any municipal fund rest with the Finance Director.

The continued occurrence of this situation could result in the eventual reduction or elimination of municipal services since future revenues will need to be used to pay for accumulated liabilities.

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Recommendation

The Municipality should revise and amend the budget as current information related to collections of budgeted revenues became available.

3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM AUDIT

a. SBGP - CFDA No. 14.228

- **Condition 06-1**

The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.

Criteria

The 24CFR 85.20(b)(7) establishes that the federal funds recipient will adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.

Cause

The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.

Effect

The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.

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Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

ACTION TAKEN - FINAL ACCION PLAN

Questioned Costs

$ -0-

- **Condition 06-2**

The Municipality has deficiencies in the execution of property management procedures. During our test of real property and equipment management, we found that the Municipality does not perform a reconciliation of the physical inventory with the accounting records. In addition, equipment acquired during the year is not properly labeled and identified.

Criteria

As per CFR 24, Part 85.32 (4)(d) property records will be accurately maintained. The records should include, for each item of equipment, a description of the equipment including serial number, an identification number, identification of the grant under which the recipient acquired th equipment, the information needed to calculate the federal shared of the equipment, the acquisition date and unit acquisition cost, the location, use and condition of the equipment. In addition, states that every two years, at a minimum, a physical inventory should be conducted and the results should be reconciled with the property records to verify the existence, current utilization, and continued need for th equipment. Any discrepancies between quantities determined by the physical inspection and those shown in the accounting records should be investigated to determine the causes of the differences.

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Cause

The Municipality does not maintain accurate records for acquisitions and dispositions for property acquired with federal awards.

Effect

The Municipality is exposed to the risk of possible unauthorized use and disposition of equipment due to the lack of internal controls and adequate property and equipment records. The possible misappropriation of the equipment acquired with federal funds could result in disallowed costs.

Recommendation

The Municipalities' management should determine that proper procedures are in place to ensure that property purchased with federal funds is identified and conduct periodic inventories and follow up an inventory discrepancies. In addition, the Municipality's management should review all dispositions of property to ensure appropriate valuation and reimbursement to federal awarding agencies.

Action Taken - See Final Pages Action Plan

Questioned Costs

$ -0-

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Program	Finding/Noncompliance	Status	
SBGP CFDA No. 14.228	**Condition 05-1**		
	This program maintains a high balance in cash.	Condition still continues.	K NO
SBGP CFDA No. 14.228	**Condition 05-2** OK		
	The program did not file on time the quarterly reports.	Condition was corrected.	5/Si
SBGP CFDA No. 14.228	**Condition 05-3**		
	The Municipality has deficiencies in the execution of property management procedures. During our test of real property and equipment management, we found that the Municipality does not perform a reconciliation of the physical inventory with the accounting records. In addition, equipment acquired during the year is not properly labeled and identified.	Condition still continues.	6/NO
SBGP CFDA No. 14.228	**Condition 04-1**		
	The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.	Condition still continues.	7/NO
SBGP CFDA No. 14.228	**Condition 04-2** OK		
	The Municipality did not comply with the requirement of preparing and filing its federal financial reports on a timely basis.	Condition was corrected.	8/Si

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Program	Finding/Noncompliance	Status
SBGP **CFDA No. 14.228**	**Condition 04-3**	
	The Municipality has deficiencies in the execution of property management procedures. During our test of real property and equipment management, we found that the Municipality does not perform a reconciliation of the physical inventory with the accounting records. In addition, equipment acquired during the year is not properly labeled and identified.	Condition still continues. 9 No

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EXHIBIT I

CORRECTIVE ACTION PLAN

ORTIZ, RODRIGUEZ, RIVERA & CO.

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Director de Finanzas

CORRECTIVE ACTION PLAN

December 1, 2006

Cognizant or Oversight Agency for Audit:

Municipality of Loíza respectfully submits the following corrective action plan for the year ended June 30, 2006

Name and address of independent public accounting firm: Ortiz, Rodríguez, Rivera & Co., Suite 152, PO Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2006

The findings from the June 30, 2006 Schedule of Findings and Questioned Costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS - FEDERAL AWARD PROGRAM AUDITS, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Finding 06-1: SBGP- CFDA 14.228

Reportable Condition: See Condition 06-1

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Action Taken

The Municipality already established procedures to coordinate efficiently the request of funds in order to disburse immediately after receipt or within three business days.

Finding 06-2: SBGP - CFDA 14.228

Reportable Condition: See Condition 06-2

Recommendation

The Municipalities' management should determine that proper procedures are in place to ensure that property purchased with federal funds is identified and conduct periodic inventories and follow up an inventory discrepancies. In addition, the Municipality's management should review all dispositions of property to ensure appropriate valuation and reimbursement to federal awarding agencies.

Action Taken

Instructions have been given to the Property Division Director that all additions and dispositions be recorded properly in the subsidiary of property. In addition, a physical inventory observation will be performed .

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Mr. Onix Ortiz, Finance Director, at (787) 876-3570.

Cordially,

Onix Ortiz Rivera

Onix Ortiz
Finance Director