

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE LUQUILLO

AUDITORIA 2006-2007

30 DE JUNIO DE 2007

CompuPrint
2007-06-30 10:00:19
C:\Users\j...
2007-06-30 10:00:19

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2007

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

YEAR ENDED JUNE 30, 2007

CONTENTS

| | Page |
|---|-------|
| <u>BASIC FINANCIAL STATEMENTS</u> | |
| Independent Auditors' Report | 1-2 |
| Required Supplementary Information (Part 1) Management's Discussion and Analysis | 3-12 |
| Government-Wide Financial Statements: | |
| Statement of Net Assets | 13 |
| Statement of Activities | 14 |
| Fund Financial Statements: | |
| Governmental Funds: | |
| Balance Sheet | 15 |
| Statement of Revenues, Expenditures and Changes in Fund Balance | 16 |
| Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities | 17 |
| Notes to basic financial statements | 18-41 |
| <u>SUPPLEMENTARY INFORMATION</u> | |
| Required Supplementary Information (Part II): | |
| Budgetary Comparison Schedule-General Fund | 42 |
| Notes to Budgetary Comparison Schedule-General Fund | 43 |
| Schedule of expenditures of federal awards | 44-45 |
| Notes to the schedule of expenditures of federal awards | 46 |
| <u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u> | |
| Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i> | 47-48 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2007

CONTENTS

Page

INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS
(CONTINUED)

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

49-51

FINDINGS AND QUESTIONED COSTS

Schedule of findings and questioned cost

52-60

Summary schedule of prior year audit findings

61-65



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

**To the Honorable Mayor and
the Municipal Legislature
Municipality of Luquillo
Luquillo, 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 Luquillo, Puerto Rico** (the **Municipality**) as of and for the year ended June 30, 2007, which collectively comprise the **Municipality's** basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

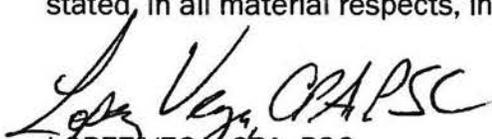
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo, Puerto Rico**, as of June 30, 2007, and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

INDEPENDENT AUDITORS' REPORT (CONTINUED)

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2007, on our consideration of the **Municipality's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule-General Fund on page 42 and 43 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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


LÓPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
November 16, 2007

Stamp No. 2312120 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2007

This discussion and analysis of the **Municipality of Luquillo** (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2007. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2006, second year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements - and Management's Discussion and Analysis- for State and Local Governments.*" This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the fiscal year 2006-2007, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2007 constitute factual evidence of the Municipality's economic strength by the end of such year. The following comments deserve special mention:

1. At the end of fiscal year 2007, total liabilities amounted to \$11,843,808. Out of said amount, \$10,153,301 corresponded to long-term liabilities of which \$7,534,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
2. Total net assets of the Municipality amounted to \$26,022,557 which represents an increase of 17% compared to prior fiscal year;
3. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$14,515,740, derived from the following sources: \$54,762 charges for services; \$2,222,833 from operating grants and contributions; \$2,327,586 from capital grants and contributions obtained from other sources, and \$9,910,559 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL HIGHLIGHTS (CONTINUED)

4. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$10,644,874;
5. As reflected in the Statement of Activities, the current fiscal year operations contributed to the increase in the Net Assets Figure by \$3,870,866;
6. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$8,054,584;
7. At the end of the current fiscal year, the Municipality's General Fund balance amounted to \$3,186,045. It is pertinent to note that it is the municipal administration's contention that the importance of such figure should not be overestimated since it has adopted the policy to use internal generated resources to increase services to Municipality's community rather than let them unused in the accounted records;
8. The actual General Fund budgetary activities resulted in a favorable balance of \$969,169 which is indicative of full compliance with the balanced budget principle applicable to all municipalities of the Commonwealth Government of Puerto Rico as required by the Municipal Autonomous Act enacted in August 1991.
9. In response to the continued increments in the municipal operating revenues, the Municipal Legislature approved a revision to the General Fund Budget for fiscal year 2007 which amounted to \$596,521.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2007. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL STATEMENTS COMPONENTS

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

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

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

A brief review of the Statement of Activities of the Municipality at June 30, 2007, shows total expenses incurred to afford the cost of all functions and programs amounted to \$10,644,874. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$4,605,181 was derived from the following sources: \$54,762 charges for services; \$2,222,833 from operating grants and contributions; and \$2,327,586 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$9,910,559. When such figure is added to the \$4,605,181 previously mentioned, total revenues available for the financing of activities amounted to \$14,515,740. There was an excess of revenues over expenses in the amount of \$3,870,866 which contributed to the figure of net assets attained at the end of the fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

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

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As explained in the Capital Assets and Debt Administration Section of this MD&A, on July 1, 2002, the Municipality commenced partially the prospective reporting of infrastructure assets. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

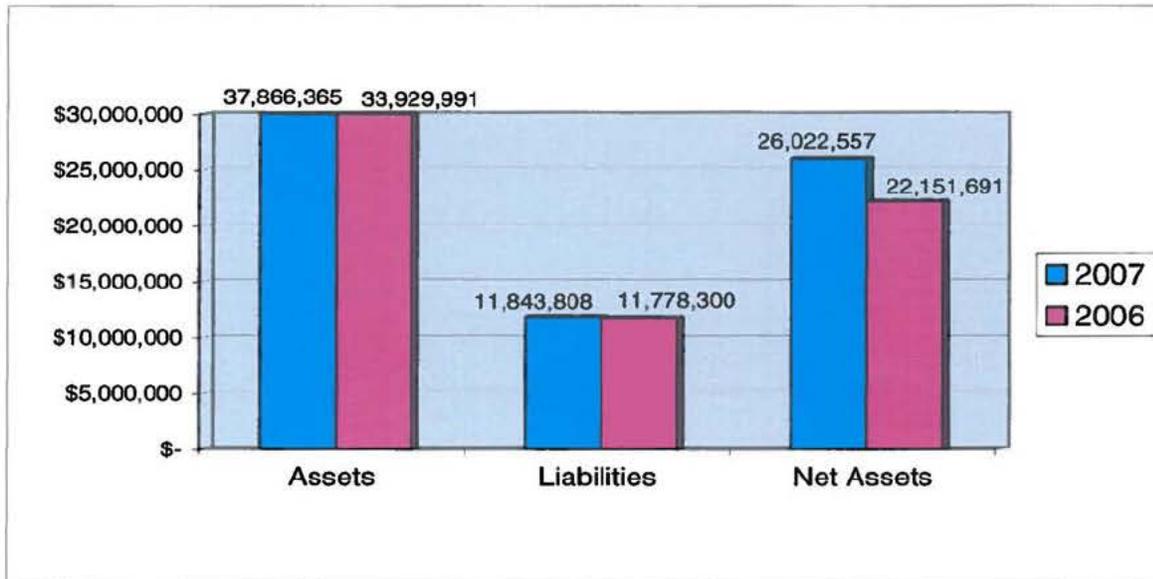
YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the **Municipality of Luquillo**, primary government assets exceeded total liabilities by \$26,022,557 at the end of 2007, compared to \$22,151,691 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

| Condensed Statement of Net Assets | 2007 | 2006 | Change | % |
|---|----------------------|----------------------|---------------------|------------|
| Current and other assets | \$ 9,443,106 | \$ 7,767,128 | \$ 1,675,978 | 22% |
| Capital assets | 28,423,259 | 26,162,863 | 2,260,396 | 9% |
| Total assets | 37,866,365 | 33,929,991 | 3,936,374 | 12% |
| Current and other liabilities | 1,690,507 | 2,287,675 | (597,168) | (26%) |
| Long-term liabilities | 10,153,301 | 9,490,625 | 662,676 | 7% |
| Total liabilities | 11,843,808 | 11,778,300 | 65,508 | 1% |
| Invested in capital assets, net of related debt | 21,799,259 | 20,283,113 | 1,516,146 | 7% |
| Restricted | 4,737,067 | 2,916,610 | 1,820,457 | 62% |
| Unrestricted deficit | (513,769) | (1,048,032) | 534,263 | (51%) |
| Total net assets | \$ 26,022,557 | \$ 22,151,691 | \$ 3,870,866 | 17% |



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2007, the net effect of the revenues derived from several programs plus current operating revenues compared to the total expense, amounted to \$3,870,866. Approximately 52 percent of the Municipality's total revenues resulted from grants and contributions, including federal aid, while 44 percent came from taxes. The largest expenses were for general government, health and welfare, and public works. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

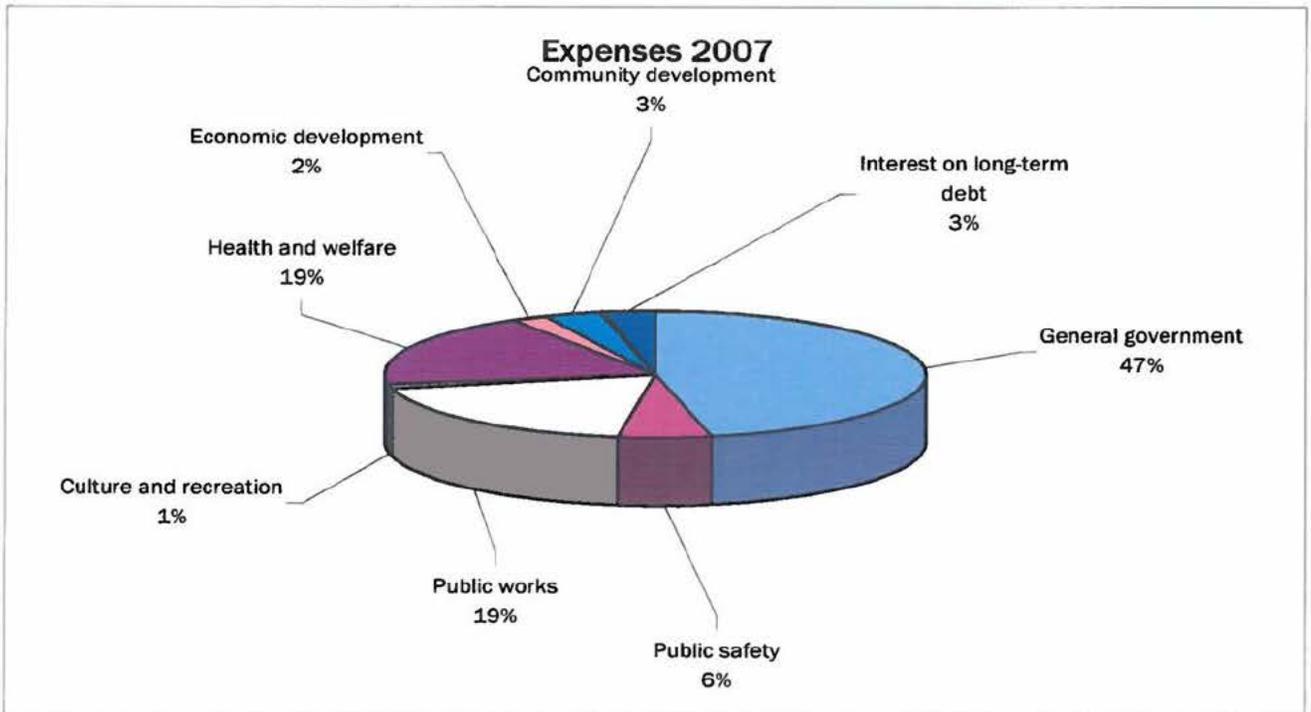
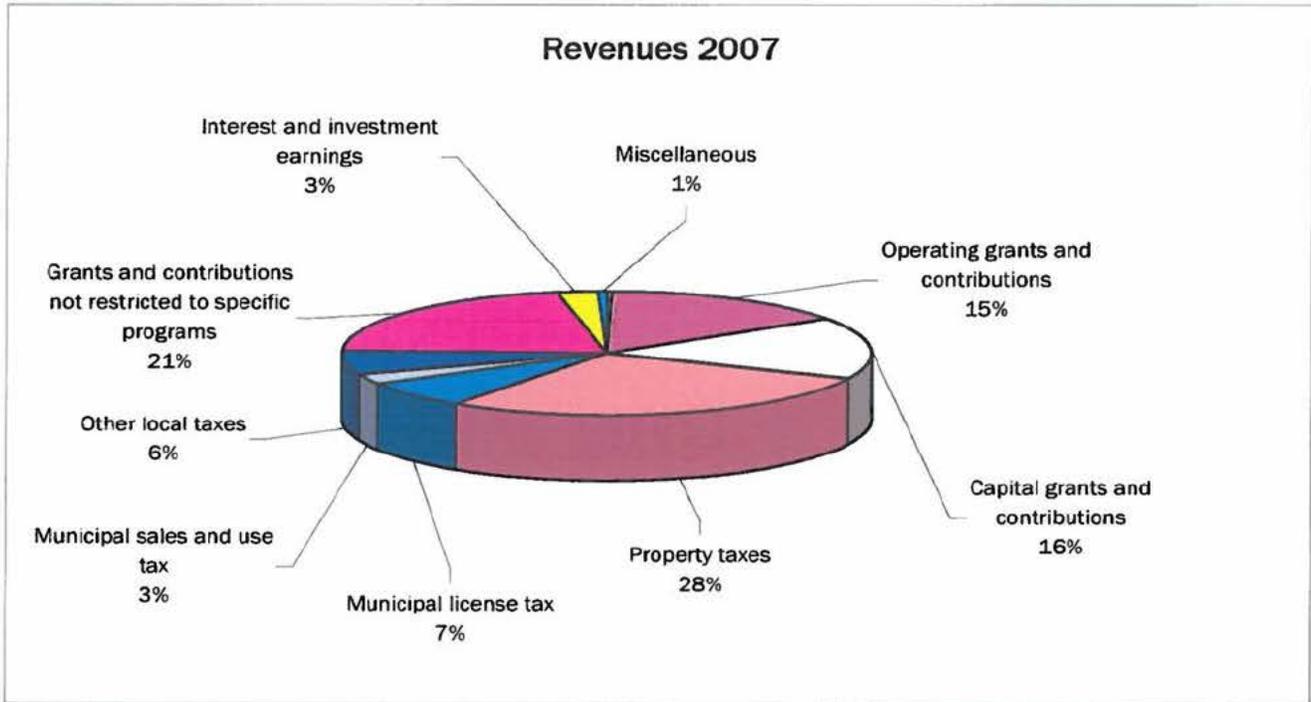
| Condensed Statement of Activities | 2007 | 2006 | Change | % |
|--|----------------------|----------------------|---------------------|--------------|
| Program revenues: | | | | |
| Charges for services | \$ 54,762 | \$ 96,331 | \$ (41,569) | (43%) |
| Operating grants and contributions | 2,222,833 | 2,082,098 | 140,735 | 7% |
| Capital grants and contributions | 2,327,586 | 224,723 | 2,102,863 | 936% |
| General revenues: | | | | |
| Property taxes | 4,056,119 | 3,912,762 | 143,357 | 4% |
| Municipal license tax | 996,690 | 922,998 | 73,692 | 8% |
| Municipal sales and use tax | 404,196 | | 404,196 | 100% |
| Other local taxes | 911,240 | 857,914 | 53,326 | 6% |
| Grants and contributions not restricted to specific programs | 3,081,780 | 3,110,566 | (28,786) | (1%) |
| Interest and investment earnings | 382,209 | 229,903 | 152,306 | 66% |
| Miscellaneous | 78,325 | 86,873 | (8,548) | (10%) |
| Total revenues | 14,515,740 | 11,524,168 | 2,991,572 | 26% |
| Expenses: | | | | |
| General government | 4,961,482 | 4,769,529 | 191,953 | 4% |
| Public safety | 601,216 | 561,698 | 39,518 | 7% |
| Public works | 2,039,419 | 2,539,988 | (500,569) | (20%) |
| Culture and recreation | 109,298 | 386,209 | (276,911) | (72%) |
| Health and welfare | 1,991,193 | 2,036,672 | (45,479) | (2%) |
| Economic development | 232,030 | 227,505 | 4,525 | 2% |
| Community development | 342,893 | 364,730 | (21,837) | (6%) |
| Education | 35,114 | - | 35,114 | 100% |
| Interest on long-term debt | 332,229 | 314,505 | 17,724 | 6% |
| Total expenses | 10,644,874 | 11,200,836 | (555,962) | (5%) |
| Change in net assets | 3,870,866 | 323,332 | 3,547,534 | 1097% |
| Net assets, beginning of year, as restated | 22,151,691 | 21,828,359 | 323,332 | 1% |
| Net assets, end of year | \$ 26,022,557 | \$ 22,151,691 | \$ 3,870,866 | 17% |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

As noted 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 balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$8,054,584, an increase of \$2,259,281 in comparison with the prior year. There are reservations of fund balance amounting to \$5,563,148. This is the fund balance that is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$663,500), 2) to pay debt service (\$1,983,339), 3) to pay for capital projects (\$1,678,959) and 4) for other purposes (\$1,237,350).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2007, the general fund has an undesignated fund balance of \$2,491,436.

GENERAL FUND BUDGETARY HIGHLIGHTS

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

In response to the increments in the municipal operating revenues, the Municipal Legislature approved a revision to the General Fund Budget for fiscal year 2007 which amounted to \$596,521. Such increments were used to provide further increases in capital assets and for the extension of several municipal services to Luquillo's communities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2007, amounts to \$38,475,533, with an accumulated depreciation of \$10,052,274 (including \$783,355 of current year depreciation expense), leaving a net book value of \$28,423,259. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure, furnishing, computers and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2007, the Municipality has \$281,953 of unexpended proceeds from bond and notes issuances that are committed to future construction activities.

Debt Administration

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2007-2008.

FINAL COMMENTS

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

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2007. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 1012, Luquillo, Puerto Rico 00773-1012, or call (787) 889-2068.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Net Assets
June 30, 2007

| | Governmental Activities |
|--|------------------------------------|
| Assets | |
| Cash and cash equivalents | \$ 5,336,361 |
| Cash with fiscal agent | 3,737,229 |
| Accounts receivable: | |
| Municipal license tax | 4,750 |
| Municipal sales and use tax | 49,486 |
| Intergovernmental | 291,332 |
| Interest | 23,948 |
| Capital assets | |
| Land, improvements, and construction in progress | 14,575,519 |
| Other capital assets, net of depreciation | 13,847,740 |
| Total capital assets | <u>28,423,259</u> |
| Total assets | <u>37,866,365</u> |
| Liabilities | |
| Accounts payable and accrued liabilities | 649,235 |
| Due to other governmental entities | 86,506 |
| Deferred revenues: | |
| Municipal license tax | 628,080 |
| Federal grant revenues | 164,105 |
| Intergovernmental | |
| Other | |
| Interest payable | 162,581 |
| Noncurrent liabilities: | |
| Due within one year | 735,498 |
| Due in more than one year | 9,417,803 |
| Total liabilities | <u>11,843,808</u> |
| Net Assets | |
| Invested in capital assets, net of related debt | 21,799,259 |
| Restricted for: | |
| Capital projects | 1,678,959 |
| Debt service | 1,820,758 |
| Other purposes | 1,237,350 |
| Unrestricted (deficit) | <u>(513,769)</u> |
| Total net assets | <u>\$ 26,022,557</u> |

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

**Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Activities
For the Year Ended June 30, 2007**

| Functions/Programs | Expenses | Program Revenues | | | Net (Expense) Revenue and Changes in Net Assets |
|--|----------------------|-------------------------|--|--|--|
| | | Charges for Services | Operating Grants and Contributions | Capital Grants and Contributions | Governmental Activities |
| General government | \$ 4,961,482 | \$ - | \$ 113,335 | \$ - | \$ (4,848,147) |
| Public safety | 601,216 | 6,968 | 120,332 | | (473,916) |
| Public works | 2,039,419 | 17,030 | 7,700 | 2,280,991 | 266,302 |
| Health and welfare | 1,991,193 | 8,219 | 813,196 | 41,895 | (1,127,883) |
| Culture and recreation | 109,298 | 13,700 | 57,123 | 4,700 | (33,775) |
| Economic development | 232,030 | 8,845 | 206,476 | | (16,709) |
| Community development | 342,893 | | 904,671 | | 561,778 |
| Education | 35,114 | | | | (35,114) |
| Interest on long-term debt | 332,229 | | | | (332,229) |
| Total governmental activities | \$ 10,644,874 | \$ 54,762 | \$ 2,222,833 | \$ 2,327,586 | \$ (6,039,693) |
| General revenues: | | | | | |
| Property taxes | | | | | 4,056,119 |
| Municipal license tax | | | | | 996,690 |
| Municipal sales and use tax | | | | | 404,196 |
| Other local taxes | | | | | 911,240 |
| Grants and contributions not restricted to specific programs | | | | | 3,081,780 |
| Interest and investment earnings | | | | | 382,209 |
| Miscellaneous | | | | | 78,325 |
| Total general revenues | | | | | 9,910,559 |
| Change in net assets | | | | | 3,870,866 |
| Net assets - beginning, as restated | | | | | 22,151,691 |
| Net assets - ending | | | | | \$ 26,022,557 |

Commonwealth of Puerto Rico
Municipality of Luquillo
Balance Sheet
Governmental Funds
June 30, 2007

| | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total Governmental Funds |
|---|---------------------|---|---|--|-------------------------|--------------------------------|--------------------------------|
| Assets | | | | | | | |
| Cash and cash equivalents | \$ 3,163,231 | \$ 641,629 | \$ 168,231 | \$ 1,237,542 | \$ - | \$ 125,728 | \$ 5,336,361 |
| Cash with fiscal agent | | 1,128,205 | 129,046 | 498,762 | 1,981,216 | | 3,737,229 |
| Accounts receivable: | | | | | | | |
| Municipal license tax | 4,750 | | | | | | 4,750 |
| Municipal sales and use tax | 49,486 | | | | | | 49,486 |
| Intergovernmental | 44,225 | 81,476 | 150,116 | | 15,515 | | 291,332 |
| Interest | 16,544 | | | | 7,404 | | 23,948 |
| Due from other funds | 1,016,972 | | | | | | 1,016,972 |
| Total assets | \$ 4,295,208 | \$ 1,851,310 | \$ 447,393 | \$ 1,736,304 | \$ 2,004,135 | \$ 125,728 | \$ 10,460,078 |
| Liabilities and Fund Balances | | | | | | | |
| Liabilities : | | | | | | | |
| Accounts payable and accrued liabilities | \$ 351,198 | \$ - | \$ 115,254 | \$ - | \$ - | \$ - | \$ 466,452 |
| Due to other governmental entities | 86,506 | | | | | | 86,506 |
| Due to other funds | | 767,360 | 168,034 | 57,345 | 20,796 | 3,437 | 1,016,972 |
| Deferred revenues: | | | | | | | |
| Municipal license tax | 628,080 | | | | | | 628,080 |
| Intergovernmental | 43,379 | | | | | | 43,379 |
| Federal grant revenues | | | 164,105 | | | | 164,105 |
| Total liabilities | 1,109,163 | 767,360 | 447,393 | 57,345 | 20,796 | 3,437 | 2,405,494 |
| Fund balances: | | | | | | | |
| Reserved for: | | | | | | | |
| Encumbrances | 663,500 | | | | | | 663,500 |
| Capital projects | | | | 1,678,959 | | | 1,678,959 |
| Debt service fund | | | | | 1,983,339 | | 1,983,339 |
| Other purposes | 31,109 | 1,083,950 | | | | | 1,115,059 |
| Reserved reported in nonmajor funds: | | | | | | | |
| Other purposes | | | | | | 122,291 | 122,291 |
| Unreserved: | | | | | | | |
| Undesignated | 2,491,436 | | | | | | 2,491,436 |
| Total fund balances | 3,186,045 | 1,083,950 | - | 1,678,959 | 1,983,339 | 122,291 | 8,054,584 |
| Total liabilities and fund balances | \$ 4,295,208 | \$ 1,851,310 | \$ 447,393 | \$ 1,736,304 | \$ 2,004,135 | \$ 125,728 | |

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

| | |
|--|----------------------|
| Accrual basis of accounting accounts receivable recognized in government-wide financial statements | 43,379 |
| Accrual basis of accounting accounts payable recognized in government-wide financial statements | (182,783) |
| Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds | 28,423,259 |
| Long-term liabilities, including accrued interest payable, are not due and payable in the current period, and therefore, are not reported in the funds | (10,315,882) |
| Net assets of governmental activities | \$ 26,022,557 |

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2007

| | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total Governmental Funds |
|---|------------------|---|---|--|-------------------|--------------------------|--------------------------|
| Revenues | | | | | | | |
| Property taxes | \$ 3,186,564 | \$ - | \$ - | \$ - | \$ 826,176 | \$ - | \$ 4,012,740 |
| Municipal license taxes | 996,690 | | | | | | 996,690 |
| Municipal sales and use tax | 404,196 | | | | | | 404,196 |
| Licenses, permits and other local taxes | 911,240 | | | | | | 911,240 |
| Charges for services | 21,948 | | | | | | 21,948 |
| Intergovernmental | 3,195,116 | 345,825 | | 2,327,586 | | | 5,868,527 |
| Fines and forfeitures | 6,968 | | | | | | 6,968 |
| Rent of property | 25,845 | | | | | | 25,845 |
| Interest | 338,961 | | | 43,248 | | | 382,209 |
| Federal grants | | | 1,313,837 | | | 435,466 | 1,749,303 |
| Miscellaneous | 78,325 | | | | | 14,370 | 92,695 |
| Total revenues | 9,165,853 | 345,825 | 1,313,837 | 2,370,834 | 826,176 | 449,836 | 14,472,361 |
| Expenditures | | | | | | | |
| Current: | | | | | | | |
| General government | 5,149,494 | 5,160 | | | | | 5,154,654 |
| Public safety | 303,664 | 245,414 | 55,555 | | | | 604,633 |
| Public works | 1,714,247 | 88,743 | | 1,080,562 | | | 2,883,552 |
| Health and welfare | 1,187,810 | 18,776 | 353,612 | | | 426,566 | 1,986,764 |
| Culture and recreation | 233,703 | 35,665 | | 525,330 | | | 794,698 |
| Economic development | 15,475 | 216,787 | | | | | 232,262 |
| Community development | | | 904,670 | | | | 904,670 |
| Education | | | | 35,114 | | | 35,114 |
| Debt service: | | | | | | | |
| Principal | | | | | 417,000 | | 417,000 |
| Interest | | | | | 324,733 | | 324,733 |
| Total expenditures | 8,604,393 | 610,545 | 1,313,837 | 1,641,006 | 741,733 | 426,566 | 13,338,080 |
| Excess (deficiency) of revenues over (under) expenditures | 561,460 | (264,720) | | 729,828 | 84,443 | 23,270 | 1,134,281 |
| Other financing sources (uses) | | | | | | | |
| Long-term debt issued | | 1,125,000 | | | | | 1,125,000 |
| Total other financing sources (uses) | - | 1,125,000 | - | - | - | - | 1,125,000 |
| Net change in fund balances | 561,460 | 860,280 | - | 729,828 | 84,443 | 23,270 | 2,259,281 |
| Fund balance- beginning, as restated | 2,624,585 | 223,670 | | 949,131 | 1,898,896 | 99,021 | 5,795,303 |
| Fund balance- ending | \$ 3,186,045 | \$ 1,083,950 | \$ - | \$ 1,678,959 | \$ 1,983,339 | \$ 122,291 | \$ 8,054,584 |

*OK
w/entry
02/09/08*

Commonwealth of Puerto Rico
Municipality of Luquillo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2007

| | | |
|---|-----------|------------------|
| Net Change in Fund Balances - Total Governmental Funds | \$ | 2,259,281 |
| Amounts reported for governmental activities in the Statement of Activities are different because: | | |
| Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. | | 3,043,804 |
| Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. | | (783,355) |
| Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets, resulting in a loss on disposal of capital assets on the Government-Wide Statement of Activities and Changes in Net Assets. | | (53) |
| Interest Payable on long-term debt was reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it did not require the use of current financial resources. Therefore, Interest Payable was not reported as expenditures in Governmental Funds. The following amount represents the change in accrued interest from prior year. | | (7,494) |
| Accounts Payable reported in the Government-Wide Statement of Activities and Changes in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. The following amount represents the change in this accounts payable from prior year. | | (22,020) |
| Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments. | | (708,000) |
| Repayment of long-term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long -term property tax advance debt in the Government-Wide Statement of Net Assets. This is the change in the property tax advance debt in the current period. | | 9,528 |
| Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represented the change in long-term compensated absences from prior year. | | (94,726) |
| Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenue in the funds. The following amount represents the change in this revenues from prior year. | | 43,379 |
| Repayment of long term Puerto Rico Land Authority debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. This is the long term Puerto Rico Land Authority debt paid in the current period. | | 89,750 |
| Repayment of long term Land Information Management System (LIMS) is an expenditure in Governmental Funds, but the repayment reduces long term LIMS in the Government-Wide Statement of Net Assets. This is the amount paid in the current period. | | 40,772 |
| Change in Net Assets of Governmental Activities | \$ | 3,870,866 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2007

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Luquillo** (the Municipality) was founded on the year 1797. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a twelve member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

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

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

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, the Municipality does not have component units to include within its reporting entity.

B. Government-wide and fund financial statements

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

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

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

Special Revenue Fund - State and Local Grants - is the accounting entity in which revenues derived from local funds, state or other restricted revenue source is accounted for the uses and limitations specified by Municipality ordinances or state statutes.

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

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

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

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

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

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

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

Special Revenue Fund – Section 8 – Special Revenue Funds are used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

D. Measurement focus, basis of accounting and financial presentation

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

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

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

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

E. Assets, liabilities and net assets

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

Cash with fiscal agent in the debt 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. Also, cash with fiscal agent consists of unused proceeds of bonds and notes issued for the acquisition of equipment and construction of major capital improvements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

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

Receivables are stated net of estimated allowance for uncollectible accounts, which are determined, based upon past collections experience and current economic conditions. Intergovernmental receivables in the General Fund represent mostly charge for services rendered to other governmental entities. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

- 3. Inventories** - Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
- 4. Capital assets** - Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

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

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

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

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

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality. All sick leave pay and salary related benefits are accrued when incurred in the governmental-wide financial statements when the employee meets such criteria.

- 7. Claims and judgments** – The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund when the liability is incurred.

- 8. Reservations of fund balance** – Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

- a. **Capital Projects** – Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- b. **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.
- c. **Other Purposes** – Represents net assets available for specific use and/or legally segregated for other specific future use.
- d. **Debt Service Fund** – Represents net assets available to finance future debt service payments.

9. Interfund and intra-entity transactions – The Municipality has the following types of transactions among funds:

- a. **Operating Transfers** – Legally required transfers that are reported when incurred as “Operating transfer-in” by the recipient fund and as “Operating transfers-out” by the disbursing fund.
- b. **Intra-Entity Transactions** – Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

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

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (CRIM) for the year ended June 30, 2007 amounted to approximately \$212,648. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$184,829 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that “long term liabilities, including compensated absences, bonds and notes

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

payable, are not due and payable in the current period and therefore are not reported in the funds.”, and that “capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.” The details of this reconciliation are as follows:

| | | Total Net Assets - Governmental Activities |
|--|--------------------|---|
| <u>Net assets invested in capital assets, net of related debt</u> | | |
| Capital assets, net of depreciation | \$ 28,423,259 | |
| Deduct: | | |
| Bonds Payable | (4,410,000) | |
| Notes Payable | (2,174,000) | |
| Land Authority | <u>(40,000)</u> | \$ 21,799,259 |
| <u>Net assets restricted for capital projects</u> | | |
| Fund balance restricted for Capital Projects | | 1,678,959 |
| <u>Net assets restricted for debt service</u> | | |
| Debt Service Fund - fund balances | \$ 1,983,339 | |
| Deduct: | | |
| Interest payable | <u>(162,581)</u> | 1,820,758 |
| <u>Net assets restricted for other purposes</u> | | |
| General Fund-fund balance restricted for other purposes | 31,109 | |
| Special Revenue Fund - Local and State Grants - fund balance restricted for other purposes | 1,083,950 | |
| Other governmental funds-fund balance restricted for other purposes | <u>122,291</u> | 1,237,350 |
| <u>Net assets unrestricted (deficit)</u> | | |
| General Fund - total fund balance: | \$ 3,186,045 | |
| Add: | | |
| Accrual basis accounts receivables | 43,379 | |
| Deduct: | | |
| General Fund-fund restricted for other purposes | (31,109) | |
| Accrual basis accounts payable | (182,783) | |
| Bond and Notes Payable | (950,000) | |
| Property taxes | (1,294,671) | |
| LIMS repayment plan | (216,168) | |
| Land Authority debt | (3,600) | |
| Compensated absences | <u>(1,064,862)</u> | <u>(513,769)</u> |
| Total net assets - governmental activities | | <u>\$ 26,022,557</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

2. DEPOSITS

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

The Municipality's bank balances in commercial banks of \$3,163,231 in the General Fund, the \$641,629 in the Special Revenue Fund - Local and State Grants, the \$168,231 in the Special Revenue Fund - Other Federal Grants, and the \$1,237,542 in the Capital Projects Fund- State and Local Grants were fully collateralized at June 30, 2007. In the Other Governmental Funds there were deposits with commercial banks of \$125,728 that were fully collateralized.

The deposits at GDB of \$1,128,205 in the Special Revenue Fund - Local and State Grants, the \$129,046 in the Special Revenue Fund - Other Federal Grants, the \$498,762 in the Capital Projects Fund - Local and State Grants that are restricted principally for capital projects, and the \$1,981,216 in the Debt Service Fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax* - The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2007, the tax rates were as follows:

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

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable of \$4,750 represents filed municipal license tax returns that were uncollected as of June 30, 2007, net of allowance for uncollectible accounts.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

3. RECEIVABLES (CONTINUED)

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

B. *Municipal Sales and Use Tax* - On October 4, 2006, the Municipal Legislature, by Ordinance Number 06-2006-2007, authorized the Mayor to impose a sales tax of 1.5%. The dispositions of this Ordinance began on November 15, 2006. Municipal sales and use tax receivable of \$49,486 represents filed municipal sales and tax returns that were uncollected as of June 30, 2007, net of allowance for uncollectible accounts.

C. *Intergovernmental Receivables* -

Intergovernmental receivables in the General Fund represent expenditures incurred not yet reimbursed by the other governmental entities. Following is a detail of the intergovernmental receivables:

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|-------------------------|
| Municipal Revenue Collection Center ("CRIM") | \$ 43,379 |
| Puerto Rico Electric Power Authority ("PREPA") | <u>846</u> |
| Total | <u>\$ 44,225</u> |

Intergovernmental receivables in the Special Revenue Fund - Local and State Grants represent expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivables:

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|-------------------------|
| Commonwealth of Puerto Rico-Department of Labor and Human Resources-Law 52 Grant | \$ 68,673 |
| Commonwealth of Puerto Rico-Department of Labor and Human Resources-Law 82 Grant | <u>12,803</u> |
| Total | <u>\$ 81,476</u> |

Intergovernmental receivables in the Special Revenue Fund - Other Federal Grants represent expenditures incurred not yet reimbursed by the federal government or the pass-through grantor. Following is a detail of the intergovernmental receivables:

| <u>Program Description</u> | <u>Amount</u> |
|--|--------------------------|
| Community Development Block Grants-State's Program | \$ 116,261 |
| Special Program for Aging-Title III, Part B, Grants for Supportive Services and Senior Centers | 5,692 |
| Child Care and Development Block Grant | <u>28,163</u> |
| Total | <u>\$ 150,116</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in the Debt Service Fund represents property tax receivable at June 30, 2007. Following is a detail of the intergovernmental receivable:

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|-------------------------|
| Municipal Revenue Collection Center (CRIM) | \$ <u>15,515</u> |
| Total | \$ <u>15,515</u> |

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2007 are summarized as follows:

a. Due from/to other fund:

| <u>Receivable Fund</u> | <u>Payable Fund</u> | <u>Purpose</u> | <u>Amount</u> |
|------------------------|---|--|----------------------------|
| General Fund | Special Revenue Fund – Local and State Grants | Payrolls, accruals, and other expenditures not reimbursed | \$ 767,360 |
| General Fund | Special Revenue Fund – Other Federal Grants | Payrolls, accruals, and other expenditures not reimbursed | 168,034 |
| General Fund | Capital Projects Fund – Local and State Grants | Payrolls, accruals, and other expenditures not reimbursed | 57,345 |
| General Fund | Debt Service Fund | Interest not transferred | 20,796 |
| General Fund | Other Governmental Funds | Payrolls, accruals, and other expenditures not reimbursed | <u>3,437</u> |
| Total | | | \$ <u>1,016,972</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

5. CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2007, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

| <u>Governmental Activities:</u> | <u>Balance July 1, 2006 as restated</u> | <u>Additions</u> | <u>Retirements</u> | <u>Balance June 30, 2007</u> |
|--|---|---------------------|---------------------|----------------------------------|
| Capital asset, not being depreciated: | | | | |
| Land | \$ 10,462,413 | \$ - | \$ - | \$ 10,462,413 |
| Construction in progress | <u>3,579,882</u> | <u>1,423,488</u> | <u>(890,264)</u> | <u>4,113,106</u> |
| Total capital assets not being depreciated | <u>14,042,295</u> | <u>1,423,488</u> | <u>(890,264)</u> | <u>14,575,519</u> |
| Capital assets, being depreciated: | | | | |
| Buildings | 11,355,667 | 28,988 | | 11,384,655 |
| Buildings improvements | 1,404,756 | 1,651,600 | | 3,056,356 |
| Infrastructure | 2,384,257 | 124,108 | | 2,508,365 |
| Infrastructure improvements | 1,591,935 | 467,783 | | 2,059,718 |
| Equipment | 1,841,268 | 125,444 | (86) | 1,966,626 |
| Furnishing | 525,033 | 14,054 | | 539,087 |
| Work of art | 400 | | | 400 |
| Computers | 229,472 | 53,108 | (5,026) | 277,554 |
| Vehicles | <u>2,061,758</u> | <u>45,495</u> | <u>-</u> | <u>2,107,253</u> |
| Total capital assets being depreciated | <u>21,394,546</u> | <u>2,510,580</u> | <u>(5,112)</u> | <u>23,900,014</u> |
| Less accumulated depreciation for: | | | | |
| Buildings | (2,809,181) | (284,375) | | (3,093,556) |
| Buildings improvements | (88,555) | (68,486) | | (157,041) |
| Infrastructure | (2,118,270) | (62,670) | | (2,180,940) |
| Infrastructure improvements | (147,142) | (127,984) | | (275,126) |
| Equipment | (1,551,461) | (110,820) | 33 | (1,662,248) |
| Furnishing | (495,733) | (14,578) | | (510,311) |
| Works of art | (163) | (40) | | (203) |
| Computers | (190,390) | (34,217) | 5,026 | (219,581) |
| Vehicles | <u>(1,873,083)</u> | <u>(80,185)</u> | <u>-</u> | <u>(1,953,268)</u> |
| Total accumulated depreciation | <u>(9,273,978)</u> | <u>(783,355)</u> | <u>5,059</u> | <u>(10,052,274)</u> |
| Total capital assets being depreciated, net | <u>12,120,568</u> | <u>1,727,225</u> | <u>(53)</u> | <u>13,847,740</u> |
| Governmental activities capital assets, net | <u>\$ 26,162,863</u> | <u>\$ 3,150,713</u> | <u>\$ (890,317)</u> | <u>\$ 28,423,259</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

5. CAPITAL ASSETS (CONTINUED)

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

| Governmental activities: | <u>Amount</u> |
|---|--------------------------|
| General government | \$ 282,901 |
| Public works | 222,931 |
| Culture and recreation | 115,294 |
| Community development | 105,989 |
| Health and welfare | 29,529 |
| Public safety | 26,183 |
| Economic development | <u>528</u> |
| Total depreciation expense-governmental activities | <u>\$ 783,355</u> |

6. PROPERTY TAXES

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

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. The CRIM issued the preliminary liquidation noting that the collections exceeded advances by \$43,379. In the governmental funds, the entire receivable has been offset by deferred revenue since the excess was not available to pay liabilities of the current period. In the government-wide financial statements, the entire receivable is recognized as revenue.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

6. PROPERTY TAXES (CONTINUED)

The governmental-wide statement of net assets includes an outstanding debt balance of \$49,660 corresponding to the 2006 CRIM final liquidation.

On December 31, 1992, the Municipality entered into an agreement with the Commonwealth of Puerto Rico - Treasury Department, for the repayment of excess property tax advances. As of June 30, 2007, the related unpaid property taxes advances included in the Statement of Net Assets amounted to \$2,849.

On January 26, 2000, Public Law No. 42 was enacted, which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No. 146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2003, Public Law No. 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law No. 42 enacted on January 26, 2000.

On June 26, 1997, Public Law No. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The government-wide Statement of Net Assets includes an outstanding balance of \$700,940 and \$541,222 related to Law No. 146 and the Law No. 42, respectively.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

6. PROPERTY TAXES (CONTINUED)

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

The annual tax rate is 8.83% for real property and 6.83% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 2.00% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2007 are summarized as follows:

| Description | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund Section Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total |
|---------------------|-------------------|---|---|--|-------------------|--------------------------|-------------------|
| Accounts payable | \$ 121,950 | \$ - | \$ 115,254 | \$ - | \$ - | \$ - | \$ 237,204 |
| Accrued liabilities | <u>229,248</u> | - | - | - | - | - | <u>229,248</u> |
| Total | <u>\$ 351,198</u> | <u>\$ -</u> | <u>\$ 115,254</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 466,452</u> |

8. DUE TO OTHER GOVERNMENTAL ENTITIES

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

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|------------------|
| Department of Labor - Unemployment | \$ 4,817 |
| Puerto Rico Aqueduct and Sewer Authority ("AAA") | 6,680 |
| Department of Treasury - Income Tax | 62,170 |
| General Services Administration | 3,235 |
| Puerto Rico Telephone Company | <u>9,604</u> |
| Total | <u>\$ 86,506</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

9. DEFERRED REVENUES

- A. Municipal License Tax** – The deferred revenues of \$628,080 in the General Fund relates to municipal license tax collected in fiscal year 2006-07 that will be earned in fiscal year 2007-08.
- B. Federal Grants** – The deferred revenues presented in the Special Revenue Fund – Other Federal Grants represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

| <u>Program Description</u> | <u>Amount</u> |
|--|--------------------------|
| Disaster Grants-Public Assistance | \$ 129,046 |
| Emergency Management Performance Grant | 12,322 |
| State and Community Highway Safety Program | 8,103 |
| Nutrition Program for the Elderly | 11,509 |
| Others | <u>3,125</u> |
| Total | <u>\$ 164,105</u> |

10. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2007, was as follows:

| <u>Description</u> | <u>Beginning Balance</u> | <u>Borrowings or Additions</u> | <u>Payments or Deductions</u> | <u>Ending Balance</u> | <u>Due Within One Year</u> |
|-------------------------|------------------------------|------------------------------------|-----------------------------------|-----------------------------|--------------------------------|
| Bonds Payable | \$ 5,595,000 | \$ - | \$ (235,000) | \$ 5,360,000 | \$ 255,000 |
| Notes Payable | 1,231,000 | 1,125,000 | (182,000) | 2,174,000 | 318,000 |
| Property Taxes Advances | 1,304,199 | - | (9,528) | 1,294,671 | 59,727 |
| Land Authority | 133,350 | - | (89,750) | 43,600 | 3,600 |
| Compensated Absences | 970,136 | 152,439 | (57,713) | 1,064,862 | 55,937 |
| LIMS Repayment Plan | <u>256,940</u> | <u>-</u> | <u>(40,772)</u> | <u>216,168</u> | <u>43,234</u> |
| Total | <u>\$ 9,490,625</u> | <u>\$ 1,277,439</u> | <u>\$ (614,763)</u> | <u>\$ 10,153,301</u> | <u>\$ 735,498</u> |

- 1. Legal debt margin** – The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

10. LONG-TERM LIABILITIES (CONTINUED)

2. Bonds Payable – The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. Bonds payable outstanding at June 30, 2007 are as follows:

| <u>Type of bonds</u> | <u>Maturity Date</u> | <u>Original Amount</u> | <u>Range of Interest Rates</u> | <u>Balance at June 30, 2007</u> |
|---------------------------------------|----------------------|------------------------|--------------------------------|---------------------------------|
| 1993 Series | 7-1-12 | \$ 2,015,000 | 5.00% to 8.00% | \$ 950,000 |
| 2000 Series | 7-1-14 | 460,000 | 2.70% to 7.81% | 310,000 |
| 2003 Series | 7-1-27 | 4,430,000 | 5.00% to 5.31% | <u>4,100,000</u> |
| Total general obligation bonds | | | | <u>\$ 5,360,000</u> |

These bonds are payable from the special ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

| <u>Year Ending June 30,</u> | <u>Principal</u> | <u>Interest</u> |
|-----------------------------|----------------------------|----------------------------|
| 2008 | \$ 255,000 | \$ 264,626 |
| 2009 | 275,000 | 263,310 |
| 2010 | 295,000 | 245,776 |
| 2011 | 315,000 | 226,709 |
| 2012 | 340,000 | 206,001 |
| 2013-2017 | 1,085,000 | 803,899 |
| 2018-2022 | 1,035,000 | 580,387 |
| 2023-2027 | 1,415,000 | 278,504 |
| 2028-2032 | <u>345,000</u> | <u>8,659</u> |
| Total | <u>\$ 5,360,000</u> | <u>\$ 2,877,871</u> |

3. Notes Payable – The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. During the current year, the Municipality issued notes for approximately \$1,125,000. Notes payable outstanding at June 30, 2007 are as follows:

| <u>Type of notes</u> | <u>Maturity Date</u> | <u>Original Amount</u> | <u>Range of Interest rates</u> | <u>Balance at June 30, 2007</u> |
|----------------------------|----------------------|------------------------|--------------------------------|---------------------------------|
| 2003 Series | 1-1-10 | \$ 521,000 | 4.75% | \$ 244,000 |
| 2004 Series | 1-1-13 | 228,000 | 4.25% | 200,000 |
| 2006 Series | 7-1-12 | 685,000 | 4.23% to 5.33% | 605,000 |
| 2007 Series | 7-1-14 | 1,125,000 | 6.48% to 7.50% | <u>1,125,000</u> |
| Total notes payable | | | | <u>\$ 2,174,000</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

10. LONG-TERM LIABILITIES (CONTINUED)

The notes are payable from the ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

| <u>Year Ending June 30,</u> | <u>Principal</u> | <u>Interest</u> |
|---------------------------------|----------------------------|--------------------------|
| 2008 | \$ 318,000 | \$ 91,327 |
| 2009 | 337,000 | 106,557 |
| 2010 | 362,000 | 88,716 |
| 2011 | 299,000 | 65,250 |
| 2012 | 315,000 | 46,527 |
| 2013-2017 | <u>543,000</u> | <u>33,848</u> |
| Total | <u>\$ 2,174,000</u> | <u>\$ 432,225</u> |

- 4. Advances from CRIM** – This amount represents the balance owed to the CRIM at June 30, 2007, as described in Note 6.
- 5. Compensated Absences** – The government-wide statement of net assets includes approximately \$582,421 of accrued sick leave benefits, and approximately \$482,441 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
- 6. Land Authority** – This amount represents a payment agreement with the Land Authority for the acquisition of a parcel of land.
- 7. LIMS Repayment Plan** – During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System – LIMS, contracted by the CRIM. A total of \$413,522 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2007 the outstanding debt balance is \$216,168. This amount will be presented in the government wide Statement of Net Assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

11. PENSION PLAN

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

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

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

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

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2007 recorded as pension expenditures were \$ 288,926. This amount represented 100% of the required contribution.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

11. PENSION PLAN (CONTINUED)

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

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2007, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

12. RISK MANAGEMENT

The Property Division of the Municipality is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the area of Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

13. CONTINGENCIES

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

13. CONTINGENCIES (CONTINUED)

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

14. SUBSEQUENT EVENTS

A) Sales and Use Tax

On July 29, 2007, an amendment to Act No. 117 of July 4, 2006, Known as the "The Fairness Act of 2006", was enacted with the purpose of establishing a mandatory sales and use tax of 1.5% at the municipal level. The municipalities of Puerto Rico are responsible to collect 1% of the corresponding tax with the same exemptions and limitations that the portion collected by the Treasury Department. The Act provides an optional surtax on the un-process food. This surtax must be approved by the Municipal Legislature.

The Treasury Department is responsible to create the Municipal Development Fund (.02%), the Municipal Redemption Fund (.02%) and the Municipal Improvements Fund (.01%) with the remaining 0.5%.

15. PRIOR PERIOD ADJUSTMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

| Description | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund - Other Federal Programs | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Fund | Total |
|---|--------------------|---|---|--|---------------------|-------------------------|---------------------|
| Fund balance, beginning | \$2,624,585 | \$ 223,670 | \$ - | \$ 949,131 | \$ 1,898,896 | \$ - | \$ 5,696,282 |
| To corrected prior year deferred federal grant revenues | - | - | - | - | - | 99,021 | 99,021 |
| Fund balance, beginning as restated | <u>\$2,624,585</u> | <u>\$ 223,670</u> | <u>\$ -</u> | <u>\$ 949,131</u> | <u>\$ 1,898,896</u> | <u>\$ 99,021</u> | <u>\$ 5,795,303</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

15. PRIOR PERIOD ADJUSTMENTS (CONTINUED)

B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS

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

| <u>Description</u> | <u>Total</u> |
|---|----------------------|
| Net assets, beginning | \$ 15,667,978 |
| To correct prior year deferred federal grant revenues | 99,021 |
| Implementation of the retroactive capitalization of infrastructure assets | <u>6,384,692</u> |
| Net assets, beginning as restated | <u>\$ 22,151,691</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

**BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)**

YEAR ENDED JUNE 30, 2007

| | <u>Budgeted Amounts</u> | | Actual Amounts (Budgetary Basis) (See Note 1) | Variance with Final Budget Positive (Negative) |
|---|-------------------------|------------------|---|---|
| | Original | Final | | |
| REVENUES: | | | | |
| Property taxes | \$ 3,070,136 | \$ 3,070,136 | \$ 3,186,564 | \$ 116,428 |
| Municipal license tax | 832,000 | 951,793 | 991,940 | 40,147 |
| Licenses, permits and other local taxes | 530,000 | 772,777 | 911,240 | 138,463 |
| Charges for services | 39,780 | 19,333 | 21,948 | 2,615 |
| Intergovernmental | 3,086,371 | 3,089,706 | 3,195,116 | 105,410 |
| Rent of property | 31,700 | 22,030 | 25,845 | 3,815 |
| Fines and forfeitures | 8,000 | 5,668 | 6,968 | 1,300 |
| Interest | 100,000 | 217,546 | 317,192 | 99,646 |
| Miscellaneous | 145,000 | 33,297 | 77,944 | 44,647 |
| Municipal sales and use tax | - | <u>257,222</u> | <u>417,262</u> | <u>160,040</u> |
| Total revenues | <u>7,842,987</u> | <u>8,439,508</u> | <u>9,152,019</u> | <u>712,511</u> |
| Budget carryover (1) | - | <u>760,587</u> | <u>760,587</u> | - |
| Total revenues after carryover | <u>7,842,987</u> | <u>9,200,095</u> | <u>9,912,606</u> | <u>712,511</u> |
| EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES: | | | | |
| FINANCING USES: | | | | |
| Current: | | | | |
| General government | 4,462,911 | 5,578,386 | 5,400,813 | 177,573 |
| Public safety | 283,318 | 312,489 | 308,757 | 3,732 |
| Public works | 1,616,253 | 1,782,756 | 1,742,000 | 40,756 |
| Health and welfare | 1,238,972 | 1,268,937 | 1,238,577 | 30,360 |
| Culture and recreation | 223,236 | 241,826 | 237,826 | 4,000 |
| Economic development | <u>18,297</u> | <u>15,701</u> | <u>15,464</u> | <u>237</u> |
| Total expenditures, encumbrances and other financing uses | <u>7,842,987</u> | <u>9,200,095</u> | <u>8,943,437</u> | <u>256,658</u> |
| EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES) | | | <u>\$ 969,169</u> | <u>\$ 969,169</u> |
| Explanation of Differences: | | | | |
| Sources/inflows of resources: | | | | |
| Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule | | | | \$ 9,912,606 |
| Differences-budget to GAAP: | | | | |
| Budgeted carryover | | | | (760,587) |
| GAAP adjustments to revenues | | | | <u>13,834</u> |
| Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances | | | | <u>\$ 9,165,853</u> |
| Uses/outflows of resources: | | | | |
| Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule | | | | \$ 8,943,437 |
| Differences-budget to GAAP: | | | | |
| Prior year encumbrances recorded as current year expenditures for GAAP basis | | | | 281,377 |
| Current year encumbrances recorded as expenditures for budgetary purposes | | | | <u>(620,421)</u> |
| Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances | | | | <u>\$ 8,604,393</u> |

(1) Represents fund balance carried over from prior year

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2007

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2007 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2007.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2007

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u> |
|---|----------------------------|---|-------------------------|
| U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT: | | | |
| Direct Program: | | | |
| Section 8 Housing Choice Vouchers | 14.871 | | \$ 415,954 |
| Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs: | | | |
| Community Development Block Grants - State's Program | 14.228 | 06-AB, FC-41 05-AB 04-AB, FC-41 03-AB, FC-41 02-AB, FC-41 01-FD-41 00-FD-41 99-FD-41 98-FD-41 94-FD-41 | <u>904,671</u> |
| Total U.S. Department of Housing and Urban Development | | | <u>1,320,625</u> |
| U.S. DEPARTMENT OF JUSTICE: | | | |
| Pass-through the Commonwealth of Puerto Rico - Department of Justice | | | |
| Edward Byrne Memorial Justice Assistance Grant Program | 16.738 | 2005-DJ-00CVL-01 | <u>15,770</u> |
| Total U.S. Department of Justice | | | <u>15,770</u> |
| U.S. DEPARTMENT OF TRANSPORTATION: | | | |
| Pass-through the Commonwealth of Puerto Rico - Traffic Safety Commission | | | |
| State and Community Highway Safety | 20.600 | Not Available | <u>55,555</u> |
| Total U.S. Department of Transportation | | | <u>55,555</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2007

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u> |
|---|------------------------------------|---|----------------------------|
| U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES: | | | |
| Pass-through the Commonwealth of Puerto Rico - Governor's Office (Elderly Office): | | | |
| Special Programs for the Aging - Title III, Part B, Grants for Supportive Services and Senior Centers | 93.044 | Not Available | 98,659 |
| Nutrition Services Incentive Program | 93.053 | Not Available | 20,798 |
| Pass-through the Commonwealth of Puerto Rico - Family Department: | | | |
| Community Service Block Grant | 93.569 | Not Available | 19,591 |
| Child Care and Development Block Grant | 93.575 | Not Available | <u>194,679</u> |
| Total U.S. Department of Health and Human Services | | | <u>333,727</u> |
| U.S DEPARTMENT OF HOMELAND SECURITY: | | | |
| Pass-through the Commonwealth of Puerto Rico Governor Office - Public Security Affair Office | | | |
| Homeland Security Grant Program | 97.067 | Not Available | <u>4,114</u> |
| Total U.S. Department of Homeland Security | | | <u>4,114</u> |
| TOTAL EXPENDITURES OF FEDERAL AWARDS | | | <u>\$ 1,729,791</u> |

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2007

1. BASIS OF PRESENTATION:

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

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund – Other Federal Grants and in the Other Governmental Funds in the Municipality’s fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

| Description | Special Revenue Fund - Other Federal Grants | Other Governmental Funds | Total |
|--|--|--------------------------------|---------------------|
| Per Schedule of Expenditures of Federal Awards | \$ 1,313,837 | \$ 415,954 | \$ 1,729,791 |
| Non federal programs expenditures | <u> </u> | <u>10,612</u> | <u>10,612</u> |
| Total expenditures in the general purpose financial Statements | <u>\$ 1,313,837</u> | <u>\$ 426,566</u> | <u>\$ 1,740,403</u> |



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

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

**To the Honorable Mayor
and the Municipal Legislature
Municipality of Luquillo
Luquillo, 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 Luquillo, Puerto Rico**, as of and for the year ended June 30, 2007, which collectively comprise the **Municipality's** basic financial statements and have issued our report thereon dated November 16, 2007, which was unqualified. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

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

We also noted certain other matters that we reported to management of the Municipality of Luquillo in a separate letter dated November 16, 2007.

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

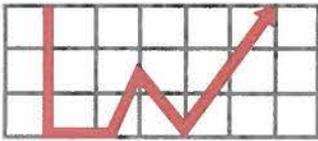
This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.


LÓPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
November 16, 2007

Stamp No. 2312121 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.





López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

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

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

Compliance

We have audited the compliance of the **Municipality of Luquillo** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. The **Municipality of Luquillo's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Luquillo's** management. Our responsibility is to express an opinion on the **Municipality of Luquillo'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 the **Municipality of Luquillo's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the **Municipality of Luquillo's** compliance with those requirements.

In our opinion, the **Municipality of Luquillo** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007. 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 **07-02** through **07-05**.

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

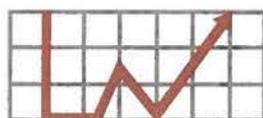
Internal Control Over Compliance

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

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

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items **07-02** through **07-05** to be significant deficiencies.

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



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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

The **Municipality of Luquillo's** response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit **Municipality of Luquillo's** response and, accordingly, we express no opinion on it.

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Luquillo** in a separate letter dated February 26, 2008.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
February 26, 2008

Stamp No. 2312122 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2007

Section I – Summary of Auditor’s Results

Financial Statements

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

Federal awards

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

Identification of major programs:

| CFDA Number | Name of Federal Program or Cluster |
|-------------|--|
| 14.228 | Community Development Block Grants – State’s Program |
| 14.871 | Section 8 Housing Choice Voucher |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section II - Financial Statements Findings

| | |
|--|--|
| Finding Reference | 07-01 |
| Requirement | Financial Reporting - Accounting Records |
| Statement of Condition | During our examination of the Municipality's accounting system, we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal funds). |
| Criteria | Chapter VIII, Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system. |
| Cause of Condition | The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record. |
| Effect of Condition | The Municipality's accounting system did not provide updated and complete financial information that present the financial position, the result of operations and the change in fund balances. Such information is necessary to take management decisions. |
| Recommendation | We recommend that the Municipality should implement the necessary internal controls and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, expenditures, interfund transactions, etc. |
| Questioned Cost | None |
| Management Response and Corrective Action | The Municipality maintains two set of accounting records; a manual system and a computerized system provided in the past by the Office of the Commissioner of Municipal Affairs (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section II - Financial Statements Findings

Finding Reference **07-01 (Continued)**

Nevertheless, as part of the corrective action plan, the Commissioner of Municipal Affairs ("OCAM") consider alternatives to improve the accounting system, including the acquisition of new accounting software, and therefore, we will hope to solve our accounting system condition in a near future. Although, the Legislature of the Commonwealth Government of Puerto Rico has appropriated funds for the design and implementation of a new system, no further action has been taken on this matter.

Implementation Date: July, 2009

Responsible Persons: Annette Caraballo
Finance Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

| | |
|--|--|
| Finding Reference | 07-02 |
| Program | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development |
| Requirement | Cash Management |
| Statement of Condition | We realized a Cash Management Test and after our procedures, we found that during the current fiscal year, the Municipality maintained a monthly average cash balance in books of, approximately, \$121,233. Also, at June 30, 2007, the cash balance in book was \$125,728. |
| Criteria | OMB Common Rules, Subpart C, Section .20 (b) (7), requires a cash management system; in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by the grantee. |
| Cause of Condition | The Municipality did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs. |
| Effect of Condition | The PHA did not comply with the OMB Common Rules, Subpart C, Section .20 (b) (7). |
| Recommendation | We recommend to the Municipality's management to instruct the program accountant to review the accounting records and related transactions supporting documents for the current and past years, in order to identify the cash balance respects to its origin, and later, to make any necessary adjusting journal entries to correct accounting records. |
| Questioned Costs | None |
| Management Response and Corrective Action | As part of our corrective action plan, the Program's accountant reviewed current and past cash transactions, in order to record the necessary accounting adjustments and properly present the financial position and the result of the Program's operation. As of March 27, 2008, the accountant has substantially identified the origin of the adjusted cash balance amount maintained by Program at June 30, 2007. Implementation Date: March, 2008 Responsible Person: Yazmin Maldonado Program Accountant |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 07-03 |
| Program | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development |
| Requirement | Eligibility of Individuals |
| Statement of Condition | <p>We performed an eligibility test of fifteen (15) participant files and found the following exceptions:</p> <ul style="list-style-type: none">a. In eleven (11) cases, the PHA used an incorrect utility allowance for the HAP calculation;b. In one (1) case, the PHA used an incorrect Fair Market Rent allowance for the HAP calculation;c. In one (1) case, the PHA used an incorrect family income for the HAP calculation. |
| Criteria | <p>Code of Federal Regulations 24, Subpart K, Section 982.505 establish the procedures to be followed in order to calculate the Housing Assistance Payment. Also, the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6) establishes procedures for the HAP calculation.</p> |
| Cause of Condition | <p>The PHA controls and procedures failed to assure that all HAP's payments are duly computed by the program staff.</p> |
| Effect of Condition | <p>The PHA is not in compliance with Code of Federal Regulations 24, Subpart K, Section 982.505 and with the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6).</p> |
| Recommendation | <p>We recommend the PHA to strengthen it's monitoring procedures to assure that the Housing Assistance Payments are duly computed as required by the Federal Regulations. Also, we recommend that the PHA must verify the tenant files to determine which families required adjustments in their rents, and adjust them retroactively to the date of the last reexamination, if need.</p> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 07-03 (Continued)

Questioned Costs None.

**Management Response
and Corrective Action**

The Municipality's management concurs with the finding. During the fiscal year 2007-2008, we gave instructions to the program staff to correct the situations commented in the finding.

Implementation Date: July 2008

Responsible Person: Nelson Márquez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Finding and Questioned Cost

| | |
|-------------------------------|--|
| Finding Reference | 07-04 |
| Program | Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM) |
| Requirement | Allowable Activities |
| Statement of Condition | <p>We performed a housekeeper activities test of seven (7) participant’s files and found the following exceptions:</p> <ul style="list-style-type: none">a) In seven (7) participant’s files, there was no evidence that the Service Coordinator visited, at least twice per month, the participant’s housing unit to ensure the quality of services;b) In one (1) participant’s file, there was no supporting evidence of the income reported;c) In one (1) participant’s file, there was no evidence of the contract between the Municipality and the participant, establishing the service plan to be offered (Form OCAM-AH-005). |
| Criteria | Code of Federal Regulations 24, Section 570.484 states that the Municipality must assure that the program funds benefit very low, low- and moderate income persons and retain documentation justifying its certification. Also, the Municipality has an operational guide that includes all procedures and program’s requirements for housekeeper activities. |
| Cause of Condition | The Municipality’s controls and procedures failed to assure that the participant’s files include all the required documents to comply with the program requirements. |
| Effect of Condition | The Municipality is not in noncompliance with Code of Federal Regulations 24, Section 570.484 and with the operational guide. |
| Recommendation | We recommended management to follow the procedures established in the operational guide “Guía Operacional para la Prestación del Servicio de Auxiliares del Hogar”, including the use of the forms included on it. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **07-04 (Continued)**

Questioned Costs None

**Management Response
and Corrective Action** We will take the following measures to correct the finding: (a) We will notify the responsible person to proceed according with established regulations, and (b) we will establish a quality control program.

Implementation Date: April, 2008

Responsible Person: Nelson Márquez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

Section III – Major Federal Award Program Findings and Questioned Costs

| | |
|--|--|
| Finding Reference | 07-05 |
| Program | Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM) |
| Requirement | Procurement |
| Statement of Condition | In our procurement test, we noted that for three (3) professional service contracts for design and supervision of constructions’ works, the Municipality did not document the contractors’ selection or rejection process. |
| Criteria | Common Rule Subpart C __.36 (9) states that grantees and subgrantees will maintain records sufficient to detail the significant history of procurement. These records will include, but are not necessarily limited to the following; rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price. |
| Cause of Condition | The Municipality internal control procedures failed to assure that proper documentation detailing procurement and contractor selection or rejection process is maintained for each project. |
| Effect of Condition | The Municipality is not in compliance with Common Rule Subpart C __.36 (9). |
| Recommendation | We recommend management to maintain detailed files documenting the public notice requesting professional services, the quotations received for each project and the subsequent analysis to select or reject a contractor. |
| Questioned Costs | None |
| Management Response and Corrective Action | The Municipality Management concurs with the finding. The program staff will be instructed to maintain detailed files documenting the public notice requesting professional services, the quotations received for each project, and the subsequent analysis to select or reject a contractor. Implementation Date: July, 2008 Responsible Person: Nelson Márquez Federal Program Director |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2007

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|---|
| 06-03 | 14.871 | <p><u>The auditors realized a Cash Management Test and after the procedures, they found that the Municipality maintained during the current fiscal year, average cash balance in books of approximately \$124,212. At June 30, 2006, the cash balance in book was \$118,303. Of these funds, \$2,967 was from operating reserve, \$44,435 was from Family Self Sufficiency's program (related to the balance not yet spent), \$5,509 was received from renter's frauds identified by the program, \$4,513 was from incorrect deposits by HUD, \$22,838 was from funds not used for Administrative fees, \$5,000 was from funds not used for Audit fees, \$160 was from accumulated interest and the remaining \$32,881 was not identified by the auditors with respect to its origin.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-02.</p> |
| 06-04 | 14.228 | <p><u>The auditors performed a housekeeper activities test of seven (7) participant's files and found the following exceptions: (a) In six (6) participant's files, there was no evidence the Service Coordinator visit at least two times per month the participant housing unit to ensure the quality of services; (b) In one (1) participant's file, there was no evidence of the approval form (OCAM-AH-004A); (c) In five (5) participant's files, there was no evidence of the participation contract between the Municipality and the participant, establishing the service plan to be offered (OCAM-AH-005).</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-04.</p> |
| 06-05 | 14.228 | <p><u>The auditors performed a cash disbursement test and examined thirty one (31) disbursement vouchers which belonged to Community Development Block Grants - State Program. The following will summarize the internal control exceptions noted: (a) The Municipality did not reserve the necessary budgetary credits for the payment of services, at the time of formalizing contracts (seven (7) disbursement vouchers); (b) Nine (9) disbursement vouchers did not have all of its supporting documents stamped as paid.</u></p> <p>Full corrective action has been taken.</p> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|---|
| 06-06 | 14.228 | <p><u>During the cash management test, the auditors noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, the program cash account maintained a monthly average cash balance of \$71,608 in books.</u></p> <p>Full corrective action has been taken.</p> |
| 05-03 | 14.871 | <p><u>The Cash Management Test revealed that the Municipality maintained during fiscal year 2005-2006, average cash balance in books of approximately \$85,749. At June 30, 2005, the cash balance in book was \$75,663. Of these funds, \$2,967 was from operating reserve, \$31,500 was from Family Self Sufficiency's program (related to the balance not yet spent), and the remaining \$41,196 was not identified by the auditors with respects to its origin.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-02.</p> |
| 05-04 | 14.871 | <p><u>The eligibility test of fifteen (15) participant files revealed the following exceptions: a) in one (1) case, the PHA paid an incorrect Housing Assistance Payment to the owner, as result, during the fiscal year 2004-2005, the program paid a HAP to the owner of \$3,489 instead of \$3,540; b) in four (4) cases, the PHA used an incorrect utility allowance for the HAP calculation and, in one (1) of these cases, an incorrect Fair Market Rent was used for the HAP calculation.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-03.</p> |
| 05-07 | 14.228 | <p><u>The housekeeper activities test of six (6) participant's files revealed the following exceptions: a) in three (3) participant's files, there was no evidence of the copy of the social security; b) in one (1) participant's file, there was no evidence of the birth certificate; c) in one (1) participant's file, there was no evidence of the approval form (OCAM-AH-004A); d) in six (6) participant's files, there was no evidence of the participation contract between the Municipality and the participant, establishing the service plan to be offered (OCAM-AH-005).</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 07-04.</p> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|---|
| 05-08 | 14.228 | <p><u>The cash disbursement test of twenty one (21) disbursement vouchers which belonged to Community Development Block Grants - State's Program revealed the following exceptions: a) in one (1) disbursement voucher, the purchase order was issued after the receiving of goods of services; b) one (1) disbursement voucher did not include the three (3) quotations required by law; c) ten (10) disbursement vouchers did not include all supporting document marked as paid.</u></p> <p>Full corrective action has been taken.</p> |
| 05-09 | 14.228 | <p><u>The cash management test revealed that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, the program cash account maintained a monthly average cash balance of \$82,364 in books.</u></p> <p>Full corrective action has been taken.</p> |
| 05-10 | 14.228 | <p><u>The contract provision test of two (2) contracts for the Community Development Block Grants - State's Program, formalized during the fiscal year ended June 30, 2005, revealed the following situations: a) two (2) contracts did not include a provision for compliance with the Clean Air Act and Water Act; b) two (2) contracts did not include a provision for granting access to GAO or other Federally Agency, to books, documents, etc; c) two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act; d) two (2) contracts did not include provision for retention of all required records for three years; e) two (2) contracts did not include a provision for compliance with suspension and debarment.</u></p> <p>Full corrective action has been taken.</p> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|--|
| 04-02 | 14.871 | <p><u>The PHA maintained, during the current fiscal year, average cash balance in books of approximately \$78,254. At June 30, 2004, the cash balance in book was \$63,385; \$3,495 of these funds was from HUD overpayment during the fiscal year 2003-2004 as determined in the preliminary year-end settlement; \$7,399 was from operating reserve at June 30, 2004; and the remaining \$52,491 was not identified with respects to its origin.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p> |
| 04-05 | 14.228 | <p><u>Three (3) housekeeping assistance project participant's files did not have copy of the social security of the family members. Also, five (5) participant's files did not have complete evidence to support medical expenditures of the participant; eight (8) participant's files did not have evidence of the approval form (OCAM-AH-004A); eight (8) participant's files did not have the participation contract between the Municipality and the participant, establishing the service plan to be offered (OCAM-AH-005) and; in seven (7) cases, the Service Coordinator visited approximately one time every two month the participant house to ensure the quality of services. Also, the Service Coordinator did not use the OCAM-AH-006 when visited the participant housing unit.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p> |
| 04-07 | 14.228 | <p><u>Procurement test - Two (2) contracts did not include a provision for compliance with the Clean Air Act and Water Act; three (3) contracts did not include a provision for compliance with Energy Policy and Conservation Act and; one (1) contract did not include provisions for retention of all required records for three years.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2007

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|---|
| 04-11 | 93.575 | <p><u>No evidence was maintained of the submission by the Municipality of the Equipment Inventory and the Trial Balance as of September 30, 2003 and September 30, 2004, respectively. Also, no evidence was found of the submission date of the Annual Closing Report (CC-006) for the program fiscal years ended September 30, 2003 and September 30, 2004.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p> |

OFICINA DEL COMISIONADO
MUNICIPALES
08-446
21 JAN 22 PM 1:19
UNIDAD DE CORREO

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED JUNE 30, 2007

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2007

CONTENTS

| | Page |
|---|-------|
| <u>BASIC FINANCIAL STATEMENTS</u> | |
| Independent Auditors' Report | 1-2 |
| Required Supplementary Information (Part 1) Management's Discussion and Analysis | 3-12 |
| Government-Wide Financial Statements: | |
| Statement of Net Assets | 13 |
| Statement of Activities | 14 |
| Fund Financial Statements: | |
| Governmental Funds: | |
| Balance Sheet | 15 |
| Statement of Revenues, Expenditures and Changes in Fund Balance | 16 |
| Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities | 17 |
| Notes to basic financial statements | 18-41 |
| <u>SUPPLEMENTARY INFORMATION</u> | |
| Required Supplementary Information (Part II): | |
| Budgetary Comparison Schedule-General Fund | 42 |
| Notes to Budgetary Comparison Schedule-General Fund | 43 |



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

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

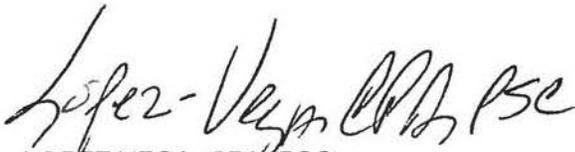
We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo, Puerto Rico** (the Municipality) as of and for the year ended June 30, 2007, which collectively comprise the Municipality's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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

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

INDEPENDENT AUDITORS' REPORT (CONTINUED)

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule-General Fund on page 42 and 43 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
November 16, 2007

Stamp No. 2196023 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2007

This discussion and analysis of the **Municipality of Luquillo** (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2007. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2006, second year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements - and Management's Discussion and Analysis- for State and Local Governments.*" This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the fiscal year 2006-2007, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2007 constitute factual evidence of the Municipality's economic strength by the end of such year. The following comments deserve special mention:

1. At the end of fiscal year 2007, total liabilities amounted to \$11,843,808. Out of said amount, \$10,153,301 corresponded to long-term liabilities of which \$7,534,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
2. Total net assets of the Municipality amounted to \$26,022,557 which represents an increase of 17% compared to prior fiscal year;
3. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$14,515,740, derived from the following sources: \$54,762 charges for services; \$2,222,833 from operating grants and contributions; \$2,327,586 from capital grants and contributions obtained from other sources, and \$9,910,559 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL HIGHLIGHTS (CONTINUED)

4. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$10,644,874;
5. As reflected in the Statement of Activities, the current fiscal year operations contributed to the increase in the Net Assets Figure by \$3,870,866;
6. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$8,054,584;
7. At the end of the current fiscal year, the Municipality's General Fund balance amounted to \$3,186,045. It is pertinent to note that it is the municipal administration's contention that the importance of such figure should not be overestimated since it has adopted the policy to use internal generated resources to increase services to Municipality's community rather than let them unused in the accounted records;
8. The actual General Fund budgetary activities resulted in a favorable balance of \$969,169 which is indicative of full compliance with the balanced budget principle applicable to all municipalities of the Commonwealth Government of Puerto Rico as required by the Municipal Autonomous Act enacted in August 1991.
9. In response to the continued increments in the municipal operating revenues, the Municipal Legislature approved a revision to the General Fund Budget for fiscal year 2007 which amounted to \$596,521.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2007. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL STATEMENTS COMPONENTS

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

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

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

A brief review of the Statement of Activities of the Municipality at June 30, 2007, shows total expenses incurred to afford the cost of all functions and programs amounted to \$10,644,874. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$4,605,181 was derived from the following sources: \$54,762 charges for services; \$2,222,833 from operating grants and contributions; and \$2,327,586 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$9,910,559. When such figure is added to the \$4,605,181 previously mentioned, total revenues available for the financing of activities amounted to \$14,515,740. There was an excess of revenues over expenses in the amount of \$3,870,866 which contributed to the figure of net assets attained at the end of the fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

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

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As explained in the Capital Assets and Debt Administration Section of this MD&A, on July 1, 2002, the Municipality commenced partially the prospective reporting of infrastructure assets. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

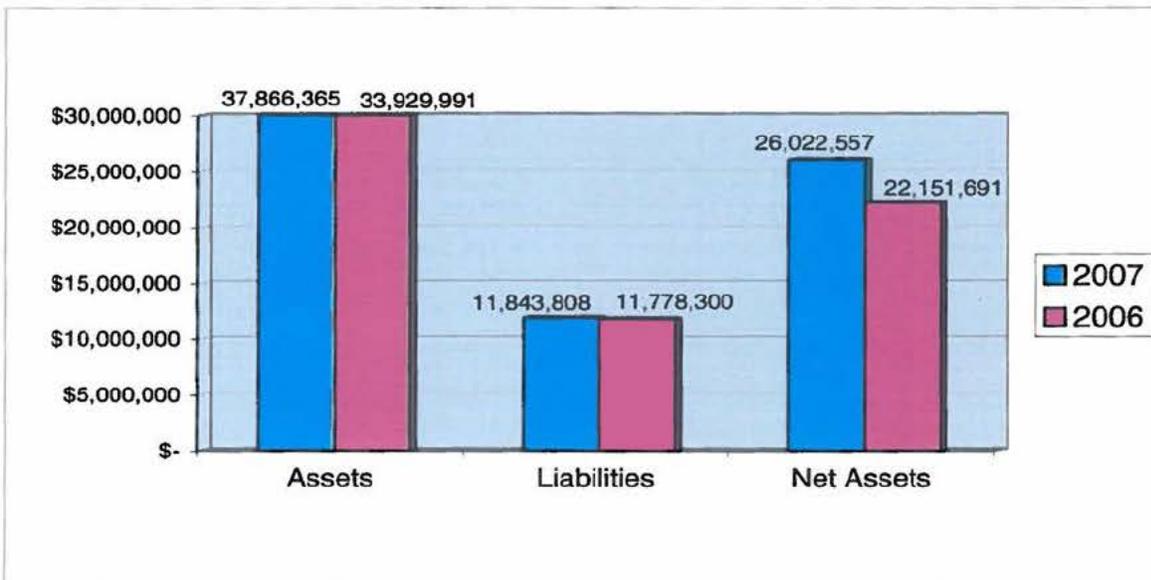
YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the **Municipality of Luquillo**, primary government assets exceeded total liabilities by \$26,022,557 at the end of 2007, compared to \$22,151,691 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

| Condensed Statement of Net Assets | 2007 | 2006 | Change | % |
|---|----------------------|----------------------|---------------------|------------|
| Current and other assets | \$ 9,443,106 | \$ 7,767,128 | \$ 1,675,978 | 22% |
| Capital assets | 28,423,259 | 26,162,863 | 2,260,396 | 9% |
| Total assets | 37,866,365 | 33,929,991 | 3,936,374 | 12% |
| Current and other liabilities | 1,690,507 | 2,287,675 | (597,168) | (26%) |
| Long-term liabilities | 10,153,301 | 9,490,625 | 662,676 | 7% |
| Total liabilities | 11,843,808 | 11,778,300 | 65,508 | 1% |
| Invested in capital assets, net of related debt | 21,799,259 | 20,283,113 | 1,516,146 | 7% |
| Restricted | 4,737,067 | 2,916,610 | 1,820,457 | 62% |
| Unrestricted deficit | (513,769) | (1,048,032) | 534,263 | (51%) |
| Total net assets | \$ 26,022,557 | \$ 22,151,691 | \$ 3,870,866 | 17% |



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2007, the net effect of the revenues derived from several programs plus current operating revenues compared to the total expense, amounted to \$3,870,866. Approximately 52 percent of the Municipality's total revenues resulted from grants and contributions, including federal aid, while 44 percent came from taxes. The largest expenses were for general government, health and welfare, and public works. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

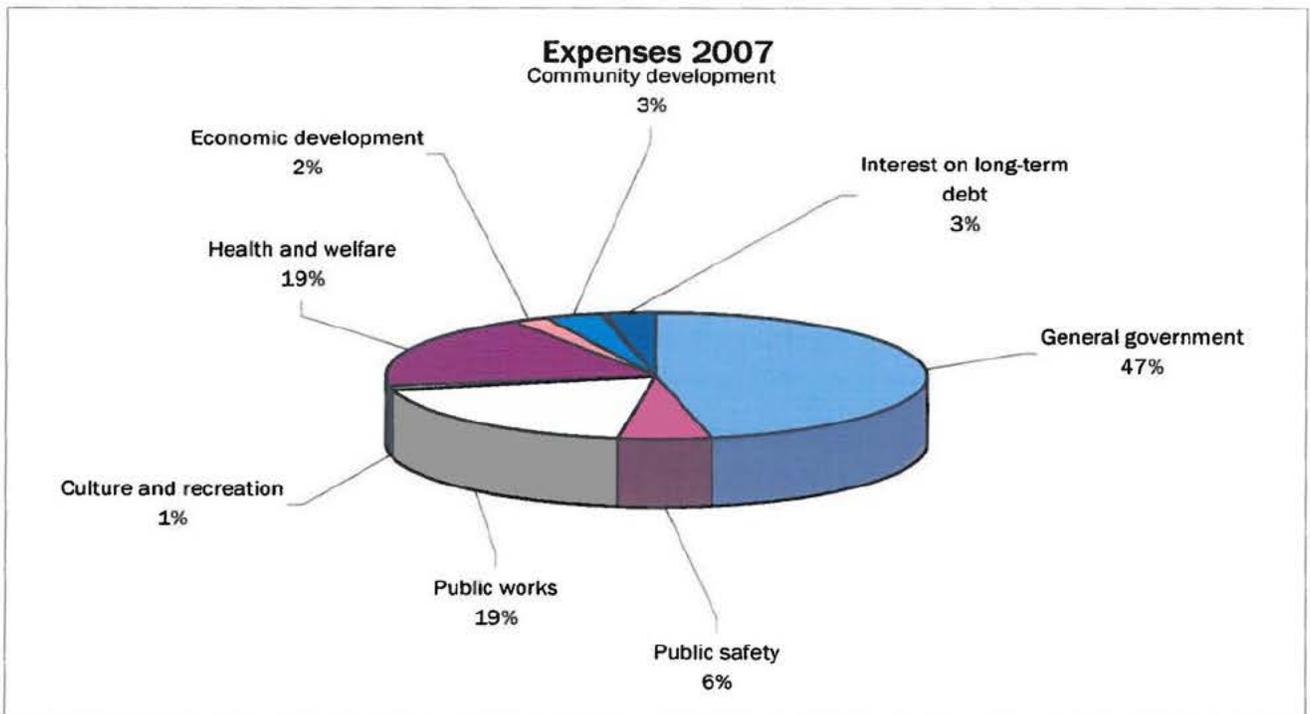
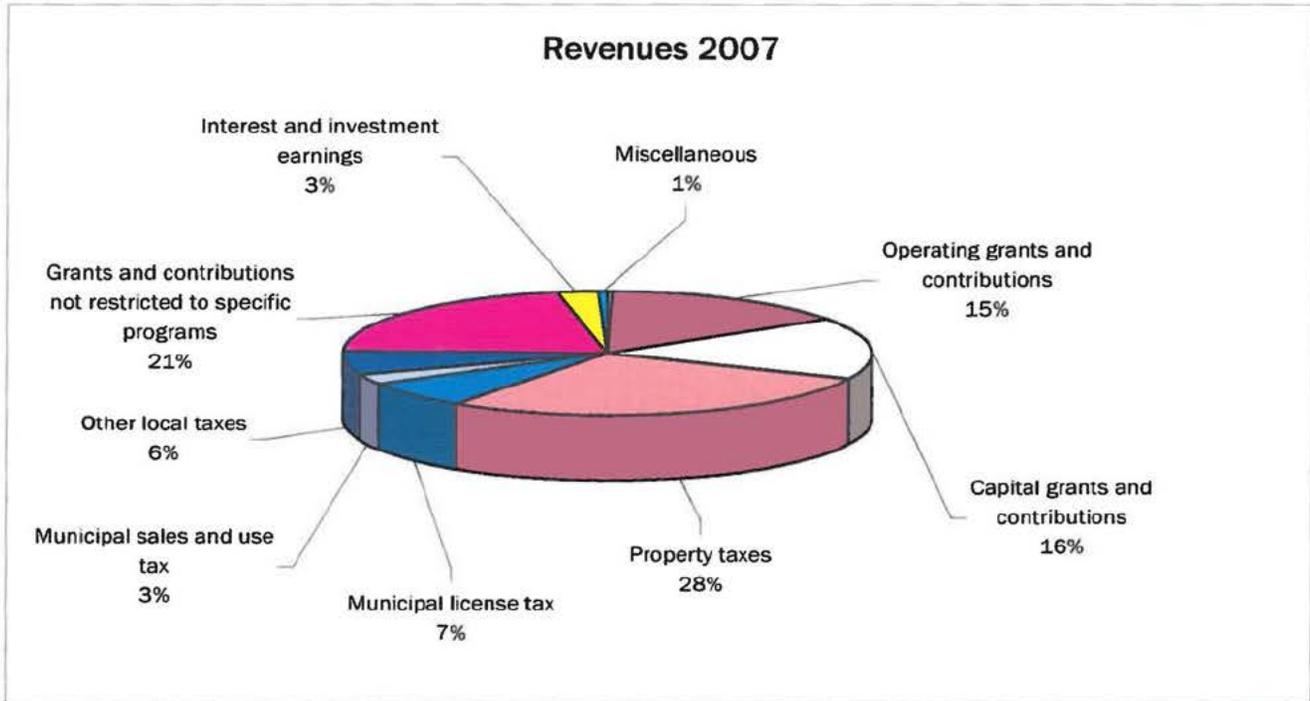
| Condensed Statement of Activities | 2007 | 2006 | Change | % |
|--|----------------------|----------------------|---------------------|--------------|
| Program revenues: | | | | |
| Charges for services | \$ 54,762 | \$ 96,331 | \$ (41,569) | (43%) |
| Operating grants and contributions | 2,222,833 | 2,082,098 | 140,735 | 7% |
| Capital grants and contributions | 2,327,586 | 224,723 | 2,102,863 | 936% |
| General revenues: | | | | |
| Property taxes | 4,056,119 | 3,912,762 | 143,357 | 4% |
| Municipal license tax | 996,690 | 922,998 | 73,692 | 8% |
| Municipal sales and use tax | 404,196 | | 404,196 | 100% |
| Other local taxes | 911,240 | 857,914 | 53,326 | 6% |
| Grants and contributions not restricted to specific programs | 3,081,780 | 3,110,566 | (28,786) | (1%) |
| Interest and investment earnings | 382,209 | 229,903 | 152,306 | 66% |
| Miscellaneous | 78,325 | 86,873 | (8,548) | (10%) |
| Total revenues | 14,515,740 | 11,524,168 | 2,991,572 | 26% |
| Expenses: | | | | |
| General government | 4,961,482 | 4,769,529 | 191,953 | 4% |
| Public safety | 601,216 | 561,698 | 39,518 | 7% |
| Public works | 2,039,419 | 2,539,988 | (500,569) | (20%) |
| Culture and recreation | 109,298 | 386,209 | (276,911) | (72%) |
| Health and welfare | 1,991,193 | 2,036,672 | (45,479) | (2%) |
| Economic development | 232,030 | 227,505 | 4,525 | 2% |
| Community development | 342,893 | 364,730 | (21,837) | (6%) |
| Education | 35,114 | - | 35,114 | 100% |
| Interest on long-term debt | 332,229 | 314,505 | 17,724 | 6% |
| Total expenses | 10,644,874 | 11,200,836 | (555,962) | (5%) |
| Change in net assets | 3,870,866 | 323,332 | 3,547,534 | 1097% |
| Net assets, beginning of year, as restated | 22,151,691 | 21,828,359 | 323,332 | 1% |
| Net assets, end of year | \$ 26,022,557 | \$ 22,151,691 | \$ 3,870,866 | 17% |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

As noted 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 balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$8,054,584, an increase of \$2,259,281 in comparison with the prior year. There are reservations of fund balance amounting to \$5,563,148. This is the fund balance that is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$663,500), 2) to pay debt service (\$1,983,339), 3) to pay for capital projects (\$1,678,959) and 4) for other purposes (\$1,237,350).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2007, the general fund has an undesignated fund balance of \$2,491,436.

GENERAL FUND BUDGETARY HIGHLIGHTS

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

In response to the increments in the municipal operating revenues, the Municipal Legislature approved a revision to the General Fund Budget for fiscal year 2007 which amounted to \$596,521. Such increments were used to provide further increases in capital assets and for the extension of several municipal services to Luquillo's communities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2007, amounts to \$38,475,533, with an accumulated depreciation of \$10,052,274 (including \$783,355 of current year depreciation expense), leaving a net book value of \$28,423,259. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure, furnishing, computers and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2007, the Municipality has \$281,953 of unexpended proceeds from bond and notes issuances that are committed to future construction activities.

Debt Administration

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2007

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2007-2008.

FINAL COMMENTS

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

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2007. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 1012, Luquillo, Puerto Rico 00773-1012, or call (787) 889-2068.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Net Assets
June 30, 2007

| | Governmental Activities |
|--|------------------------------------|
| Assets | |
| Cash and cash equivalents | \$ 5,336,361 |
| Cash with fiscal agent | 3,737,229 |
| Accounts receivable: | |
| Municipal license tax | 4,750 |
| Municipal sales and use tax | 49,486 |
| Intergovernmental | 291,332 |
| Interest | 23,948 |
| Capital assets | |
| Land, improvements, and construction in progress | 14,575,519 |
| Other capital assets, net of depreciation | 13,847,740 |
| Total capital assets | <u>28,423,259</u> |
| Total assets | <u>37,866,365</u> |
| Liabilities | |
| Accounts payable and accrued liabilities | 649,235 |
| Due to other governmental entities | 86,506 |
| Deferred revenues: | |
| Municipal license tax | 628,080 |
| Federal grant revenues | 164,105 |
| Intergovernmental | |
| Other | |
| Interest payable | 162,581 |
| Noncurrent liabilities: | |
| Due within one year | 735,498 |
| Due in more than one year | 9,417,803 |
| Total liabilities | <u>11,843,808</u> |
| Net Assets | |
| Invested in capital assets, net of related debt | 21,799,259 |
| Restricted for: | |
| Capital projects | 1,678,959 |
| Debt service | 1,820,758 |
| Other purposes | 1,237,350 |
| Unrestricted (deficit) | <u>(513,769)</u> |
| Total net assets | <u>\$ 26,022,557</u> |

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

**Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Activities
For the Year Ended June 30, 2007**

| Functions/Programs | Expenses | Program Revenues | | | Net (Expense) Revenue and |
|--|----------------------|------------------|---------------------|---------------------|---------------------------|
| | | Charges for | Operating | Capital | Changes in Net Assets |
| | | Services | Grants and | Grants and | Governmental |
| | | | Contributions | Contributions | Activities |
| General government | \$ 4,961,482 | \$ - | \$ 113,335 | \$ - | \$ (4,848,147) |
| Public safety | 601,216 | 6,968 | 120,332 | | (473,916) |
| Public works | 2,039,419 | 17,030 | 7,700 | 2,280,991 | 266,302 |
| Health and welfare | 1,991,193 | 8,219 | 813,196 | 41,895 | (1,127,883) |
| Culture and recreation | 109,298 | 13,700 | 57,123 | 4,700 | (33,775) |
| Economic development | 232,030 | 8,845 | 206,476 | | (16,709) |
| Community development | 342,893 | | 904,671 | | 561,778 |
| Education | 35,114 | | | | (35,114) |
| Interest on long-term debt | 332,229 | | | | (332,229) |
| Total governmental activities | \$ 10,644,874 | \$ 54,762 | \$ 2,222,833 | \$ 2,327,586 | \$ (6,039,693) |
| General revenues: | | | | | |
| Property taxes | | | | | 4,056,119 |
| Municipal license tax | | | | | 996,690 |
| Municipal sales and use tax | | | | | 404,196 |
| Other local taxes | | | | | 911,240 |
| Grants and contributions not restricted to specific programs | | | | | 3,081,780 |
| Interest and investment earnings | | | | | 382,209 |
| Miscellaneous | | | | | 78,325 |
| Total general revenues | | | | | 9,910,559 |
| Change in net assets | | | | | 3,870,866 |
| Net assets - beginning, as restated | | | | | 22,151,691 |
| Net assets - ending | | | | | \$ 26,022,557 |

Commonwealth of Puerto Rico
Municipality of Luquillo
Balance Sheet
Governmental Funds
June 30, 2007

| | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total Governmental Funds |
|---|---------------------|---|---|--|-------------------------|--------------------------------|--------------------------------|
| Assets | | | | | | | |
| Cash and cash equivalents | \$ 3,163,231 | \$ 641,629 | \$ 168,231 | \$ 1,237,542 | \$ - | \$ 125,728 | \$ 5,336,361 |
| Cash with fiscal agent | | 1,128,205 | 129,046 | 498,762 | 1,981,216 | | 3,737,229 |
| Accounts receivable: | | | | | | | |
| Municipal license tax | 4,750 | | | | | | 4,750 |
| Municipal sales and use tax | 49,486 | | | | | | 49,486 |
| Intergovernmental | 44,225 | 81,476 | 150,116 | | 15,515 | | 291,332 |
| Interest | 16,544 | | | | 7,404 | | 23,948 |
| Due from other funds | 1,016,972 | | | | | | 1,016,972 |
| Total assets | \$ 4,295,208 | \$ 1,851,310 | \$ 447,393 | \$ 1,736,304 | \$ 2,004,135 | \$ 125,728 | \$ 10,460,078 |
| Liabilities and Fund Balances | | | | | | | |
| Liabilities : | | | | | | | |
| Accounts payable and accrued liabilities | \$ 351,198 | \$ - | \$ 115,254 | \$ - | \$ - | \$ - | \$ 466,452 |
| Due to other governmental entities | 86,506 | | | | | | 86,506 |
| Due to other funds | | 767,360 | 168,034 | 57,345 | 20,796 | 3,437 | 1,016,972 |
| Deferred revenues: | | | | | | | |
| Municipal license tax | 628,080 | | | | | | 628,080 |
| Intergovernmental | 43,379 | | | | | | 43,379 |
| Federal grant revenues | | | 164,105 | | | | 164,105 |
| Total liabilities | 1,109,163 | 767,360 | 447,393 | 57,345 | 20,796 | 3,437 | 2,405,494 |
| Fund balances: | | | | | | | |
| Reserved for: | | | | | | | |
| Encumbrances | 663,500 | | | | | | 663,500 |
| Capital projects | | | | 1,678,959 | | | 1,678,959 |
| Debt service fund | | | | | 1,983,339 | | 1,983,339 |
| Other purposes | 31,109 | 1,083,950 | | | | | 1,115,059 |
| Reserved reported in nonmajor funds: | | | | | | | |
| Other purposes | | | | | | 122,291 | 122,291 |
| Unreserved: | | | | | | | |
| Undesignated | 2,491,436 | | | | | | 2,491,436 |
| Total fund balances | 3,186,045 | 1,083,950 | - | 1,678,959 | 1,983,339 | 122,291 | 8,054,584 |
| Total liabilities and fund balances | \$ 4,295,208 | \$ 1,851,310 | \$ 447,393 | \$ 1,736,304 | \$ 2,004,135 | \$ 125,728 | |

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

| | |
|--|----------------------|
| Accrual basis of accounting accounts receivable recognized in government-wide financial statements | 43,379 |
| Accrual basis of accounting accounts payable recognized in government-wide financial statements | (182,783) |
| Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds | 28,423,259 |
| Long-term liabilities, including accrued interest payable, are not due and payable in the current period, and therefore, are not reported in the funds | (10,315,882) |
| Net assets of governmental activities | \$ 26,022,557 |

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2007

| | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total Governmental Funds |
|--|---------------------|---|---|--|-------------------------|--------------------------------|--------------------------------|
| Revenues | | | | | | | |
| Property taxes | \$ 3,186,564 | \$ - | \$ - | \$ - | \$ 826,176 | \$ - | \$ 4,012,740 |
| Municipal license taxes | 996,690 | | | | | | 996,690 |
| Municipal sales and use tax | 404,196 | | | | | | 404,196 |
| Licenses, permits and other local taxes | 911,240 | | | | | | 911,240 |
| Charges for services | 21,948 | | | | | | 21,948 |
| Intergovernmental | 3,195,116 | 345,825 | | 2,327,586 | | | 5,868,527 |
| Fines and forfeitures | 6,968 | | | | | | 6,968 |
| Rent of property | 25,845 | | | | | | 25,845 |
| Interest | 338,961 | | | 43,248 | | | 382,209 |
| Federal grants | | | 1,313,837 | | | 435,466 | 1,749,303 |
| Miscellaneous | 78,325 | | | | | 14,370 | 92,695 |
| Total revenues | 9,165,853 | 345,825 | 1,313,837 | 2,370,834 | 826,176 | 449,836 | 14,472,361 |
| Expenditures | | | | | | | |
| Current: | | | | | | | |
| General government | 5,149,494 | 5,160 | | | | | 5,154,654 |
| Public safety | 303,664 | 245,414 | 55,555 | | | | 604,633 |
| Public works | 1,714,247 | 88,743 | | 1,080,562 | | | 2,883,552 |
| Health and welfare | 1,187,810 | 18,776 | 353,612 | | | 426,566 | 1,986,764 |
| Culture and recreation | 233,703 | 35,665 | | 525,330 | | | 794,698 |
| Economic development | 15,475 | 216,787 | | | | | 232,262 |
| Community development | | | 904,670 | | | | 904,670 |
| Education | | | | 35,114 | | | 35,114 |
| Debt service: | | | | | | | |
| Principal | | | | | 417,000 | | 417,000 |
| Interest | | | | | 324,733 | | 324,733 |
| Total expenditures | 8,604,393 | 610,545 | 1,313,837 | 1,641,006 | 741,733 | 426,566 | 13,338,080 |
| Excess (deficiency) of revenues over (under) expenditures | 561,460 | (264,720) | | 729,828 | 84,443 | 23,270 | 1,134,281 |
| Other financing sources (uses) | | | | | | | |
| Long-term debt issued | | 1,125,000 | | | | | 1,125,000 |
| Total other financing sources (uses) | - | 1,125,000 | - | - | - | - | 1,125,000 |
| Net change in fund balances | 561,460 | 860,280 | - | 729,828 | 84,443 | 23,270 | 2,259,281 |
| Fund balance- beginning, as restated | 2,624,585 | 223,670 | | 949,131 | 1,898,896 | 99,021 | 5,795,303 |
| Fund balance- ending | \$ 3,186,045 | \$ 1,083,950 | \$ - | \$ 1,678,959 | \$ 1,983,339 | \$ 122,291 | \$ 8,054,584 |

Commonwealth of Puerto Rico
Municipality of Luquillo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2007

| | |
|---|---------------------|
| Net Change In Fund Balances - Total Governmental Funds | \$ 2,259,281 |
| Amounts reported for governmental activities in the Statement of Activities are different because: | |
| Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. | 3,043,804 |
| Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. | (783,355) |
| Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets, resulting in a loss on disposal of capital assets on the Government-Wide Statement of Activities and Changes in Net Assets. | (53) |
| Interest Payable on long-term debt was reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it did not require the use of current financial resources. Therefore, Interest Payable was not reported as expenditures in Governmental Funds. The following amount represents the change in accrued interest from prior year. | (7,494) |
| Accounts Payable reported in the Government-Wide Statement of Activities and Changes in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. The following amount represents the change in this accounts payable from prior year. | (22,020) |
| Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments. | (708,000) |
| Repayment of long-term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long -term property tax advance debt in the Government-Wide Statement of Net Assets. This is the change in the property tax advance debt in the current period. | 9,528 |
| Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represented the change in long-term compensated absences from prior year. | (94,726) |
| Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenue in the funds. The following amount represents the change in this revenues from prior year. | 43,379 |
| Repayment of long term Puerto Rico Land Authority debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. This is the long term Puerto Rico Land Authority debt paid in the current period. | 89,750 |
| Repayment of long term Land Information Management System (LIMS) is an expenditure in Governmental Funds, but the repayment reduces long term LIMS in the Government-Wide Statement of Net Assets. This is the amount paid in the current period. | 40,772 |
| Change in Net Assets of Governmental Activities | \$ 3,870,866 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2007

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Luquillo** (the Municipality) was founded on the year 1797. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a twelve member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

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

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

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, the Municipality does not have component units to include within its reporting entity.

B. Government-wide and fund financial statements

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

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

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

Special Revenue Fund - State and Local Grants - is the accounting entity in which revenues derived from local funds, state or other restricted revenue source is accounted for the uses and limitations specified by Municipality ordinances or state statutes.

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

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

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

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

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

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

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

Special Revenue Fund – Section 8 – Special Revenue Funds are used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

D. Measurement focus, basis of accounting and financial presentation

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

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

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

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

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

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

E. Assets, liabilities and net assets

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

Cash with fiscal agent in the debt 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. Also, cash with fiscal agent consists of unused proceeds of bonds and notes issued for the acquisition of equipment and construction of major capital improvements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

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

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

Receivables are stated net of estimated allowance for uncollectible accounts, which are determined, based upon past collections experience and current economic conditions. Intergovernmental receivables in the General Fund represent mostly charge for services rendered to other governmental entities. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

- 3. Inventories** - Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
- 4. Capital assets** - Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

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

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

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

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

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality. All sick leave pay and salary related benefits are accrued when incurred in the governmental-wide financial statements when the employee meets such criteria.

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

- 8. Reservations of fund balance** - Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

- a. **Capital Projects** – Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- b. **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.
- c. **Other Purposes** – Represents net assets available for specific use and/or legally segregated for other specific future use.
- d. **Debt Service Fund** – Represents net assets available to finance future debt service payments.

9. Interfund and intra-entity transactions – The Municipality has the following types of transactions among funds:

- a. **Operating Transfers** – Legally required transfers that are reported when incurred as “Operating transfer-in” by the recipient fund and as “Operating transfers-out” by the disbursing fund.
- b. **Intra-Entity Transactions** – Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

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

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (CRIM) for the year ended June 30, 2007 amounted to approximately \$212,648. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$184,829 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that “long term liabilities, including compensated absences, bonds and notes

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

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

payable, are not due and payable in the current period and therefore are not reported in the funds.”, and that “capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.” The details of this reconciliation are as follows:

| | | Total Net Assets - Governmental Activities |
|--|--------------------|---|
| <u>Net assets invested in capital assets, net of related debt</u> | | |
| Capital assets, net of depreciation | \$ 28,423,259 | |
| Deduct: | | |
| Bonds Payable | (4,410,000) | |
| Notes Payable | (2,174,000) | |
| Land Authority | <u>(40,000)</u> | \$ 21,799,259 |
| <u>Net assets restricted for capital projects</u> | | |
| Fund balance restricted for Capital Projects | | 1,678,959 |
| <u>Net assets restricted for debt service</u> | | |
| Debt Service Fund - fund balances | \$ 1,983,339 | |
| Deduct: | | |
| Interest payable | <u>(162,581)</u> | 1,820,758 |
| <u>Net assets restricted for other purposes</u> | | |
| General Fund-fund balance restricted for other purposes | 31,109 | |
| Special Revenue Fund - Local and State Grants - fund balance restricted for other purposes | 1,083,950 | |
| Other governmental funds-fund balance restricted for other purposes | <u>122,291</u> | 1,237,350 |
| <u>Net assets unrestricted (deficit)</u> | | |
| General Fund - total fund balance: | \$ 3,186,045 | |
| Add: | | |
| Accrual basis accounts receivables | 43,379 | |
| Deduct: | | |
| General Fund-fund restricted for other purposes | (31,109) | |
| Accrual basis accounts payable | (182,783) | |
| Bond and Notes Payable | (950,000) | |
| Property taxes | (1,294,671) | |
| LIMS repayment plan | (216,168) | |
| Land Authority debt | (3,600) | |
| Compensated absences | <u>(1,064,862)</u> | <u>(513,769)</u> |
| Total net assets - governmental activities | | <u>\$ 26,022,557</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

2. DEPOSITS

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

The Municipality's bank balances in commercial banks of \$3,163,231 in the General Fund, the \$641,629 in the Special Revenue Fund - Local and State Grants, the \$168,231 in the Special Revenue Fund - Other Federal Grants, and the \$1,237,542 in the Capital Projects Fund- State and Local Grants were fully collateralized at June 30, 2007. In the Other Governmental Funds there were deposits with commercial banks of \$125,728 that were fully collateralized.

The deposits at GDB of \$1,128,205 in the Special Revenue Fund - Local and State Grants, the \$129,046 in the Special Revenue Fund - Other Federal Grants, the \$498,762 in the Capital Projects Fund - Local and State Grants that are restricted principally for capital projects, and the \$1,981,216 in the Debt Service Fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax* - The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2007, the tax rates were as follows:

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

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable of \$4,750 represents filed municipal license tax returns that were uncollected as of June 30, 2007, net of allowance for uncollectible accounts.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

3. RECEIVABLES (CONTINUED)

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

B. **Municipal Sales and Use Tax** – On October 4, 2006, the Municipal Legislature, by Ordinance Number 06-2006-2007, authorized the Mayor to impose a sales tax of 1.5%. The dispositions of this Ordinance began on November 15, 2006. Municipal sales and use tax receivable of \$49,486 represents filed municipal sales and tax returns that were uncollected as of June 30, 2007, net of allowance for uncollectible accounts.

C. **Intergovernmental Receivables** –

Intergovernmental receivables in the General Fund represent expenditures incurred not yet reimbursed by the other governmental entities. Following is a detail of the intergovernmental receivables:

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|-------------------------|
| Municipal Revenue Collection Center ("CRIM") | \$ 43,379 |
| Puerto Rico Electric Power Authority ("PREPA") | <u>846</u> |
| Total | <u>\$ 44,225</u> |

Intergovernmental receivables in the Special Revenue Fund – Local and State Grants represent expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivables:

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|-------------------------|
| Commonwealth of Puerto Rico-Department of Labor and Human Resources-Law 52 Grant | \$ 68,673 |
| Commonwealth of Puerto Rico-Department of Labor and Human Resources-Law 82 Grant | <u>12,803</u> |
| Total | <u>\$ 81,476</u> |

Intergovernmental receivables in the Special Revenue Fund – Other Federal Grants represent expenditures incurred not yet reimbursed by the federal government or the pass-through grantor. Following is a detail of the intergovernmental receivables:

| <u>Program Description</u> | <u>Amount</u> |
|--|--------------------------|
| Community Development Block Grants-State's Program | \$ 116,261 |
| Special Program for Aging-Title III, Part B, Grants for Supportive Services and Senior Centers | 5,692 |
| Child Care and Development Block Grant | <u>28,163</u> |
| Total | <u>\$ 150,116</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in the Debt Service Fund represents property tax receivable at June 30, 2007. Following is a detail of the intergovernmental receivable:

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|-------------------------|
| Municipal Revenue Collection Center (CRIM) | \$ <u>15,515</u> |
| Total | \$ <u>15,515</u> |

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2007 are summarized as follows:

a. Due from/to other fund:

| <u>Receivable Fund</u> | <u>Payable Fund</u> | <u>Purpose</u> | <u>Amount</u> |
|------------------------|---|--|----------------------------|
| General Fund | Special Revenue Fund – Local and State Grants | Payrolls, accruals, and other expenditures not reimbursed | \$ 767,360 |
| General Fund | Special Revenue Fund – Other Federal Grants | Payrolls, accruals, and other expenditures not reimbursed | 168,034 |
| General Fund | Capital Projects Fund – Local and State Grants | Payrolls, accruals, and other expenditures not reimbursed | 57,345 |
| General Fund | Debt Service Fund | Interest not transferred | 20,796 |
| General Fund | Other Governmental Funds | Payrolls, accruals, and other expenditures not reimbursed | <u>3,437</u> |
| Total | | | \$ <u>1,016,972</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2007, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

| <u>Governmental Activities:</u> | <u>Balance July 1, 2006 as restated</u> | <u>Additions</u> | <u>Retirements</u> | <u>Balance June 30, 2007</u> |
|--|---|---------------------|---------------------|----------------------------------|
| Capital asset, not being depreciated: | | | | |
| Land | \$ 10,462,413 | \$ - | - | \$ 10,462,413 |
| Construction in progress | <u>3,579,882</u> | <u>1,423,488</u> | <u>(890,264)</u> | <u>4,113,106</u> |
| Total capital assets not being depreciated | <u>14,042,295</u> | <u>1,423,488</u> | <u>(890,264)</u> | <u>14,575,519</u> |
| Capital assets, being depreciated: | | | | |
| Buildings | 11,355,667 | 28,988 | | 11,384,655 |
| Buildings improvements | 1,404,756 | 1,651,600 | | 3,056,356 |
| Infrastructure | 2,384,257 | 124,108 | | 2,508,365 |
| Infrastructure improvements | 1,591,935 | 467,783 | | 2,059,718 |
| Equipment | 1,841,268 | 125,444 | (86) | 1,966,626 |
| Furnishing | 525,033 | 14,054 | | 539,087 |
| Work of art | 400 | | | 400 |
| Computers | 229,472 | 53,108 | (5,026) | 277,554 |
| Vehicles | <u>2,061,758</u> | <u>45,495</u> | <u>-</u> | <u>2,107,253</u> |
| Total capital assets being depreciated | <u>21,394,546</u> | <u>2,510,580</u> | <u>(5,112)</u> | <u>23,900,014</u> |
| Less accumulated depreciation for: | | | | |
| Buildings | (2,809,181) | (284,375) | | (3,093,556) |
| Buildings improvements | (88,555) | (68,486) | | (157,041) |
| Infrastructure | (2,118,270) | (62,670) | | (2,180,940) |
| Infrastructure improvements | (147,142) | (127,984) | | (275,126) |
| Equipment | (1,551,461) | (110,820) | 33 | (1,662,248) |
| Furnishing | (495,733) | (14,578) | | (510,311) |
| Works of art | (163) | (40) | | (203) |
| Computers | (190,390) | (34,217) | 5,026 | (219,581) |
| Vehicles | <u>(1,873,083)</u> | <u>(80,185)</u> | <u>-</u> | <u>(1,953,268)</u> |
| Total accumulated depreciation | <u>(9,273,978)</u> | <u>(783,355)</u> | <u>5,059</u> | <u>(10,052,274)</u> |
| Total capital assets being depreciated, net | <u>12,120,568</u> | <u>1,727,225</u> | <u>(53)</u> | <u>13,847,740</u> |
| Governmental activities capital assets, net | <u>\$ 26,162,863</u> | <u>\$ 3,150,713</u> | <u>\$ (890,317)</u> | <u>\$ 28,423,259</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

5. CAPITAL ASSETS (CONTINUED)

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

| Governmental activities: | <u>Amount</u> |
|---|--------------------------|
| General government | \$ 282,901 |
| Public works | 222,931 |
| Culture and recreation | 115,294 |
| Community development | 105,989 |
| Health and welfare | 29,529 |
| Public safety | 26,183 |
| Economic development | <u>528</u> |
| Total depreciation expense-governmental activities | <u>\$ 783,355</u> |

6. PROPERTY TAXES

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

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. The CRIM issued the preliminary liquidation noting that the collections exceeded advances by \$43,379. In the governmental funds, the entire receivable has been offset by deferred revenue since the excess was not available to pay liabilities of the current period. In the government-wide financial statements, the entire receivable is recognized as revenue.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

6. PROPERTY TAXES (CONTINUED)

The governmental-wide statement of net assets includes an outstanding debt balance of \$49,660 corresponding to the 2006 CRIM final liquidation.

On December 31, 1992, the Municipality entered into an agreement with the Commonwealth of Puerto Rico – Treasury Department, for the repayment of excess property tax advances. As of June 30, 2007, the related unpaid property taxes advances included in the Statement of Net Assets amounted to \$2,849.

On January 26, 2000, Public Law No. 42 was enacted, which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No. 146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2003, Public Law No. 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law No. 42 enacted on January 26, 2000.

On June 26, 1997, Public Law No. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The government-wide Statement of Net Assets includes an outstanding balance of \$700,940 and \$541,222 related to Law No. 146 and the Law No. 42, respectively.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

6. PROPERTY TAXES (CONTINUED)

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

The annual tax rate is 8.83% for real property and 6.83% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 2.00% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2007 are summarized as follows:

| Description | General Fund | Special Revenue Fund- State & Local Grants | Special Revenue Fund Section Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total |
|---------------------|-------------------|---|--|--|-------------------------|--------------------------------|-------------------|
| Accounts payable | \$ 121,950 | \$ - | \$ 115,254 | \$ - | \$ - | \$ - | \$ 237,204 |
| Accrued liabilities | <u>229,248</u> | - | - | - | - | - | <u>229,248</u> |
| Total | <u>\$ 351,198</u> | <u>\$ -</u> | <u>\$ 115,254</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 466,452</u> |

8. DUE TO OTHER GOVERNMENTAL ENTITIES

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

| <u>Governmental Entity</u> | <u>Amount</u> |
|--|------------------|
| Department of Labor – Unemployment | \$ 4,817 |
| Puerto Rico Aqueduct and Sewer Authority ("AAA") | 6,680 |
| Department of Treasury – Income Tax | 62,170 |
| General Services Administration | 3,235 |
| Puerto Rico Telephone Company | <u>9,604</u> |
| Total | <u>\$ 86,506</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

9. DEFERRED REVENUES

- A. Municipal License Tax** – The deferred revenues of \$628,080 in the General Fund relates to municipal license tax collected in fiscal year 2006-07 that will be earned in fiscal year 2007-08.
- B. Federal Grants** – The deferred revenues presented in the Special Revenue Fund – Other Federal Grants represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

| <u>Program Description</u> | <u>Amount</u> |
|--|--------------------------|
| Disaster Grants-Public Assistance | \$ 129,046 |
| Emergency Management Performance Grant | 12,322 |
| State and Community Highway Safety Program | 8,103 |
| Nutrition Program for the Elderly | 11,509 |
| Others | <u>3,125</u> |
| Total | <u>\$ 164,105</u> |

10. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2007, was as follows:

| <u>Description</u> | <u>Beginning Balance</u> | <u>Borrowings or Additions</u> | <u>Payments or Deductions</u> | <u>Ending Balance</u> | <u>Due Within One Year</u> |
|-------------------------|------------------------------|------------------------------------|-----------------------------------|----------------------------|--------------------------------|
| Bonds Payable | \$ 5,595,000 | \$ - | \$ (235,000) | \$ 5,360,000 | \$ 255,000 |
| Notes Payable | 1,231,000 | 1,125,000 | (182,000) | 2,174,000 | 318,000 |
| Property Taxes Advances | 1,304,199 | - | (9,528) | 1,294,671 | 59,727 |
| Land Authority | 133,350 | - | (89,750) | 43,600 | 3,600 |
| Compensated Absences | 970,136 | 152,439 | (57,713) | 1,064,862 | 55,937 |
| LIMS Repayment Plan | <u>256,940</u> | <u>-</u> | <u>(40,772)</u> | <u>216,168</u> | <u>43,234</u> |
| Total | <u>\$ 9,490,625</u> | <u>\$ 1,277,439</u> | <u>\$ (614,763)</u> | <u>\$10,153,301</u> | <u>\$ 735,498</u> |

- 1. Legal debt margin** – The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

10. LONG-TERM LIABILITIES (CONTINUED)

2. Bonds Payable – The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. Bonds payable outstanding at June 30, 2007 are as follows:

| <u>Type of bonds</u> | <u>Maturity Date</u> | <u>Original Amount</u> | <u>Range of Interest Rates</u> | <u>Balance at June 30, 2007</u> |
|---------------------------------------|----------------------|------------------------|--------------------------------|---------------------------------|
| 1993 Series | 7-1-12 | \$ 2,015,000 | 5.00% to 8.00% | \$ 950,000 |
| 2000 Series | 7-1-14 | 460,000 | 2.70% to 7.81% | 310,000 |
| 2003 Series | 7-1-27 | 4,430,000 | 5.00% to 5.31% | <u>4,100,000</u> |
| Total general obligation bonds | | | | <u><u>\$ 5,360,000</u></u> |

These bonds are payable from the special ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

| <u>Year Ending June 30,</u> | <u>Principal</u> | <u>Interest</u> |
|-----------------------------|----------------------------|----------------------------|
| 2008 | \$ 255,000 | \$ 264,626 |
| 2009 | 275,000 | 263,310 |
| 2010 | 295,000 | 245,776 |
| 2011 | 315,000 | 226,709 |
| 2012 | 340,000 | 206,001 |
| 2013-2017 | 1,085,000 | 803,899 |
| 2018-2022 | 1,035,000 | 580,387 |
| 2023-2027 | 1,415,000 | 278,504 |
| 2028-2032 | <u>345,000</u> | <u>8,659</u> |
| Total | <u><u>\$ 5,360,000</u></u> | <u><u>\$ 2,877,871</u></u> |

3. Notes Payable – The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. During the current year, the Municipality issued notes for approximately \$1,125,000. Notes payable outstanding at June 30, 2007 are as follows:

| <u>Type of notes</u> | <u>Maturity Date</u> | <u>Original Amount</u> | <u>Range of Interest rates</u> | <u>Balance at June 30, 2007</u> |
|----------------------------|----------------------|------------------------|--------------------------------|---------------------------------|
| 2003 Series | 1-1-10 | \$ 521,000 | 4.75% | \$ 244,000 |
| 2004 Series | 1-1-13 | 228,000 | 4.25% | 200,000 |
| 2006 Series | 7-1-12 | 685,000 | 4.23% to 5.33% | 605,000 |
| 2007 Series | 7-1-14 | 1,125,000 | 6.48% to 7.50% | <u>1,125,000</u> |
| Total notes payable | | | | <u><u>\$ 2,174,000</u></u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

10. LONG-TERM LIABILITIES (CONTINUED)

The notes are payable from the ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

| <u>Year Ending June 30,</u> | <u>Principal</u> | <u>Interest</u> |
|---------------------------------|----------------------------|--------------------------|
| 2008 | \$ 318,000 | \$ 91,327 |
| 2009 | 337,000 | 106,557 |
| 2010 | 362,000 | 88,716 |
| 2011 | 299,000 | 65,250 |
| 2012 | 315,000 | 46,527 |
| 2013-2017 | <u>543,000</u> | <u>33,848</u> |
| Total | <u>\$ 2,174,000</u> | <u>\$ 432,225</u> |

- 4. Advances from CRIM** – This amount represents the balance owed to the CRIM at June 30, 2007, as described in Note 6.
- 5. Compensated Absences** – The government-wide statement of net assets includes approximately \$582,421 of accrued sick leave benefits, and approximately \$482,441 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
- 6. Land Authority** – This amount represents a payment agreement with the Land Authority for the acquisition of a parcel of land.
- 7. LIMS Repayment Plan** – During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System – LIMS, contracted by the CRIM. A total of \$413,522 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2007 the outstanding debt balance is \$216,168. This amount will be presented in the government wide Statement of Net Assets.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

11. PENSION PLAN

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

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

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

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

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2007 recorded as pension expenditures were \$ 288,926. This amount represented 100% of the required contribution.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

11. PENSION PLAN (CONTINUED)

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

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2007, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

12. RISK MANAGEMENT

The Property Division of the Municipality is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the area of Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

13. CONTINGENCIES

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

13. CONTINGENCIES (CONTINUED)

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

14. SUBSEQUENT EVENTS

A) Sales and Use Tax

On July 29, 2007, an amendment to Act No. 117 of July 4, 2006, Known as the "The Fairness Act of 2006", was enacted with the purpose of establishing a mandatory sales and use tax of 1.5% at the municipal level. The municipalities of Puerto Rico are responsible to collect 1% of the corresponding tax with the same exemptions and limitations that the portion collected by the Treasury Department. The Act provides an optional surtax on the un-process food. This surtax must be approved by the Municipal Legislature.

The Treasury Department is responsible to create the Municipal Development Fund (.02%), the Municipal Redemption Fund (.02%) and the Municipal Improvements Fund (.01%) with the remaining 0.5%.

15. PRIOR PERIOD ADJUSTMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

| Description | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund - Other Federal Programs | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Fund | Total |
|---|--------------------|---|---|--|---------------------|-------------------------|---------------------|
| Fund balance, beginning | \$2,624,585 | \$ 223,670 | \$ - | \$ 949,131 | \$ 1,898,896 | \$ - | \$ 5,696,282 |
| To corrected prior year deferred federal grant revenues | - | - | - | - | - | 99,021 | 99,021 |
| Fund balance, beginning as restated | <u>\$2,624,585</u> | <u>\$ 223,670</u> | <u>\$ -</u> | <u>\$ 949,131</u> | <u>\$ 1,898,896</u> | <u>\$ 99,021</u> | <u>\$ 5,795,303</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2007

15. PRIOR PERIOD ADJUSTMENTS (CONTINUED)

B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS

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

| <u>Description</u> | <u>Total</u> |
|---|----------------------|
| Net assets, beginning | \$ 15,667,978 |
| To correct prior year deferred federal grant revenues | 99,021 |
| Implementation of the retroactive capitalization of infrastructure assets | <u>6,384,692</u> |
| Net assets, beginning as restated | <u>\$ 22,151,691</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)**

YEAR ENDED JUNE 30, 2007

| | <u>Budgeted Amounts</u> | | Actual Amounts (Budgetary Basis) (See Note 1) | Variance with Final Budget Positive (Negative) |
|---|-------------------------|------------------|---|---|
| | Original | Final | | |
| REVENUES: | | | | |
| Property taxes | \$ 3,070,136 | \$ 3,070,136 | \$ 3,186,564 | \$ 116,428 |
| Municipal license tax | 832,000 | 951,793 | 991,940 | 40,147 |
| Licenses, permits and other local taxes | 530,000 | 772,777 | 911,240 | 138,463 |
| Charges for services | 39,780 | 19,333 | 21,948 | 2,615 |
| Intergovernmental | 3,086,371 | 3,089,706 | 3,195,116 | 105,410 |
| Rent of property | 31,700 | 22,030 | 25,845 | 3,815 |
| Fines and forfeitures | 8,000 | 5,668 | 6,968 | 1,300 |
| Interest | 100,000 | 217,546 | 317,192 | 99,646 |
| Miscellaneous | 145,000 | 33,297 | 77,944 | 44,647 |
| Municipal sales and use tax | - | <u>257,222</u> | <u>417,262</u> | <u>160,040</u> |
| Total revenues | <u>7,842,987</u> | <u>8,439,508</u> | <u>9,152,019</u> | <u>712,511</u> |
| Budget carryover (1) | - | <u>760,587</u> | <u>760,587</u> | - |
| Total revenues after carryover | <u>7,842,987</u> | <u>9,200,095</u> | <u>9,912,606</u> | <u>712,511</u> |
| EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES: | | | | |
| Current: | | | | |
| General government | 4,462,911 | 5,578,386 | 5,400,813 | 177,573 |
| Public safety | 283,318 | 312,489 | 308,757 | 3,732 |
| Public works | 1,616,253 | 1,782,756 | 1,742,000 | 40,756 |
| Health and welfare | 1,238,972 | 1,268,937 | 1,238,577 | 30,360 |
| Culture and recreation | 223,236 | 241,826 | 237,826 | 4,000 |
| Economic development | <u>18,297</u> | <u>15,701</u> | <u>15,464</u> | <u>237</u> |
| Total expenditures, encumbrances and other financing uses | <u>7,842,987</u> | <u>9,200,095</u> | <u>8,943,437</u> | <u>256,658</u> |
| EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES) | | | <u>\$ 969,169</u> | <u>\$ 969,169</u> |
| Explanation of Differences: | | | | |
| Sources/inflows of resources: | | | | |
| Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule | | | | \$ 9,912,606 |
| Differences-budget to GAAP: | | | | |
| Budgeted carryover | | | | (760,587) |
| GAAP adjustments to revenues | | | | <u>13,834</u> |
| Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances | | | | <u>\$ 9,165,853</u> |
| Uses/outflows of resources: | | | | |
| Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule | | | | \$ 8,943,437 |
| Differences-budget to GAAP: | | | | |
| Prior year encumbrances recorded as current year expenditures for GAAP basis | | | | 281,377 |
| Current year encumbrances recorded as expenditures for budgetary purposes | | | | <u>(620,421)</u> |
| Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances | | | | <u>\$ 8,604,393</u> |

(1) Represents fund balance carried over from prior year

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND

YEAR ENDED JUNE 30, 2007

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2007 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2007.