

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

**MUNICIPIO DE MAYAGUEZ**  
**AUDITORIA 2005-2006**  
**30 DE JUNIO DE 2006**

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

**BASIC FINANCIAL STATEMENTS**  
**With Independent Auditors' Report Thereon**  
**June 30, 2006**

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
**Basic Financial Statements**  
**June 30, 2006**

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
**SINGLE AUDIT REPORT**  
**JUNE 30, 2006**

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## **NIEVES VELAZQUEZ & CO., P.S.C.**

Certified Public Accountants and Financial Consultants

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### **Independent Auditors' Report**

The Honorable Mayor, Members of the  
Municipal Legislature and People of  
the Municipality of Mayagüez  
Mayagüez, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major governmental fund, and the aggregate remaining fund information of the Municipality of Mayagüez of the Commonwealth of Puerto Rico (the Municipality), as of and for the fiscal year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements, as listed in the accompanying table of contents. We also have audited the accompanying statement of revenues and expenditures – budget and actual – budgetary basis – general fund of the Municipality for the fiscal year then ended, which is presented as part of the basic financial statements. 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 respective financial statements are free of material misstatements. 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 governmental fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2006, and the respective changes in financial position thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the budgetary comparison of the general fund for the fiscal year then ended in conformity with the budgetary (statutory) basis of accounting, as described in Note 1.

**Independent Auditors' Report**  
(Continuation)

The accompanying Management's Discussion and Analysis is not a required part of the basic financial statements referred to above, 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.

December 22, 2006

*Nieves Velazquez & Co., P.S.C.*

Stamp No. 2076450 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

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

**FINANCIAL HIGHLIGHTS**

***Government-Wide Highlights:***

- The Municipality's assets exceeded its liabilities (net assets) by \$42,453,038 at June 30, 2006. The Municipality's net assets increased by \$330,332 (excess of revenues over expenses) during the fiscal year ended June 30, 2006.
- The Municipality's assets decreased from \$158,624,223 at June 30, 2005 to \$153,282,917 at June 30, 2006, for a decrease of \$5,341,301 (3.37 percent).
- The liabilities of the Municipality decreased from \$117,622,380 at June 30, 2005 to \$110,829,879 at June 30, 2006, for a decrease of \$6,792,501 (5.77 percent).
- The revenues of the Municipality decreased from \$82,132,482 for the fiscal year ended June 30, 2005 to \$79,681,101 for the fiscal year ended June 30, 2006, for a decrease of \$2,451,381 (2.98 percent).
- The Municipality's expenses increased from \$78,905,762 for the fiscal year ended June 30, 2005 to \$79,350,769 for the fiscal year ended June 30, 2006, for an increase of \$445,007 (.56 percent).

***Governmental Funds' Highlights:***

- The total fund balances of governmental funds amounted to \$35,406,931 at June 30, 2006, which decreased by \$4,769,442 (excess of expenditures and other financing uses over revenues and other financing sources) during fiscal year ended June 30, 2006.
- The total assets of governmental funds decreased from \$97,155,512 at June 30, 2005 to \$91,361,031 at June 30, 2006, for a decrease of \$5,794,481 (5.96 percent).
- The governmental fund's total liabilities decreased from \$56,979,139 at June 30, 2005 to \$55,954,100 at June 30, 2006, for a decrease of \$1,034,039 (1.81 percent).
- The total revenues of governmental funds decreased from \$81,536,115 for the fiscal year ended June 30, 2005 to \$79,689,780 for the fiscal year ended June 30, 2006, for a decrease of \$1,846,335 (2.26 percent).
- The governmental fund's total expenditures decreased from \$94,649,405 for the fiscal year ended June 30, 2005 to \$85,580,083 for the fiscal year ended June 30, 2006, for a decrease of \$9,069,322 (9.58 percent).

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL HIGHLIGHTS (CONTINUATION)**

***Governmental Funds' Highlights: (Continuation)***

- Other financing sources (uses), net, of governmental funds decreased from \$8,404,397 for the fiscal year ended June 30, 2005 to \$0.00 for the fiscal year ended June 30, 2006, for a decrease of \$8,404,397 (100 percent).

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

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

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

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

**a) Government-wide Financial Statements**

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (CONTINUATION)**

**a) Government-wide Financial Statements (Continuation)**

**1. Statement of Net Assets**

The purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality. On the other hand, the Municipality reports liabilities, such as claims and judgments or municipal solid waste landfill closure and postclosure care costs, even though these liabilities might not be paid until several fiscal years into the future.

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

**2. Statement of Activities**

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (CONTINUATION)**

**a) Government-wide Financial Statements (Continuation)**

**2. Statement of Activities (Continuation)**

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

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

**b) Governmental Fund Financial Statements**

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

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (CONTINUATION)**

**b) Governmental Fund Financial Statements (Continuation)**

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

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

The Municipality has five major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The five major governmental funds are: (1) general fund, (2) state legislative joint resolutions special revenue fund, (3) head start special revenue fund, (4) permanent improvements bonds fund and (5) debt service fund.

**c) Notes to Basic Financial Statements**

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

**d) Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information (RSI) which consists of the Schedule of Funding Progress of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS). ERS is the multi-employer cost-sharing retirement system in which the employees of the Municipality participate.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (CONTINUATION)**

**e) Other Supplementary Information**

The RSI is followed by a section of other supplementary information consisting of: (1) combining balance sheet – nonmajor governmental funds, (2) combining statement of revenues, expenditures and changes in fund balances (deficits) – nonmajor governmental funds, (3) budgetary comparison schedule – debt service fund, (4) notes to budgetary comparison schedule – debt service fund, and (5) schedules of capital assets used in the operation of governmental funds, as detailed in the accompanying table of contents.

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The Municipality's overall financial position and operations for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS:

**Comparative Condensed Statement of Net Assets  
Governmental Activities  
June 30,**

	<b>2006</b>	<b>2005, as restated (note 14)</b>
<b>Assets:</b>		
Current assets	\$ 84,641,523	\$ 92,209,564
Noncurrent assets:		
Capital assets, net	67,135,914	66,015,414
Other noncurrent assets	1,505,480	1,520,108
Total assets	\$ 153,282,917	\$ 159,745,086
<b>Liabilities:</b>		
Current liabilities	35,088,081	40,117,423
Long-term liabilities due within one year	9,680,918	9,762,136
Long-term liabilities due after one year	66,060,880	67,742,821
Total liabilities	110,829,879	117,622,380
<b>Net assets (liabilities):</b>		
Invested in capital assets, net of related debt	\$ 33,333,288	\$ 29,727,461
Restricted	19,711,350	21,842,073
Unrestricted	(10,591,600)	(9,446,828)
Total net assets	\$ 42,453,038	\$ 42,122,706

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**  
**(CONTINUATION)**

At June 30, 2006, the Municipality's current assets, amounting to \$84,641,523, are mainly composed of restricted cash (\$45,916,600), unrestricted cash and cash equivalents (\$12,318,632), short-term investments in certificates of deposit (\$7,292,400), property taxes receivable (\$8,843,317), municipal license taxes receivable (\$4,056,757) and intergovernmental receivables (\$4,751,678).

The restricted cash represents resources legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded programs. Restricted cash also consists of unspent proceeds of bonds issued to pay accounts payable and certain specific commitments. The short-term investments in certificates of deposit are unrestricted and available to meet operational needs and obligations with citizens and creditors. Restricted property taxes receivable represent resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's noncurrent assets, amounting to \$68,641,394 at June 30, 2006, are substantially composed of capital assets, with a cost basis of \$118,802,137, which are reported net of accumulated depreciation and amortization of \$51,666,223.

At June 30, 2006, the assets of the Municipality decreased by \$6,642,169 (4.05 percent) in comparison with prior fiscal year, principally for the following facts:

- Restricted cash decreased by \$5,248,616 mainly due to expenses paid with operational loans during the current fiscal year.
- Unrestricted cash and cash equivalents decreased by \$695,843 while investments in certificates of deposit decreased due to a management's strategic decision to reallocate a portion of the Municipality's investment portfolio into cash equivalents consisting of certificates of deposit amounting to \$6,000,000 at June 30, 2006. The asset reallocation is part of a cash flows' management program implemented by the Municipality (see note 2).
- Property taxes receivable decreased by \$668,179 due to increased property tax collections received by the Municipality during the last quarter of the current fiscal year, caused by strong collection efforts made by the Municipality as part of its cooperative agreement with the Municipal Revenue Collection Center (CRIM).
- Intergovernmental receivables decreased by \$3,426,422 due to a proceed of a new bond issuance amounting to \$3,965,000 from Governmental Development Bank (GDB) which was recorded as a receivable at June 30, 2005 until collected during current fiscal year (see note 5).
- Other receivables decreased by \$84,144 mainly due to a payment received by Advanced Cardiology Health Center for its facilities on REBMC, and other miscellaneous receivables of other services rendered by the Municipality.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**  
**(CONTINUATION)**

- Capital assets increased by \$1,120,500 due to the excess of current year additions (\$6,889,153) over depreciation/amortization expense (\$3,768,653) and reserve for impairment asset (2,000,000) for the fiscal year ended June 30, 2006.

At June 30, 2006, the Municipality's current liabilities amounting to \$46,718,749 are mainly composed of unearned revenues (\$26,352,519), accounts payable and accrued liabilities (\$7,572,351), intergovernmental payables (\$1,163,211), and the portions due within one year of compensated absences (\$3,823,006) and bonds payable (\$5,290,000). Unearned revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded programs. As noted in the condensed statement of net assets, the Municipality's current assets exceeded current liabilities by \$39,872,524, for a current ratio (current assets to current liabilities) of 1.89 to 1.00.

The Municipality's noncurrent liabilities, amounting to \$66,060,880 at June 30, 2006, are mainly composed of portions due after one year of bonds payable (\$52,888,192), notes payable (\$3,319,896), and compensated absences (\$4,042,618). Noncurrent liabilities include also the estimated liability for the municipal solid waste landfill closure and postclosure care costs (\$1,996,062).

At June 30, 2006, the liabilities of the Municipality decreased by \$6,792,501 (5.77 percent) in comparison with prior fiscal year-end, principally for the following facts:

- Bonds payable decreased by \$4,910,000 due to the related debt service principal payments made during current fiscal year.
- Notes payable decreased by \$458,658 due to the net effect of the related debt service principal payments of \$541,795 and the accretion of note discounts of \$83,137 made during current fiscal year.
- Deferred revenues decreased by \$1,383,203 due to: (1) the increase of \$400,756 in municipal license taxes collected in advance (corresponding to fiscal year 2006-2007), and (2) the decrease of \$1,783,959 in grants and contributions for which not all eligibility requirements have been met at June 30, 2006.
- Compensated absences increased by \$327,655 due to the excess of accumulation of vacations, sick leave and compensatory time (\$518,826) over compensated absences payments to employees during current fiscal year.

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. The assets of the Municipality exceeded liabilities by \$42,453,038 at June 30, 2006. The most significant portion of net assets (\$33,333,288) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since capital assets cannot be used to liquidate these liabilities.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**  
**(CONTINUATION)**

Another significant portion of net assets (\$19,711,350) at June 30, 2006, represents resources that are subject to external restrictions on how they may be used, such as: (1) debt service (\$7,737,727), (2) permanent improvements bonds (\$1,616,551), (3) mortgage loans and notes (\$1,641,948) and (4) other purposes, principally to finance federally and state funded programs (\$8,715,124).

The remaining component of total net assets consists of an unrestricted liabilities amounting to \$10,591,600 at June 30, 2006. This unrestricted liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as solid waste landfill closure and postclosure care costs, bonds and notes payable, compensated absences, claims and judgments, certain obligations under capital leases, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality increased by \$330,332 for the fiscal year ended June 30, 2006. Such increase is due to the excess of total revenues (\$79,681,101) over expenses (\$79,350,769) for the fiscal year ended June 30, 2006 and is principally composed as follows:

- An increase of \$3,605,827 in net assets invested in capital assets, net of related debt. The increase in this net asset category is due to the combination of: (1) the excess of current year additions (\$6,889,154) over depreciation/amortization of capital assets (\$3,768,654), (2) the net increase of \$3,266,650 in outstanding debt related to the acquisition, construction or improvement of capital assets, and (3) and the net decrease of \$2,758,782 in the unspent proceeds of debt associated with the acquisition, construction or improvement of capital assets.
- A decrease of \$1,009,860 in restricted net assets due principally to a decrease of \$3,030,058 in net assets restricted to finance federally and state funded programs, which are mainly supported with intergovernmental grants and contributions, and an increase in general fund restricted net assets of \$1,918,056.
- A increase of \$1,442,772 in unrestricted net liabilities due to: (1) an increase of \$71,348 in the estimated liability for solid waste landfill closure and postclosure care costs, (2) an increase in \$3,419,174 in accrued legal claims and judgments, (3) a decrease of \$668,179 in property taxes receivable, (4) a decrease of \$3,426,422 in intergovernmental receivables of unrestricted resources, and (5) a decrease of \$87,409 in other receivables.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(CONTINUATION)**

The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS:

**Statement of Activities  
Governmental Activities  
Fiscal Years Ended June 30, 2006 and 2005**

	<b>2006</b>	<b>2005, as restated (note 14)</b>
<b>Program revenues:</b>		
Program-specific operating grants and contributions	\$ 19,979,651	\$ 18,124,247
Program-specific capital grants and contributions	4,215,104	9,573,245
Charges for services	2,983,718	3,646,425
Total programs revenues	\$ 27,178,473	\$ 31,343,917
<b>General revenues:</b>		
Property taxes	26,708,931	25,414,939
Municipal license taxes	13,596,515	14,110,503
Unrestricted grants and contributions	6,683,304	8,475,008
Other general revenues (various sources)	5,513,878	3,908,978
Total general revenues	52,502,628	51,909,428
Total revenues	79,681,101	83,253,345
<b>Program expenses:</b>		
General government	18,035,902	23,837,538
Public safety	7,726,094	5,242,116
Urban economic development	10,230,352	8,423,422
Health and sanitation	11,751,780	9,655,800
Culture, recreation and education	15,552,549	15,873,843
Public housing and welfare	12,243,755	12,864,235
Interest on long-term obligations	3,810,337	3,008,808
Total expenses	79,350,769	78,905,762
<b>Net increase in assets</b>	330,332	4,347,583
<b>Net assets, at beginning of fiscal year</b>	42,122,706	37,775,123
<b>Net assets, at end of fiscal year</b>	\$ 42,453,038	\$ 42,122,706

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(CONTINUATION)**

As previously mentioned, the Municipality's net assets increased by \$330,331 or .78 percent during current fiscal year. Approximately 65.90 percent (\$52,502,628) of the Municipality's total revenues for the current fiscal year came from property, municipal license and construction excise taxes, while 30.44 percent (\$24,194,755) resulted from restricted and unrestricted capital and operating grants and contributions. Charges for services and other revenues, amounting to \$2,983,718, provided 3.70 percent of the total revenues for the current fiscal year.

There was a significant decrease of \$2,896,388 (89.76 percent) in the net change in net assets for the Municipality as a whole, when operations for the fiscal current year are compared to those of the prior fiscal year. This occurred because the decrease of \$2,451,381 in total revenues was not sufficient to offset the increase in total expenses of \$445,007. The most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

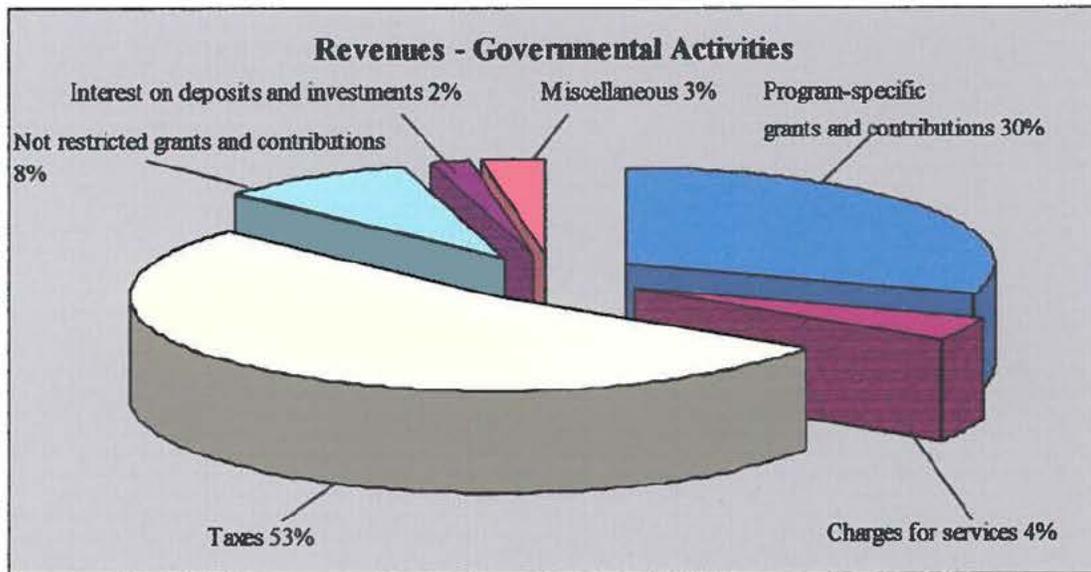
- Municipal license revenues decrease by \$513,988 during the fiscal year. The increase in municipal license taxes is also due to the increase of \$400,756 in deferred municipal licenses (corresponding to fiscal year 2006-2007 and collected in advance), and the overall economic condition of the west region of the Commonwealth.
- Program-specific capital an operating grants and contributions increased by \$3,502,737 principally due to: (1) a decrease of \$1,393,290 in grants revenues received from HUD under the Home Program (2) an increase of \$493,130 in grant revenues received from U.S. Department of Justice under the Community Oriented Policing Services Grant and Home Land Security Grant, (3) an increase in other grant revenues amounting to \$4,467,153 which were received during current fiscal year.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(CONTINUATION)**

The following table presents the composition of revenues for the fiscal year ended June 30, 2006:



The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2006 were related to: (1) general administrating and operating costs (\$18,035,902), which were classified as "general government" and accounted for 22.73 percent of total expenses, (2) public safety (\$7,726,094) which accounted for 9.74 percent of total expenses, (3) urban and economic development (\$10,230,352), which accounted for 12.89 percent of total expenses, (4) health and sanitation (\$11,751,780), which accounted for 14.81 percent of total expenses, and (5) culture, recreation and education (\$15,552,549), which accounted for 19.60 percent of total expenses, and (6) public housing and welfare (\$12,343,755), which accounted for 15.43 percent of total expenses.

The most significant fluctuations between the current fiscal year's expenses and those of the prior fiscal year occurred in the following functions/activities:

- General government expenses decrease due to a decrease in direct services to citizens.
- Urban and economic development expenses increased by \$1,806,930 because during current year the Municipality increased its urban development activities by increasing its investment in public permanent improvements, supported principally by resources received from HUD, under the CDBG program, and proceeds from bonds.
- Public safety expenses increased by \$2,438,978 because the Municipality increased its municipal police force by adding 30 additional officers to enable the implementation of the Public Order Code and to increase the public safety of its citizens.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

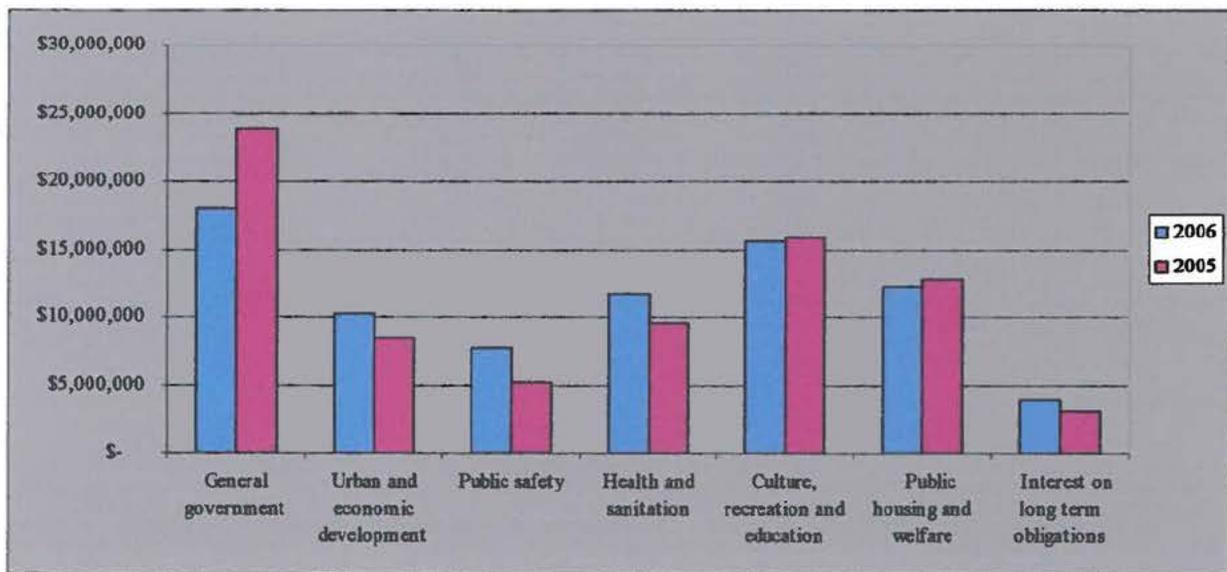
Management's Discussion and Analysis  
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**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(CONTINUATION)**

- Health and sanitation expenses increased by \$2,095,980 mainly because: (1) during current fiscal year the Municipality established an environmental police department to ensure the compliance of all applicable environmental laws and regulations in the Municipality, and (2) during current fiscal year the Municipality renegotiated its solid-waste disposal contract with a private entity.
- Interest on long-term obligations decreased by \$801,529 in comparison with the prior fiscal year principally for the net decrease of \$2,758,782 in bonds cash balance associated with the uses of funds to finances capital projects during the current fiscal year.

The following table presents the composition of expenses for the fiscal years ended June 30, 2006 and 2005:

**Expenses by Functions/Program  
Fiscal Year Ended June 2006 and 2005**



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**

**Comparative Condensed Balance Sheet - Governmental Funds  
June 30, 2006 and 2005**

	2006	2005 (as restated) (note 14)
<b>Assets:</b>		
Total assets - major governmental funds	\$ 79,861,947	\$ 85,701,516
Total assets - other governmental funds	11,499,084	12,574,859
Combined total assets	91,361,031	98,276,375
<b>Liabilities:</b>		
Total liabilities - major governmental funds	49,933,301	51,281,850
Total liabilities - other governmental funds	6,020,799	5,697,289
Combined total liabilities	55,954,100	56,979,139
<b>Fund balances:</b>		
Reserved - major governmental funds	23,862,604	25,126,703
Reserved - other governmental funds	5,478,285	6,877,570
Unreserved - major governmental funds	6,066,042	9,292,963
Combined total fund balances	35,406,931	41,297,236
<b>Total liabilities and fund balances</b>	<b>\$ 91,361,031</b>	<b>\$ 98,276,375</b>

**Analysis of Financial Position of Governmental Funds**

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

At June 30, 2006, the total assets of governmental funds decreased by \$6,915,344 (7.04 percent) in comparison with the prior fiscal year principally for: (1) the decrease of \$5,248,616 in restricted cash, (2) the increase in unrestricted cash and cash equivalents of \$695,843, (3) the increase of \$1,500,000 in long-term investments in certificates of deposit (4) the decrease of \$84,144 in other receivables, and (5) the decrease of \$3,426,422 in intergovernmental receivables.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Financial Position of Governmental Funds (Continuation)**

At June 30, 2006, the total liabilities of governmental funds decreased by \$1,025,039 (1.80 percent) in comparison with the prior fiscal year principally for: (1) the decrease of \$768,008 in accounts payable and accrued liabilities, (2) the increase in matured bonds due and payable of \$545,000, (3) and the decrease of \$1,980,153 in deferred revenues.

For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most of these fluctuations has been made.

At the end of the current fiscal year, total unreserved fund balances of the governmental funds amounted to \$6,066,042, while total fund balance reached \$36,406,931. The total fund balances decreased by \$5,890,305 during the current fiscal year. The most significant fluctuation in total fund balances occurred in the permanent improvements bonds fund, which decreased by 23.07 percent (\$2,861,760).

The following is a detailed financial analysis of the Municipality's governmental funds:

**Major Governmental Funds**

**General fund (GF)** - The GF's is the principal operating fund of the Municipality. The GF's total assets amounted to \$38,860,668 at June 30, 2006. Such assets consist of: (1) unrestricted and restricted cash and cash equivalents (\$16,166,081), (2) investments in certificates of deposit (\$7,292,400), (3) property and municipal license tax receivables (\$9,872,932), (4) short-term and long-term amounts due from other funds (\$3,161,407), and (5) intergovernmental grants and contribution receivable (1,491,979).

The GF's total liabilities amounted to \$27,570,720 at June 30, 2006. Such liabilities are composed mainly of: (1) deferred revenues (\$21,754,794), and (2) accounts payable and accrued liabilities, including amounts due to other governments (\$5,815,926).

At the end of the current fiscal year, unreserved fund balance of the GF's amounted to \$6,066,042, while total fund balance reached \$11,269,948. As a measure of the GF's liquidity it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 22.00 percent of the total GF's expenditures, while total fund balance represents 40.94 percent of that same amount.

**Debt service fund (DSF)**- The DSF's total assets amounted to \$14,921,479 at June 30, 2006, which consist mainly of restricted cash in fiscal agent (\$10,403,957) and restricted property taxes receivable (\$3,027,142). The DSF's total liabilities amounted to \$8,342,804 at June 30, 2006, which is mainly composed of: (1) matured bonds due and payable (\$5,290,000), (2) matured interest due and payable (\$1,490,903) and (3) deferred revenues (\$1,456,580). At the end of the current fiscal year, DSF's total and reserved fund balance reached \$6,578,675.

COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
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**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Major Governmental Funds (Continuation)**

**State legislative joint resolutions special revenue fund (SLJRSRF)** - The SLJRSRF's total assets amounted to \$13,606,290 at June 30, 2006, which consist of restricted cash in commercial banks. The SLJRSRF's total liabilities amounted to \$13,583,612 at June 30, 2006, which are mainly composed of deferred revenues (\$13,583,612). At the end of the current fiscal year, SLJRSRF's total and reserved fund balance reached \$22,678.

**Head start special revenue fund (HSSRF)**- The HSSRF's total assets amounted to \$107,740 at June 30, 2006, which consist mainly of restricted cash in commercial banks (\$44,192). The HSSRF's total liabilities amounted to \$107,072 at June 30, 2006, which are mainly composed of deferred revenues (\$19,521). At the end of the current fiscal year, HSSRF's total and reserved fund balance reached \$668.

**Permanent improvements bonds fund** - The PIBF's total assets amounted to \$12,365,770, which consist mainly of restricted cash in fiscal agent and commercial banks (\$12,296,490). The PIBF's total liabilities amounted to (\$329,093) at June 30, 2006, which are mainly composed of accounts payable and accrued liabilities (\$209,983). At the end of the current fiscal year, PIBF's total and reserved fund balance reached \$12,036,677.

**Other governmental funds (OGF)**- The OGF's total assets amounted to \$11,499,084 at June 30, 2006, which consist mainly of restricted cash in fiscal agent (\$5,686,521) and receivables from intergovernmental grants and contributions (\$3,199,416). The OGF's total liabilities amounted to \$6,020,799 at June 30, 2006, which are mainly composed of deferred revenues (\$1,474,212) and short-term and long-term amounts due to other funds (\$970,695). At the end of the current fiscal year, OGF's total and reserved fund balance reached \$6,020,799.

**COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**Condensed Statement of Revenues, Expenditures and Changes  
in Fund Balances - Governmental Funds  
Fiscal Year Ended June 30, 2006 and 2005**

	<b>2006</b>	<b>2005 (as restated) (note 14)</b>
<b>Revenues:</b>		
Total revenues - major governmental funds	\$ 67,564,868	\$ 69,117,216
Total revenues - other governmental funds	12,124,912	13,539,762
Combined total revenues	79,689,780	82,656,978
<b>Expenditures:</b>		
Total expenditures - major governmental funds	71,376,309	80,991,418
Total expenditures - other governmental funds	14,203,774	13,657,987
Combined total expenditures	85,580,083	94,649,405
<b>Excess of expenditures over revenues</b>	<b>(5,890,303)</b>	<b>(11,992,427)</b>
<b>Other financing sources (uses), net:</b>		
Other financing sources, net - major governmental funds	(679,577)	7,709,188
Other financing sources (uses), net - other governmental funds	679,577	695,209
Combined other financing sources (uses), net	-	8,404,397
<b>Net change in fund balance</b>	<b>(5,890,303)</b>	<b>(3,588,030)</b>
<b>Fund balance at beginning of fiscal year</b>	<b>41,297,236</b>	<b>44,885,266</b>
<b>Fund balance, at end of fiscal year</b>	<b>\$ 35,406,933</b>	<b>\$ 41,297,236</b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Operating Results of Governmental Funds**

**Major Governmental Funds**

**General fund** - The total fund balance of the GF decreased by \$1,308,765 or 10.38 percent during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$47,981,279, \$46,631,889 and \$2,668,155, respectively, for the fiscal year ended June 30, 2006.

Approximately 80.00 percent (\$38,471,011) of the GF's total revenues for the current fiscal year came from property, municipal license and construction excise taxes, while 14.50 percent (\$6,968,445) resulted from intergovernmental grants and contributions. Miscellaneous revenues, amounting to \$1,830,335, provided 3.81 percent of the total revenues for the current fiscal year.

There was a decrease of \$1,551,922 (63.79 percent) in the GF's net change in fund balance when operations for the current fiscal year are compared to those of the prior fiscal year. This occurred because the increase of \$4,339,101 in total expenditures increase in total revenues of \$30,216 was not sufficient to offset the increase in other financing uses (net) of \$2,658,155.

The GF's most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

- Miscellaneous revenues increased by \$845,136 due to, (1) the collections of past due property taxes amnesty and incentive plan approved last year by the Commonwealth's Legislature through Public Act No. 74 of March 1, 2004.
- Municipal license revenues decreased by \$745,136 due to the net change in deferred municipal license revenues and the overall economic conditions of the west region of Puerto Rico in comparison with the prior fiscal year.
- Charges for services increased by \$240,309 mainly due to the collection of rents of San Antonio Hospital of \$250,000, Mayagüez Medical Center of \$965,000.
- Property taxes increased by \$843,201 and construction excise taxes increased by \$322,743.

The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the general government and public housing and welfare expenditures, which decreased by \$5,279,313 because, as previously discussed, the Municipality implemented a strong cost reduction initiative during current fiscal year. This initiative emphasized in reducing general and administrative costs while increasing direct services to citizens. A detailed explanation of these cost reduction initiatives are described in the previous financial analysis of government-wide financial statements. The decrease in general government and public housing and welfare expenditures was partially offset by increases in the following expenditures: (1) health and sanitation (\$1,683,290), (2) public safety (\$1,603,754). Other financing uses (net) decreased by \$5,919,239 mainly due to the decrease of \$4,320,000 of the proceeds from issuance of bonds in comparison with the prior fiscal year.

COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Operating Results of Governmental Funds**

**Major Governmental Funds (Continuation)**

**Debt service fund (DSF)** - The total fund balance of the DSF decreased by \$6,301,940 or 20.34 percent during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$9,974,162, \$9,165,067 and \$1,559,965, respectively, for the fiscal year ended June 30, 2006.

Approximately 95.63 percent (\$6,669,160) of DSF's total revenues for the current fiscal year came from restricted property taxes. There was a significant decrease of \$630,940 in the DSF's net change in fund balance when operations for the current fiscal year are compared to those of the prior fiscal year. This occurred because of the increase in total revenues (\$2,174,512) and other net financing sources (\$1,119,573). These increases were partially offset by an increase of \$42,550 in total expenditures.

The increase in total DSF's revenues is mainly due to the increase of 15.87 percent (\$913,604) in property tax revenues. The decrease in other financing sources (net) is mainly due to the decrease of 29.46 percent (\$459,618) in amounts transferred-out to other funds.

**State legislative joint resolutions special revenue fund (SLJRSRF)** - The total fund balance of the SLJRSRF increased by \$7,246 or 46.95 percent during current fiscal year. Total revenues and expenditures, amounted to \$1,728,337 and \$1,721,091, respectively, for the fiscal year ended June 30, 2006.

Approximately 99.58 percent (\$1,721,091) of SLJRSRF's total revenues for the current fiscal year came from intergovernmental grants. There was an decrease of \$2,002,650 in the SLJRSRF's total revenues (mainly on intergovernmental grants), while total expenditures increased by \$2,002,468 (mainly on direct benefits to citizens).

**Head start (HSSRF)** - The total fund balance of the HSSRF increased by \$250 or 59.80 percent during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$9,980,379, \$10,854,024 and \$873,895, respectively, for the fiscal year ended June 30, 2006.

Approximately 99.73 percent (\$9,953,911) of HSSRF's total revenues for the current fiscal year came from intergovernmental grants. There was an increase of \$551,138 in the HSSRF's total revenues (mainly on intergovernmental grants), while total expenditures increased by \$636,874 (mainly on direct benefits to citizens). Other financing sources (net) increased by \$85,886.

**COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
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**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Operating Results of Governmental Funds**

**Major Governmental Funds (Continuation)**

**Other governmental funds (OGF)** - The total fund balance of the OGF increased by \$1,399,285 or 20.34 percent during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$12,124,912, \$14,203,774 and \$579,577, respectively, for the fiscal year ended June 30, 2006.

Approximately 97.21 percent (\$11,786,849) of OGF's total revenues for the current fiscal year came from intergovernmental grants. There was a decrease of \$1,873,348 in the OGF's total revenues (mainly on intergovernmental grants), while total expenditures increased by \$545,787 (mainly on direct benefits to citizens and capital outlays). Other financing sources (net) decreased by \$15,632.

**BUDGETARY HIGHLIGHTS**

**a) General Fund**

The original budget of the general fund for the fiscal year ended June 30, 2006 amounted to \$52,077,470. Actual revenues decreased final budget revenues by \$4,805,066. The total variance was primarily attributed to revenue derived by municipal license taxes \$2,889,988, charges for services \$766,257, miscellaneous for \$332,665, and others for \$816,156.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were \$47,272,404, which is 9.23 percent (\$4,805,066) less than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were \$48,015,656, which is 7.08 percent (\$3,688,704) less than the budgeted expenditures. Furthermore, the total actual other financing uses (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were \$1,782,836, which is 3.42 percent (\$1,409,726) higher than the budgeted other financing uses (net).

The total variance in expenditures was principally due to a strong cost reduction initiative implemented by the Municipality during current fiscal year, which emphasized in reducing general and administrative costs while increasing direct services to citizens.

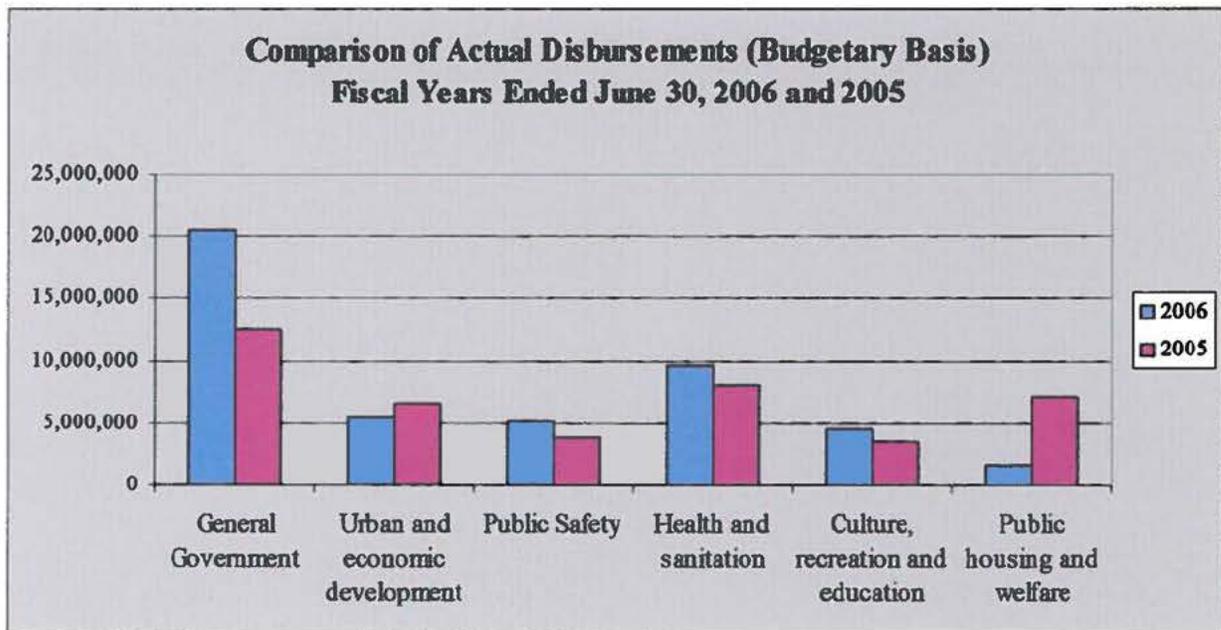
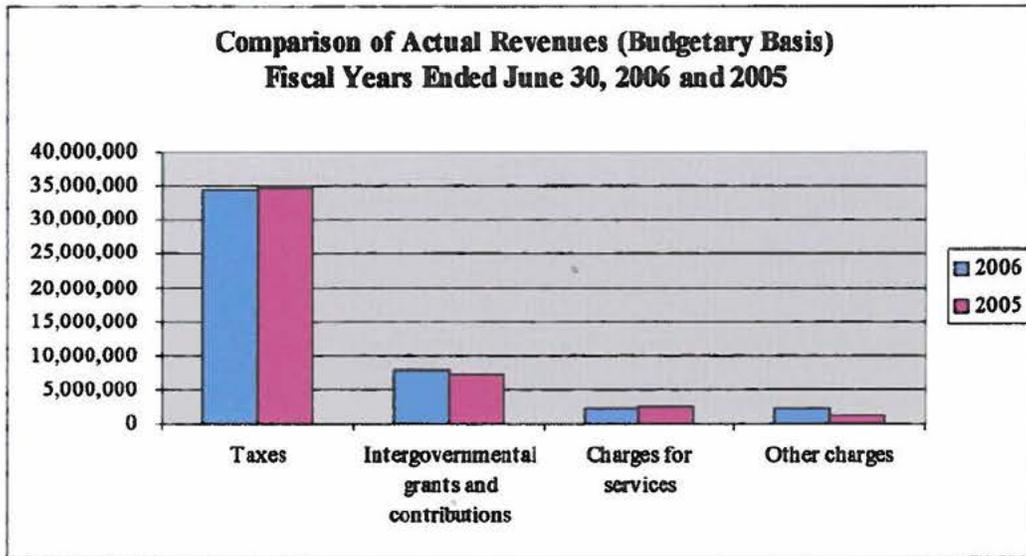
**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**BUDGETARY HIGHLIGHTS (CONTINUATION)**

**a) General Fund**

The following tables present the actual revenues and expenditures (budgetary basis) of the GF for the fiscal year ended June 30, 2006:



**COMMONWEALTH OF PUERTO RICO**  
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Management's Discussion and Analysis  
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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**a) Capital Assets**

The Municipality has invested \$118,802,137 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$51,666,223 at June 30, 2006. The total capital assets increased by \$1,120,500 during the current fiscal year mainly due to the current fiscal year's capital additions (\$6,889,154), which were partially offset by the depreciation and amortization expense (\$3,768,654), and reserve for impairment asset by (\$2,000,000) for the same period.

Approximately 93.35 percent of the total capital additions made to capital assets during the fiscal year ended June 30, 2006 were related to construction in progress (\$6,431,011). The major capital additions for the fiscal year ended June 30, 2006 were the following:

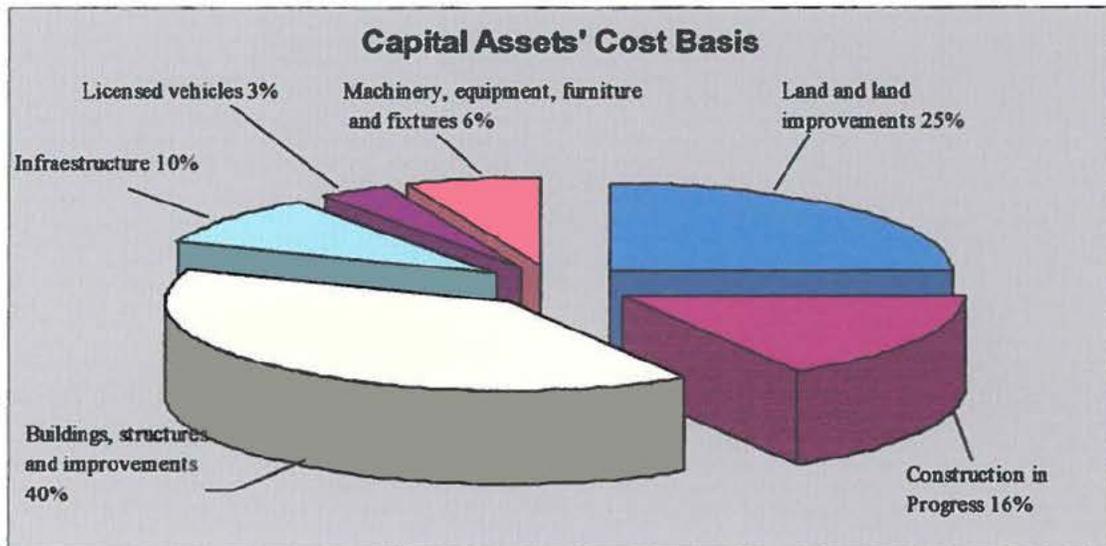
Improvements to Yagüez Theater	\$ 867,716
Improvements to Mayagüez City Hall	278,081
Construction of El Batey del Delfin park	151,711
Construction of the Discovery Square	363,916
Construction of recreational facilities at Paris Community	46,000
Design and construction of equestrian park	572,850
Improvements to recreational facilities for Las Carmelitas	228,069
Construction of Bridge at El Guallo Community	<u>33,852</u>
 Total major capital additions for the fiscal year ended June 30, 2005	 <u>\$2,542,195</u>

COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUATION)**

**a) Capital Assets (Continuation)**



**b) Debt Administration**

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

At June 30, 2006, the Municipality's total bonded debt amounted to \$58,178,192, consisting of bonds (\$57,380,000) and bond anticipation notes (\$798,192). Such debt is backed by the full faith and credit of the Municipality. The following is a summary of the debt activity for the fiscal year ended June 30, 2006:

- The Municipality has also certain outstanding notes payable due the Municipal Revenue Collection Center (\$3,191,749). Such notes payable decreased by \$441,795 during the current fiscal year mainly due to the principal payment made during the same period.

The total property assessed value the Municipality amounted to \$694,731,827 at June 30, 2005. The Municipality's legal debt margin amounted to \$21,697,148 at the current fiscal year-end.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

The territory of Mayagüez covers an area of approximately 77 square miles. Mayagüez is the municipality with the highest population density in the Region, with a population density of 1,267.9 habitants per square mile, which is equivalent to 20 percent of the total population of the Region.

Mayagüez is characterized by being the economic integration center of the Region since it is considered the principal source of jobs and services of commercial, educational and health nature in the Region. From the industrial perspective, Mayagüez accounts for 17 percent of the manufacturing jobs, 25 percent of the finance-related jobs and 21 percent of the service-related jobs in the Region.

Of the total population of the Municipality, 51 percent or approximately 51,000 persons are considered to live under the poverty level. This rate is lower than the overall rate for the region (54 percent) but higher than the overall rate for Puerto Rico (48 percent). Approximately 20 percent of the population of the Municipality receives public financial assistance as their principal source of income.

The municipalities of Añasco, Cabo Rojo, Hormigueros, San Germán, Sabana Grande and Mayagüez constitute the employment market area (EMA) of Mayagüez, as defined by the Department of Labor and Human Resources of Puerto Rico. Of the total 78,000 jobs in this Region, Mayagüez participates in 63 percent of them. This figure is lower than the corresponding EMA of the Ponce region (55 percent), but higher than the EMA of the San Juan region (24 percent). However, 82 percent of the workers of the Municipality are residents of Mayagüez, while the corresponding percentage for Ponce and San Juan are 86 percent and 75 percent, respectively.

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

Those factors were considered when preparing the Municipality's budget for the 2005-2006 fiscal year. There were no significant changes between the budgets for fiscal year 2004-2005 and the budgets for fiscal year 2005-2006. The budgets of the GF and the DSF for the fiscal year 2005-2006 amounted to \$52,024,970 and \$5,550,275, respectively. These amounts represent a decrease of \$174,721 (.33 percent) in the total budgeted revenues of the GF, and a decrease of \$551,874 (9.04 percent) in the total budgeted revenues of the DSF in comparison with the prior fiscal year.

**REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Mayagüez, Department of Finance and Budget, P. O. Box 945, Mayagüez, Puerto Rico, 00681.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Net Assets  
June 30, 2006

Assets	<u>Governmental activities</u>
<b>Current assets:</b>	
Cash in commercial banks, including cash equivalents of \$6,000,000.00	\$ 12,318,632
Accounts receivable, net of allowance for doubtful accounts of \$25,061,828	
Taxes:	
Property taxes	\$ 5,816,175
Municipal license taxes	4,056,757
Accrued interest on deposits and investments	74,836
Intergovernmental grants and contributions	1,491,979
Other	<u>838,612</u>
Total accounts receivable	12,278,359
Inventories and other current assets	175,970
Investments in certificate of deposits	7,292,400
<b>Restricted assets:</b>	
Cash in commercial banks	19,368,704
Cash in fiscal agent	26,547,896
Property taxes, net of allowance for doubtful accounts of \$3,978,936	3,027,142
Current portion of mortgage loans and notes	335,537
Accrued interest on deposits and investments	33,919
Intergovernmental grants and contributions	3,259,699
Other	<u>3,265</u>
Total restricted assets	<u>52,576,162</u>
Total current assets	<u>84,641,523</u>
<b>Noncurrent assets:</b>	
Restricted assets - mortgage loans and notes, excluding current portion	1,306,411
Capital assets, at cost:	
Depreciable capital assets	93,443,428
Nondepreciable capital assets	<u>25,358,709</u>
Total capital assets, at cost	118,802,137
Less: accumulated depreciation and amortization	<u>(51,666,223)</u>
Total capital assets, net of accumulated depreciation and amortization	67,135,914
Deferred charges, net of accumulated amortization of \$209,853	<u>199,069</u>
Total noncurrent assets	<u>68,641,394</u>
Total assets	<u><u>\$ 153,282,917</u></u>

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

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

<b>Liabilities and net assets</b>	<b>Governmental activities</b>
<b>Current liabilities (due within one year):</b>	
Accounts payable and accrued liabilities	\$ 5,350,086
Unearned revenue	11,397,329
Liabilities payable from restricted assets:	
Accounts payable and accrued liabilities, including accrued interest of \$1,508,278	\$ 2,222,265
Intergovernmental payables	1,163,211
Unearned revenue	14,955,190
Current portion of long-term obligations:	116,782
Bonds payable	5,498,000
Notes payable	243,130
Compensated absences	3,823,006
Total current portion of long-term obligations	28,021,584
Total current liabilities	44,768,999
 <b>Restricted noncurrent liabilities, excluding current portion (due in more than one year):</b>	
Bonds payable	52,680,192
Notes payable	2,948,619
Obligations under capital leases	235,639
Compensated absences	4,042,618
Estimated liability for municipal solid waste landfill closure and postclosure care costs	1,996,062
Claim and judgments	4,157,750
Total noncurrent liabilities	66,060,880
Total liabilities	110,829,879
 <b>Net assets (deficit):</b>	
Invested in capital assets, net of related debt	33,333,288
Restricted for:	
Debt service	7,737,727
Permanent improvements bonds	1,616,551
Mortgage loans and notes-non expendable	1,641,948
State legislative joint resolutions	22,678
Other specified purposes	8,692,446
Total restricted net assets	19,711,350
Unrestricted deficit	(10,591,600)
Total net assets	\$ 42,453,038

Commitments and contingencies (note 13)

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Activities  
Fiscal Year Ended June 30, 2006

Function/programs	Program revenues				Net (expenses) and changes in net assets
	Expenses	Charges for services	Program- specific operating grants and contributions	Program- specific capital grants and contributions	
<b>Governmental activities:</b>					
General government	\$ 18,035,902	-	425,038	215,092	\$ (17,395,772)
Urban and economic development	10,230,352	2,979,833	2,927,910	1,745,560	(2,577,049)
Public safety	7,726,094	3,885	971,377	468,389	(6,282,443)
Health and sanitation	11,751,780	-	-	-	(11,751,780)
Culture, recreation and education	15,552,549	-	9,917,708	-	(5,634,841)
Public housing and welfare	12,243,755	-	5,737,618	1,786,063	(4,720,074)
Interest on long-term obligations	3,810,337	-	-	-	(3,810,337)
<b>Total governmental activities</b>	<b>\$ 79,350,769</b>	<b>2,983,718</b>	<b>19,979,651</b>	<b>4,215,104</b>	<b>(52,172,296)</b>
<b>General revenues</b>					
<b>Taxes:</b>					
Property taxes					26,708,931
Municipal license taxes					13,596,515
Construction excise taxes					1,861,988
<b>Total taxes</b>					<b>42,167,434</b>
Intergovernmental grants and contributions, not restricted to specified programs					6,683,304
Interest on deposits and investments					1,530,039
Miscellaneous					2,121,851
<b>Total general revenues</b>					<b>52,502,628</b>
Net change in net assets					330,332
Net assets at beginning of fiscal year					41,001,843
Net assets restatement					1,120,863
Net assets at restated					42,122,706
Net assets at end of year					<b>\$ 42,453,038</b>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
 Balance Sheet – Governmental Funds  
 June 30, 2006

**Major governmental funds**

	General fund	State legislative joint resolutions special revenue fund	Head start special revenue fund	Permanent improvements bonds fund	Debt service fund	Other governmental funds	Total governmental funds
<b>Assets</b>							
Cash in commercial banks, including cash equivalents of \$6,000,000	\$ 12,318,632	-	-	-	-	-	\$ 12,318,632
Account receivable, net of allowance for doubtful accounts of \$25,061,828							
Taxes:							
Property taxes	5,816,175	-	-	-	-	-	5,816,175
Municipal license taxes	4,056,757	-	-	-	-	-	4,056,757
Accrued interest on deposits and investments	37,257	-	-	37,579	-	-	74,836
Intergovernmental grants and contributions	1,491,979	-	-	-	-	-	1,491,979
Due from other funds	3,161,407	-	-	-	-	-	3,161,407
Other	838,612	-	-	-	-	-	838,612
Investment in certificates of deposits	7,292,400	-	-	-	-	-	7,292,400
Restricted assets:							
Cash in commercial banks	-	13,606,290	44,192	31,701	-	5,686,521	19,368,704
Cash in fiscal agent	3,847,449	-	-	12,296,490	10,403,957	-	26,547,896
Property taxes receivable, net of allowance for doubtful accounts of \$3,978,936	-	-	-	-	3,027,142	-	3,027,142
Mortgage loans and notes, net of allowance for doubtful accounts of \$382,500	-	-	-	-	-	1,641,948	1,641,948
Accrued interest on deposits and investments	-	-	-	-	33,415	504	33,919
Intergovernmental grants and contributions	-	-	60,283	-	-	3,199,416	3,259,699
Due from other funds	-	-	-	-	1,456,965	970,695	2,427,660
Advances to other funds	-	-	3,265	-	-	-	3,265
Total assets	<u>\$ 38,860,668</u>	<u>13,606,290</u>	<u>107,740</u>	<u>12,365,770</u>	<u>14,921,479</u>	<u>11,499,084</u>	<u>\$ 91,361,031</u>
<b>Liabilities</b>							
Accounts payable and accrued liabilities	\$ 3,141,981	-	-	-	-	-	\$ 3,141,981
Intergovernmental payable and accrued liabilities	1,007,678	-	-	-	-	-	1,007,678
Due to other funds	1,666,267	-	-	-	-	-	1,666,267
Deferred revenues	21,754,794	-	-	-	-	-	21,754,794
Liabilities payable from restricted assets:							
Accounts payable and accrued liabilities	-	122,156	76,492	209,983	-	835,948	1,244,579
Intergovernmental payable and accrued liabilities	-	-	-	-	-	14,326	14,326
Due to other funds	-	-	11,059	119,110	96,321	3,696,313	3,922,803
Deferred revenues	-	13,461,456	19,521	-	1,465,580	1,474,212	16,420,769
Matured bonds due and payable	-	-	-	-	5,290,000	-	5,290,000
Matured interest due and payable	-	-	-	-	1,490,903	-	1,490,903
Total liabilities	<u>27,570,720</u>	<u>13,583,612</u>	<u>107,072</u>	<u>329,093</u>	<u>8,342,804</u>	<u>6,020,799</u>	<u>55,954,100</u>
<b>Fund balances</b>							
Reserved for:							
Encumbrances	1,376,457	-	-	-	-	-	1,376,457
Debt service	-	-	-	-	6,578,675	-	6,578,675
Permanent improvements bonds	-	-	-	12,036,677	-	368,465	12,405,142
Advances and long-term receivables	-	-	-	-	-	1,641,948	1,641,948
Other specified purposes	3,847,449	22,678	668	-	-	3,467,872	7,338,667
Unreserved	6,066,042	-	-	-	-	-	6,066,042
Total fund balances	<u>11,289,948</u>	<u>22,678</u>	<u>668</u>	<u>12,036,677</u>	<u>6,578,675</u>	<u>5,478,285</u>	<u>35,406,931</u>
Total liabilities and fund balances	<u>\$ 38,860,668</u>	<u>13,606,290</u>	<u>107,740</u>	<u>12,365,770</u>	<u>14,921,479</u>	<u>11,499,084</u>	<u>\$ 91,361,031</u>

Commitments and contingencies (note 13)

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
 Reconciliation of the Balance Sheet – Governmental Funds  
 to the Statement of Net Assets  
 June 30, 2006

The amounts of governmental activities reported in the statement of net assets and the balance sheet – governmental funds, are different for the following reasons:

Total fund balance reported in the balance sheet – governmental funds	\$ 35,406,931
Add (Deduct):	
Inventories and other current assets are not available to pay the current fiscal year expenditures, therefore are not reported in the governmental funds.	175,970
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds (see note 9). This is the carrying amount of capital assets, net of accumulated depreciation at June 30, 2006.	67,135,914
Certain deferred revenues in the governmental funds are recognized as revenues in the statement of activities. This is the amount of revenues that are measurable but not available at June 30, 2006 (property taxes, municipal licenses, intergovernmental grants and contributions, charges for services and certain miscellaneous revenues) (see note 10).	11,823,044
Debt issued by the Municipality has associated costs (debt issued costs) that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets and reported net of accumulated amortization.	199,069
The following liabilities are not due (mature) in the current fiscal year, therefore are not reported in the governmental funds at June 30, 2006. (see note 11):	
Bonds payable and bonds anticipation notes	(52,888,192)
Notes payable	(3,191,749)
Obligation under capital leases	(352,421)
Compensated absences	(7,865,624)
Claims and judgments	(4,157,750)
Estimated liability for municipal solid waste landfill closure and postclosure care costs	(1,996,062)
Accrued liabilities, including amounts due to other governments	(1,836,092)
<u>Net assets – governmental activities, as reported in the statement of net assets</u>	<u>\$ 42,453,038</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Revenues, Expenditures and  
Changes in Fund Balances – Governmental Funds  
Fiscal Year Ended June 30, 2006

	Major governmental funds						Total governmental funds
	General fund	State legislative joint resolutions special revenue fund	Head start special revenue fund	Permanent improvements bonds fund	Debt service fund	Other governmental funds	
<b>Revenues:</b>							
Taxes:							
Property taxes	\$ 20,974,727	-	-	-	6,669,610	-	\$ 27,644,337
Municipal license taxes	12,941,636	-	-	-	-	-	12,941,636
Construction excise taxes	1,861,988	-	-	-	-	-	1,861,988
Charges for services	2,692,660	-	-	-	-	21,544	2,714,204
Intergovernmental grants and contributions:							
United States of America	-	-	7,956,378	-	-	10,712,071	18,668,449
Commonwealth of Puerto Rico	6,968,445	1,721,091	1,997,533	445,429	-	1,074,778	12,207,226
Interest on deposits and investments	711,488	7,246	72	455,282	304,552	51,399	1,530,039
Miscellaneous	1,830,335	-	26,396	-	-	265,120	2,121,851
<b>Total revenues</b>	<b>47,981,279</b>	<b>1,728,337</b>	<b>9,980,379</b>	<b>900,711</b>	<b>6,974,162</b>	<b>12,124,912</b>	<b>79,689,780</b>
<b>Expenditures:</b>							
Current:							
General government	18,107,464	2,441	-	14,271	-	1,053,731	\$ 19,177,907
Urban and economic development	5,466,146	-	-	-	-	1,472,945	6,939,091
Public safety	6,589,467	-	-	-	-	1,165,810	7,755,277
Health and sanitation	10,125,326	-	-	-	-	-	10,125,326
Culture, recreation and education	3,483,114	-	10,854,024	-	-	556,520	14,893,658
Public housing and welfare	1,569,561	67,739	-	560,120	-	7,657,017	9,854,437
Debt service:							
Principal	565,335	-	-	-	5,561,000	-	6,126,335
Interest	214,831	-	-	-	3,604,067	-	3,818,898
Capital outlays:	510,645	1,650,911	-	2,429,847	-	2,297,751	6,889,154
<b>Total expenditures</b>	<b>46,631,889</b>	<b>1,721,091</b>	<b>10,854,024</b>	<b>3,004,238</b>	<b>9,165,067</b>	<b>14,203,774</b>	<b>85,580,083</b>
Excess (deficiency) of revenues over (under) expenditures	1,349,390	7,246	(873,645)	(2,103,527)	(2,190,905)	(2,078,862)	(5,890,303)
<b>Other financing sources (uses):</b>							
Transfers-in from other funds	1,947,588	-	873,895	-	1,864,517	2,155,277	6,841,277
Transfers-out to other funds	(4,605,743)	-	-	(455,282)	(304,552)	(1,475,700)	(6,841,277)
<b>Total other financing sources (uses), net</b>	<b>(2,658,155)</b>	<b>-</b>	<b>873,895</b>	<b>(455,282)</b>	<b>1,559,965</b>	<b>679,577</b>	<b>-</b>
<b>Net change in fund balance</b>	<b>(1,308,765)</b>	<b>7,246</b>	<b>250</b>	<b>(2,558,809)</b>	<b>(630,940)</b>	<b>(1,399,285)</b>	<b>(5,890,303)</b>
<b>Fund balance at beginning of fiscal year</b>	<b>12,598,714</b>	<b>15,432</b>	<b>418</b>	<b>14,595,486</b>	<b>6,088,752</b>	<b>6,877,571</b>	<b>40,176,373</b>
<b>Fund balance restatement</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,120,863</b>	<b>-</b>	<b>1,120,863</b>
<b>Fund balance, as restated</b>	<b>12,598,714</b>	<b>15,432</b>	<b>418</b>	<b>14,595,486</b>	<b>7,209,615</b>	<b>6,877,571</b>	<b>41,297,236</b>
<b>Fund balance at end of fiscal year</b>	<b>\$ 11,289,949</b>	<b>22,678</b>	<b>668</b>	<b>12,036,677</b>	<b>6,578,675</b>	<b>5,478,286</b>	<b>\$ 35,406,933</b>

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

*09/04/2007*

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
 Reconciliation of Statement of Revenues, Expenditures and Changes  
 in Fund Balances - Governmental Funds to the Statement of Activities  
 Fiscal Year ended June 30, 2006

The amounts of governmental activities reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances are different for the following reasons:

Net change in fund balances reported in the statement of revenues, expenditures and changes in fund balances – governmental funds	\$(5,890,303)
Add (Deduct):	

The following revenues recorded in the statement of activities do not provide current financial resources, therefore, are deferred in the governmental funds. This is the net change in deferred revenues of the following revenues items, which are measurable but not available at fiscal year end:

Property taxes	525,357
Municipal license taxes	654,879
Intergovernmental grants and contributions	2,333
Charges for services	(27,015)

Governmental funds report capital outlays as expenditures. However in the statement of activities the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expense. This is the amount by which capital outlay expenditures (\$6,889,154) exceeded depreciation and amortization expense (\$3,768,654) and reserve for impairment asset (\$2,000,000) for the fiscal year ended June 30, 2006.	1,120,500
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Repayment of principal of long-term obligations is reported as an expenditure in the governmental funds, however, the repayment reduces long-term liabilities in the statement of net assets (see note 11).	6,126,335
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Certain accrued interest expense reported in the statement of activities do not required the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	(17,375)
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Amortization of deferred charges reported in the statement of activities does not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	(22,920)
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Some expenses reported in the statement of activities require the use of current financial resources, therefore, are not reported as expenditures in the statement of governmental funds.	(2,223,258)
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Generally, inventory and other current assets are recorded as expenditures in the governmental funds when paid rather than capitalized as an asset. However, these assets are capitalized in the statement of net assets. This amount represents the net change in these assets for the current fiscal year.	81,799
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Net increase in net assets, as reported in statement of activities	<u>\$ 330,332</u>
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The accompanying notes to the basic financial statement are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Revenues and Expenditures – Budget and  
Actual – Budgetary Basis – General Fund  
Fiscal Year Ended June 30, 2006

	Budgeted amounts		Actual amounts (budgetary basis) (see note 1)	Variance with final budget- over (under)
	Original	Final		
<b>Revenues:</b>				
Taxes:				
Property taxes	\$ 19,794,067	19,794,067	19,794,067	-
Municipal license taxes	15,800,000	15,800,000	12,910,012	(2,889,988)
Construction excise taxes	2,050,000	2,050,000	1,861,988	(188,012)
Charges for services	3,127,061	3,127,061	2,360,804	(766,257)
Intergovernmental grants and contributions	8,243,342	8,243,342	7,910,636	(332,706)
Interest on deposits and investments	900,000	900,000	604,562	(295,438)
Miscellaneous	2,163,000	2,163,000	1,830,335	(332,665)
<b>Total revenues</b>	<b>52,077,470</b>	<b>52,077,470</b>	<b>47,272,404</b>	<b>(4,805,066)</b>
<b>Expenditures:</b>				
Current:				
General government	20,676,157	21,604,489	20,538,923	(1,065,566)
Public Safety	5,931,536	5,753,716	5,059,145	(694,571)
Urban and economic development	6,139,127	5,927,319	5,444,714	(482,605)
Health and sanitation	10,360,653	10,017,186	9,608,837	(408,349)
Culture, recreation and education	4,914,251	5,215,688	4,494,243	(721,445)
Public housing and welfare	1,954,925	1,895,331	1,579,163	(316,168)
Debt service:				
Principal	565,335	565,335	565,335	-
Interest	214,831	214,831	214,831	-
Capital outlays	-	510,465	510,465	-
<b>Total expenditures</b>	<b>50,756,815</b>	<b>51,704,360</b>	<b>48,015,656</b>	<b>(3,688,704)</b>
<b>Excess of revenues over expenditures</b>	<b>1,320,655</b>	<b>373,110</b>	<b>(743,252)</b>	<b>(1,116,362)</b>
<b>Other financing sources (uses):</b>				
Transfers-in from other funds	-	-	-	-
Transfers-out to other funds	(1,320,655)	(1,784,174)	(1,782,836)	1,338
Budgetary surplus of previous fiscal year	-	1,411,064	-	(1,411,064)
<b>Total other financing sources (uses), net</b>	<b>(1,320,655)</b>	<b>(373,110)</b>	<b>(1,782,836)</b>	<b>(1,409,726)</b>
<b>Excess of revenues and other financing sources over expenditures and other financing sources</b>	<b>\$ -</b>	<b>-</b>	<b>(2,526,088)</b>	<b>(2,526,088)</b>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies**

The Municipality of Mayagüez (the Municipality) is a local municipal government constituted on July 29, 1760 in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

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

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

**a) Financial Reporting Model**

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the fiscal year ended June 30, 2006, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

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

RSI is information presented along with, but separate from, the Municipality's basic financial statements. RSI is composed of the following elements: (1) Management's Discussion and Analysis (MD&A) and (2) Schedule of Funding Progress – Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS).

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

**a) Financial Reporting Model (Continuation)**

*The Schedule of Funding Progress – Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities* provides a three-year trend information (using latest published data available) of the funding status of ERS, which is a multi-employer cost-sharing retirement system in which the Municipality is a participating employer (see note 12).

Other supplementary information presented in this report for purposes of additional analysis consist of: (1) combining and individual nonmajor governmental fund financial statements, (2) budgetary comparison schedule – debt service fund, and (3) schedules of capital assets used in the operations of governmental funds, as listed in the accompanying table of contents.

**b) Financial Reporting Entity**

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

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14), as amended, has set forth criteria to be considered in determining financial accountability for financial reporting purposes. These criteria include appointing a voting majority of an organization's governing body and: (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***b) Financial Reporting Entity (Continuation)***

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

- a) The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b) The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c) The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2006.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***c) Government-wide Financial Statements***

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

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

- **Invested in capital assets, net of related debt** – This net asset category consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net assets** – This net asset category consists of net resources restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

c) Government-wide Financial Statements (Continuation)

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

- (1) **Debt service** – Represent net resources available to cover future debt service payments of bonds and notes payable.
  - (2) **Permanent improvements fund** – Represent net resources available to finance the acquisition, construction or improvement of major capital assets under contracts and other commitments.
  - (3) **Mortgage loans and notes** – Represent net resources available from grants provided by the U.S. Department of Housing and Urban Development (HUD), which have been set aside to provide construction mortgage loans to private business enterprises doing business in the Municipality (see note 6).
  - (4) **State legislative joint resolutions** – Represent net resources available from certain state grants, which have been set aside different purposes. Generally to provide multipurpose services and donations, construction or improvements of certain capital assets, other than accounted in permanent improvements bonds fund, and partially subsidy qualified administrative and operational activities.
  - (5) **Other specified purposes** – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs. Also represent net resources available for the payment of certain accounts payable and commitments approved by the Government Development Bank for Puerto Rico (GDB), a component unit of the Commonwealth and fiscal agent of the Municipality.
- **Unrestricted deficit** – This category consists of the excess of liabilities over related assets that are neither externally nor legally restricted, neither invested in capital assets. However, assets reported within unrestricted deficit often are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints that are imposed by management but can be removed or modified.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

**c) Government-wide Financial Statements (Continuation)**

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

**General government:**

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of legal affairs
- Department of internal audit
- Department of management of information systems
- Department of administrative services
- Department of press and communications

**Public safety:**

- Department of civil defense
- Department of municipal police
- Department of fire control

**Urban and economic development:**

- Department of planning and development
- Department of urban development
- Department of conservation and ornate

**Health and sanitation**

- Department of health
- Department of sanitation
- Department of environmental control

**Culture, recreation and education:**

- Department of culture and tourism
- Department of recreation and sports
- Department of education

**Public housing and welfare:**

- Department of housing
- Office of services to citizens
- Department of elderly services and day care center

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

c) Government-wide Financial Statements (Continuation)

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

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

- **Charges for services** – These revenues generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific operating and capital grants and contributions** – These revenues consist of transactions that are either mandatory or voluntary nonexchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Capital grants and contributions consist of revenues or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

**c) Government-wide Financial Statements (Continuation)**

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

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

The Municipality classifies all of its activities as *governmental activities* in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other nonexchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the GFFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is financed primarily through user charges; or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

**d) Governmental Fund Financial Statements**

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

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***d) Governmental Fund Financial Statements (Continuation)***

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

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

- ***General fund*** – The general fund is the Municipality's main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- ***Special revenue funds*** – The special revenue funds are major and nonmajor governmental funds, as defined below, used by the Municipality to account for revenues derived from grants, contributions or other revenue sources that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in major capital projects which are accounted for in the capital project funds). The two major special revenue funds are (1) state legislative joint resolution which is used to account for certain operating grants awarded by the legislative of the Commonwealth of Puerto Rico to subsidy certain operational and administrative activities by the Municipality, and (2) head start fund which is used to account for grants received by the Municipality from health and human services to provide educational services to children in pre-school age. The nonmajor special revenue funds are described in the other supplementary information section of this statement.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

d) Governmental Fund Financial Statements (Continuation)

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

The outstanding balance of general long-term debts for which debt service payments do not involve the advance accumulation of resources (such as notes payable, obligations under capital leases, accrued compensated absences, accrued legal claims and judgments and the estimated liability for municipal solid waste landfill closure and post-closure care costs) are only accounted for in the accompanying statement of net assets. The debt service payments of such debts are accounted for in the general fund as debt service – principal and debt service – interest expenditures.

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

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

- **Permanent funds** – Permanent funds are nonmajor governmental funds used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the Municipality's programs, that is, for the benefit of the Municipality or its citizens.

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***d) Governmental Fund Financial Statements (Continuation)***

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund is considered a major governmental fund if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures for these purposes, means all expenditures, including operating and nonoperating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are: (1) the general fund, (2) the state legislative joint resolutions special revenue fund, (3) the head start special revenue fund, (4) permanent improvements bonds fund, and (5) the debt service fund.

The state legislative joint resolutions special revenue fund is a major governmental fund used to account for financial resources derived from grants awarded each year by the Commonwealth's Senate and House of Representatives (the Commonwealth's Legislature). The purpose of the amounts awarded by the Commonwealth's Legislature vary from year to year, but are generally restricted to: (1) partially subsidy certain qualifying administrative and operational activities of the Municipality, (2) provide specific multipurpose services and donations to citizens and (3) finance the acquisition, construction or improvement of certain capital assets (not accounted for in capital project funds) approved by the Commonwealth's Legislature.

The head start special revenue fund is a major governmental fund used to account for financial resources derived from grants awarded each year by the Administration for Children and Families of the U.S. Department of Health and Human Services (DHHS) for the operation of comprehensive child development programs which serve children from birth to age 5, pregnant women, and their families. These programs are child-focused programs and have the overall goal of increasing the school readiness of young children in low-income families. Amounts awarded by DHHS are restricted to provide a wide range of individualized services in the areas of education and early childhood development; medical, dental and mental health; nutrition; and parent involvement. Services under these programs are provided through service centers approved by DHHS.

The accompanying GFFS are accompanied by other statements and schedules required by GAAP: (1) the statement of revenues and expenditures – budget and actual – budgetary basis – general fund, (2) the reconciliation of the balance sheet – governmental funds to the statement of net assets, and (3) the reconciliation of the statement of revenues, expenditures and changes in fund balances – governmental funds to the statement of activities.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

e) *Measurement Focus and Basis of Accounting*

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

*e) Measurement Focus and Basis of Accounting (Continuation)*

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

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

Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues (see note 10).

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

**Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2005, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2006 (see note 10).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***e) Measurement Focus and Basis of Accounting (Continuation)***

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, interest on deposits and investments, charges for services and certain miscellaneous revenues. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues (see note 10).

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

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

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) **Summary of Significant Accounting Policies (Continuation)**

*e) Measurement Focus and Basis of Accounting (Continuation)*

At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds.

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

- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due on July 1 of the following fiscal year, which are recorded as governmental fund liabilities when resources are available in the debt service funds (generally, June 30).
- Obligations under capital leases, compensated absences, estimated liability for municipal solid waste landfill closure and postclosure care costs, amounts subject to accrued claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).
- Other accrued liabilities not due and payable or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources are recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

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

*f) Stewardship, Compliance and Accountability*

**Budgetary Control**

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

*f) Stewardship, Compliance and Accountability (Continuation)*

**Budgetary Control (Continuation)**

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

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

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

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

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) **Summary of Significant Accounting Policies (Continuation)**

*f) Stewardship, Compliance and Accountability (Continuation)*

**Budgetary Control (Continuation)**

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

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

**Budgetary Accounting**

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

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

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

*f) Stewardship, Compliance and Accountability (Continuation)*

**Budgetary Accounting (Continuation)**

Because accounting principles applied for the purposes of the developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the general fund's budgetary basis and GAAP actual amounts is presented as follows:

Excess of revenues and other financing sources over expenditures and other financing uses - budgetary basis	\$(2,526,088)
Timing differences:	
Add:	
Current year encumbrances recorded as expenditures for budgetary purposes	1,374,457
Deduct:	
Prior year encumbrances recorded as current year expenditures for GAAP purposes	(1,261,587)
Entity differences:	
Non-budgeted expenditures	5,020,561
Basis of accounting differences:	
Net decrease in property taxes receivable	(668,179)
Net increase in municipal license taxes receivable	689,797
Net decrease in intergovernmental receivables	(3,706,517)
Net decrease in accrued interest receivable	(28,155)
Net decrease in other receivables	(84,144)
Net increase in due/advances from other funds	362,138
Net increase in deferred revenue	(588,270)
Net decrease in accounts payable and accrued liabilities	291,532
Net decrease in intergovernmental payables and accrued liabilities	(184,310)
Excess of revenues and other financing sources over expenditures and other financing uses -general fund- GAAP basis	\$(1,308,765)

The Municipality does not legally adopt budgets for its major special revenue funds: (1) the state legislative joint resolutions special revenue fund and (2) the head start special revenue fund. The financial resources received by the state legislative joint resolutions special revenue fund and the head start special revenue fund are not subject to budgeting by the Municipality since the grants awarded each year by the respective grantors vary from year to year, the respective amounts are granted at the discretion of grantors, and the Municipal Legislature is not required by Act No. 81 to approve budgets for those two major governmental funds.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***g) Unrestricted and Restricted Deposits***

The Municipality's deposits are composed of: (1) cash on hand, (2) demand deposits in commercial banks and GDB, and (3) cash and cash equivalents in commercial banks. Cash equivalents consist of certificates of deposit with original maturities of three months or less, which amounted to \$6,000,000 at June 30, 2006 (see note 2).

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements and any excess is invested in certificates of deposit with commercial banks.

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

Cash with fiscal agent in the general and debt service funds consists of property tax collections amounting to \$1,456,963 and \$10,403,957, respectively, which are restricted for the payment of the Municipality's debt service, as required by law. Cash in fiscal agent in the general fund also consists of proceeds of bonds, amounting to \$2,390,486, which are restricted for the payment certain accounts payable and specific commitments, previously agreed with and approved by GDB. Cash in fiscal agent recorded in the major and nonmajor governmental funds consists of unspent proceeds of bonds and notes and the balance of interest and noninterest bearing accounts amounting to \$12,296,490, which is restricted for the acquisition, construction or improvement of major capital assets.

Restricted cash in commercial banks for the state legislative joint resolutions special revenue fund and the head start special revenue fund, amounting to \$13,606,290 and \$44,192 respectively, represent the balance of interest and noninterest-bearing accounts restricted to finance the operations of these state and federally funded programs. Restricted cash in commercial banks for other governmental funds, amounting to \$5,686,521, represents the balance of interest and noninterest bearing accounts restricted to: (1) finance the operations of all other federal and state funded programs (\$4,823,810) recorded in the nonmajor special revenue funds, (2) grant mortgage loans to private business enterprises under the Program for the Economic Development of Mayagüez (\$187,263) (see note 6), and (3) finance the acquisition, construction and improvement of major capital assets (\$675,448).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) **Summary of Significant Accounting Policies (Continuation)**

*h) Unrestricted and Restricted Accounts and Notes Receivable*

Receivables consist of all revenues earned but not collected at June 30, 2006. These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable. At June 30, 2006 accounts receivable in the GFFS is principally composed as follows:

**General fund** – Accounts receivable in the general fund consist principally of:

- Property taxes amounting to \$5,816,175, net of an allowance for uncollectible accounts of \$12,636,508 (see note 4).
- Municipal license taxes amounting to \$4,056,757, net of an allowance for uncollectible accounts of \$1,519,352 (see note 3).
- Rent and utility charges, amounting to \$11,140,968, due from Advance Cardiology Center Corporation (ACCC), a private corporation in charge of the administration of the Ramón Emeterio Betances Medical Center (REBMC), a municipal hospital. This receivable is reserved with an allowance for uncollectible accounts of \$10,905,968 since its future collection is uncertain (see note 7).
- Due/advances from other funds amounting to \$3,161,407.
- Grants and contributions pursuant to state funded programs amounting to \$1,491,979.

**Debt service fund** – Accounts receivable in the debt service fund are composed principally of: (1) property taxes amounting to \$3,027,142, net of an allowance for uncollectible accounts of \$3,978,936, as established by law, and (2) amounts due from the general fund amounting to \$1,456,965 which are restricted for the payment of the Municipality's debt service (see notes 4 and 8).

**Non-major governmental funds** – Accounts receivable in the nonmajor governmental funds consist mainly of:

- Grants and contributions amounting to \$3,199,416 pursuant to federal and state funded programs (see note 5).
- Due from other funds amounting to \$970,695 (see note 8).
- Mortgage loans and notes receivable, amounting to \$1,641,948, from private entities under the Program for the Economic Development of Mayagüez, sponsored by the Municipality (see note 6).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***h) Unrestricted and Restricted Accounts and Notes Receivable (Continuation)***

**Non-major governmental funds (Continuation)**

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

***i) Inventories and Other Current Assets***

Inventories consist of construction materials and inventories of office supplies, food and medicines, which are held for consumption. Other current assets consist of prepaid rent and insurance costs. Generally, inventories are capitalized (consumption method) and stated at cost using the first-in, first-out method (FIFO) in the GWFS. Inventories and prepaid expenses in the GFFS are generally recorded as expenditures (purchase method) when purchased (paid) rather than capitalized as an asset.

***j) Investments***

Investments consist of certificates of deposit with original maturities exceeding three months, but not exceeding one year. Investments are held in commercial banks and are recorded at cost, which approximates fair value.

***k) Deferred Charges***

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

***l) Capital Assets***

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as capital outlays (expenditures).

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

l) Capital Assets (Continuation)

In the statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2002 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2002 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

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

As more fully described in note 14, during the prior fiscal, year, the Municipality implemented the new accounting standards issued by GASB No. 34 for which the Municipality partially made the retroactive application of the new capitalization requirements to its general infrastructure assets at June 30, 2003. The Municipality reported all networks of infrastructure assets for which information was available at the end of the prior fiscal year.

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

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20
Machinery and equipment under capital leases	3 to 5

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***l) Capital Assets (Continuation)***

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

The Municipality has adopted GASB No. 42, *Accounting for impairment of capital assets and for insurance recoveries*. This statement establishes accounting and financial reporting standard for impairment of capital assets. The Municipality made an evaluation of the capital assets and impairment losses amounted to \$2,000,000 at June 30, 2006.

***m) Deferred Revenues***

In the GFFS, deferred revenue arises when one of the following situations occur:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period (unavailable revenue). As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria are met, the liability for deferred revenue is removed and revenue is recognized.
- The Municipality receives resources before it has a legal claim to them (unearned revenue). In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

***n) Compensated Absences***

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2006 and (2) is not contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***n) Compensated Absences (Continuation)***

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

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 60 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

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

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

***o) Long-term Debt***

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds payable, notes payable, bond anticipation notes, obligations under capital leases, accrued compensated absences, estimated liability for municipal solid waste landfill closure and postclosure care costs and accrued legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due on July 1 of the following fiscal year, are recorded as governmental fund liabilities in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

In the GWFS debt issuance costs are reported as deferred charges, which are amortized under the straight-line method over the life of the debt, while in the GFFS such costs are recognized as expenditures during the current period.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***o) Long-term Debt (Continuation)***

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

***p) Municipal Solid Waste Landfill Closure and Postclosure Care Costs***

Municipal solid waste landfill closure and postclosure care costs are accounted for under the provisions of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, issued by GASB (GASB No. 18).

The estimated liability for municipal solid waste landfill closure and postclosure care costs (including monitoring and maintenance) includes an estimate of all costs to be incurred near or after the close of the Municipality's solid waste landfill. In the government-wide statement of net assets, this liability is recognized under the accrual basis of accounting over the useful life of the landfill, even though such costs will only be incurred near or after the close of the landfill.

The estimates of closing and postclosing costs include: (1) the cost of equipment and/or facilities that will be acquired near the time the landfill stops accepting waste or after for the purposes of postclosure care and monitoring, (2) the cost of applying the final cover and (3) the cost of postclosure maintenance and monitoring. These cost estimates are made using current costs (costs that would be incurred if these services would have been obtained during the current period) allocated in the accompanying statement of net assets based on the landfill capacity used through June 30, 2006. The liability is adjusted annually to reflect the effects of inflation, advances in technology, changes in regulations or similar changes.

Any changes in the estimated total current costs that occur before the landfill stops accepting solid waste are reported in the period of the changes, and an adjustment is made to the calculation, which is accounted for prospectively as a change in accounting estimate. On the other hand, the accounting for a horizontal expansion of the landfill has no effect in the factors used to calculate the accrued liability for the closure and postclosure costs of the original landfill. In this case, a separate calculation of the closure and postclosure care costs for the expanded portion of the landfill is made for each financial reporting period.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

p) *Municipal Solid Waste Landfill Closure and Post-closure Care Costs (Continuation)*

Changes in the estimated total current costs for landfill closure and postclosure care costs may also occur after the date that the landfill stops accepting solid waste. These changes may include changes due to inflation (or deflation), changes in technology, changes in closure and postclosure care requirements, corrections of errors in estimation, and changes in the extent of environmental remediation that is required. Changes in these estimates would be reported in the period in which the change is probable and reasonably estimable.

In the GFFS, municipal solid waste landfill closure and postclosure care costs are recorded in the accounting period in which they are due (when they mature) under the modified accrual basis of accounting.

q) *Leases*

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

**q) Leases (Continuation)**

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

In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded simultaneously as: (1) expenditures and (2) other financing sources. Minimum lease payments are recorded as expenditures in the GFFS.

**r) Accounting for Pension Costs**

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the Commonwealth is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth report the total amount of the net pension obligation of ERS, including any amount that may correspond to the Municipality.

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

**s) Risk Management**

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by the Municipal Revenue Collection Center ("CRIM", by its Spanish acronyms), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico (see note 4).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

**s) Risk Management (Continuation)**

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

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

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

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

**t) Reservations of Fund Balances**

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

t) Reservations of Fund Balances

- **Debt Service** – Represent fund balances available to cover future debt service payments (principal and interest) on bonds payable, which are accounted for in the debt service fund.
- **Permanent Improvements Bonds** – Represent the reservation of financial resources to be used for the acquisition, construction or improvement of capital assets under contracts and other commitments. These amounts are accounted for in the permanent improvements bonds and special revenue funds.
- **Advances and long-term receivables** – Represent the reservation of financial resources set aside for long-term accounts, notes and interfund receivables, which are not considered current available financial resources at June 30.
- **Other Specified Purposes** – Represent financial resources set aside for: (1) use in federal and state grant programs and (2) payment of certain accounts payable and commitments approved by GDB.

u) Interfund Activities

The Municipality has the following types of reciprocal and nonreciprocal interfund activities recorded among governmental funds in the accompanying GFFS:

- **Interfund loans** – Represent amounts provided with a requirement for repayment, which are recorded as “due from” in the lender governmental fund and “due to” in the borrower governmental fund. Interfund receivables, which are not considered to be currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period of time, interfund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as a transfer from the governmental fund that made the loan.
- **Interfund transfers** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as other financing sources in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.
- **Interfund reimbursements** – Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

In the GFFS, interfund activity has not been eliminated, as permitted by GAAP.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

*v) Use of Estimates*

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

*w) Future Adoption of Accounting Pronouncements*

In April 2004, GASB issued its Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (GASB No. 43). This statement establishes uniform financial reporting standards for other postemployment benefit plans (OPEB plans, including postemployment healthcare, life insurance, etc.) and supersedes the interim guidance included in GASB Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach followed in this statement is generally consistent with the approach adopted in GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, with certain modifications to reflect differences between pension plans and OPEB plans. The requirements of this statement are effective for the Municipality's fiscal year commencing on July 1, 2006.

In June 2004, GASB issued its Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB No. 45). This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities/assets, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local government employers. The requirements of this statement are effective for the Municipality's fiscal year commencing on July 1, 2007.

The Municipality's management has concluded that the future adoption of GASB Statements No. 43, and 45 will not have a significant impact on the Municipality's basic financial statements.

**2) Deposits and Investments**

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

2) Deposits and Investments (Continuation)

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2006.
- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2006, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2006, the Municipality's investments in certificates of deposits are recorded at cost, which approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2006, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.
- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of \$100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2006. Therefore, the Municipality's management has concluded that at June 30, 2006 the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.
- **Foreign exchange risk** – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2006.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**2) Deposits and Investments (Continuation)**

At June 30, 2006 the total deposits are as follows:

	Major governmental funds						Total governmental funds
	General fund	State legislative joint resolution special revenue fund	Head start special revenue fund	Debt service fund	Permanent improvements bonds special revenue fund	Other governmental funds	
<b>Unrestricted:</b>							
Cash in commercial banks, including cash equivalents of \$6,000,000	\$ 12,318,632	-	-	-	-	-	\$ 12,318,632
Total unrestricted deposits	<u>\$ 12,318,632</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>\$ 12,318,632</u>
<b>Restricted (note 1):</b>							
Cash in commercial banks	-	13,606,290	44,192	-	31,701	5,686,521	19,368,704
Cash in GDBG, as fiscal	3,847,449	-	-	10,403,957	12,296,490	-	26,547,896
Total restricted deposits	<u>3,847,449</u>	<u>13,606,290</u>	<u>44,192</u>	<u>10,403,957</u>	<u>12,328,191</u>	<u>5,686,521</u>	<u>45,916,600</u>
Total carrying amount of deposits	<u>\$ 16,166,081</u>	<u>13,606,290</u>	<u>44,192</u>	<u>10,403,957</u>	<u>12,328,191</u>	<u>5,686,521</u>	<u>\$ 58,235,232</u>

**3) Municipal License Taxes**

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

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

**COMMONWEALTH OF PUERTO RICO**  
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Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**4) Property Taxes**

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as deferred revenues in the GWFS and the GFFS (see note 10). Total municipal license tax receivable, net of an allowance for uncollectible accounts of \$1,519,352, amounted to \$4,056,757 at June 30, 2006. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$11,397,329 at June 30, 2006.

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

CRIM is responsible for the billings and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs to the Municipality the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the fiscal year, CRIM advances funds to the Municipality based on the initial estimated collection amounts for the fiscal year. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and the property tax amounts actually collected from taxpayers during the fiscal year. This settlement has to be completed on a preliminary basis not later than December 31 following the fiscal year end. If in any given fiscal year, CRIM remits to the Municipality property tax advances, which are less than the property tax actually collected, an intergovernmental receivable is recorded at June 30 in the Municipality's basic financial statements. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30. For the fiscal year ended June 30, 2006, the advances remitted by CRIM exceeded the actual property tax collections by \$20,255, which is recorded within intergovernmental payables in the accompanying GWFS and GFFS (see note 5).

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2006 was 6.43 percent (of which taxpayers pay 6.23 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property, deflated to 1957 market prices. The total real property tax rate in force at June 30, 2006 was 8.43 percent (of which 8.23 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

4) Property Taxes (Continuation)

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

According to Act No. 81, included within the total personal and real property tax rates of 6.43 percent and 8.43 percent, respectively, there is a levy of an annual special tax of 1.03 percent of the assessed value of all real and personal property not exonerated from taxation. This special tax is levied by the Commonwealth but is collected by CRIM. Collections of this special tax are directly remitted by CRIM to the Commonwealth's debt service fund, for the payment of the general long-term debt of the Commonwealth.

In addition, included within the total personal and real property tax rates of 6.43 percent and 8.43 percent, respectively, there is a portion of the tax rate in the amount of 1.40 percent that is restricted for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

Furthermore, included within the total personal and real property tax rates of 6.43 percent and 8.43 percent, respectively, there is a portion of the tax rates that is recorded in the Municipality's general fund, of which a portion is restricted for the payment of: (1) the insurance premiums acquired through the Department of Treasury, (2) the principal and interest on the Municipality's 1996 serial bonds of \$400,000, (3) the monthly contributions to CRIM, which are statutorily required as the Municipality's share of CRIM's operating expenses, (4) statutory contributions to the Puerto Rico Health Services Administration (PRHSA), as the Municipality's share of the cost of the public health insurance coverage provided to qualifying low-income citizens, (5) certain notes payable to CRIM (see note 11) and, (6) certain amounts due to certain agencies and component units of the Commonwealth, which are recorded within intergovernmental payables in the accompanying GWFS and GFFS. The 0.20 percent of unrestricted personal and real property taxes paid by the Department of Treasury as a subsidy is recorded in the Municipality's general fund.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
 Fiscal Year Ended June 30, 2006

**4) Property Taxes (Continuation)**

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

The composition of property taxes receivable and the related deferred revenue is as follows at June 30, 2006:

	<b>General fund</b>	<b>Debt service fund</b>	<b>Total</b>
Gross property taxes receivable	\$ 18,452,683	7,006,078	\$ 25,458,761
Less:			
Allowance for uncollectible accounts	(12,636,508)	(3,978,936)	(16,615,444)
Net property taxes receivable	\$ 5,816,175	3,027,142	\$ 8,843,317
 Deferred (unavailable) property tax revenues in GFFS (note 10)	 \$ 5,600,886	 1,465,580	 \$ 7,066,466

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**5) Intergovernmental Receivables and Payables**

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

	Major funds	Other governmental funds	Totals governmental funds	Statement of net assets
<i>Intergovernmental receivables:</i>				
Grants and contributions:				
U.S. Department of Health and Human Services:				
Special program for the elderly fund	\$ -	14	14	\$ 14
Head start special revenue fund	60,283	-	60,283	60,283
U.S. Department of Justice				
Cops Hiring	-	881,214	881,214	881,214
U.S. Department of Homeland Security				
Homeland security	-	529,639	529,639	529,639
Traffic enforcement	-	6,956	6,956	6,956
Federal Emergency Management Agency -				
Public assistance grant fund	-	823,892	823,892	823,892
U.S. Department of Housing and Urban Development (HUD):				
Lower income housing assistance fund	-	37,915	37,915	37,915
Urban renewal fund	-	62,932	62,932	62,932
CDBG program fund	-	293,378	293,378	293,378
Office of the Governor of Puerto Rico:				
Dulces Labios demolition fund	-	44,700	44,700	44,700
Felices Diaz special community fund	-	295,210	295,210	295,210
Surplus designation fund	-	210,092	210,092	210,092
Quebrada Grande special community fund	-	13,474	13,474	13,474
Puerto Rico Health Department - general fund	1,094,508	-	1,094,508	1,094,508
Puerto Rico Treasury Department - general fund	331,625	-	331,625	331,625
Puerto Rico Vocational Rehabilitation Administration - general fund	65,846	-	65,846	65,846
Total intergovernmental receivables	<u>\$ 1,552,262</u>	<u>3,199,416</u>	<u>4,751,678</u>	<u>\$ 4,751,678</u>
<i>Intergovernmental payables:</i>				
Excess of property tax advances over collections				
CRIM - general fund	\$ 73,122	-	73,122	\$ 73,122
Excess of property tax advances over collections				
CRIM - general fund 2006	20,255	-	20,255	20,255
Payroll withholdings (general fund):				
Department of Labor SUTA	53,387	-	53,387	53,387
Employees Retirement System of the Government of Puerto Rico and Its Instrumentalities	210,728	-	210,728	210,728
Utilities (general fund):				
Puerto Rico Aqueduct and Sewer Authority	43,812	-	43,812	181,834
Miscellaneous:				
Government Development Bank of Puerto Rico - Puerto Rico General Services Administration	606,374	-	606,374	606,374
U.S. Department of Housing and Urban Development (HUD): CDBG program fund	-	5,918	5,918	5,918
Special program for the elderly fund	-	5,929	5,929	5,929
U.S. Department of Health and Human Services:				
Child care sport and recreation fund	-	2,479	2,479	2,479
Total intergovernmental payables	<u>\$ 1,007,678</u>	<u>14,326</u>	<u>1,022,004</u>	<u>\$ 1,163,211</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

6) **Mortgage Loans Receivable**

The Municipality administers the Program for the Economic Development of Mayagüez for the purpose of granting loans to private business enterprises to promote and enhance the industrial development, commercial activity, and the creation of new employment opportunities in low-income communities in Mayagüez (the Program).

Under the Program, the Municipality has given mortgage loans to various real estate developers doing business in Mayagüez. These loans are funded with grants received by the Municipality from HUD, which is accounted for in the Mayagüez economic development fund, a nonmajor permanent fund.

The proceeds of these loans have been used by real estate developers to perform construction activities directed to enhance the economic activity in the Mayagüez area. These loans are repaid in installments of principal and interest through periods ranging from 3 to 20 years, and are guaranteed with first liens on the related properties.

These loans bear interest at rates that fluctuate between 2.00 percent and 8.00 percent. Interest income on the aforementioned mortgage loans may be used by the Municipality to grant additional loans and for purposes that support certain qualifying municipal programs or activities that are for the benefit of the Municipality and its citizens. Interest income on such loans amounted to \$20,999 for the fiscal year ended June 30, 2006.

At June 30, 2006, the total outstanding loan balances amounted to:

	<b>Mayagüez economic development fund</b>
Total loan mortgage receivable	\$ 2,024,448
Less:	
Allowance for uncollectible accounts	(382,500)
Net mortgage loans receivable	<u>1,641,948</u>
Less:	
Current portion of mortgage loan receivable	(335,537)
Net mortgage loans receivable excluding current portion	<u>\$ 1,306,411</u>

The total outstanding loan balances are offset by a reservation of fund balance of \$1,641,948 in the accompanying GFFS, to indicate the portion of the loans that does not constitute available financial resources at June 30, 2006.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**7) Municipal Health Facilities**

The Municipality has two municipal hospitals, San Antonio Hospital (SAH) and Ramón Emeterio Betances Medical Center (REBMC). In August 1998, the Municipality entered into an administration agreement with Hospital San Antonio, Inc. (HSAI), a private corporation, for the administration of the operations of SAH. The agreement expired on August 28, 2003, however, on August 29, 2003, the Municipality renewed the agreement with HSAI for an additional period of 25 years.

Pursuant to the terms and conditions of the renewed agreement between HSAI and the Municipality, HSAI leased all land, buildings, equipment and all other personal and real property related to the operations of SAH, which are owned by the Municipality. The agreement provides that HSAI shall pay the following to the Municipality:

- Annual rent charges of \$250,000 for the use of the leased property. The rent is payable in monthly installments of \$20,833 from September 1, 2003 through August 31, 2028. The rent charges under this contract shall be increased by 10 percent every 5 years.
- Past due rent charges carried over from the previous contract, amounting to \$485,805. Such amounts shall be paid in 300 monthly installments of \$1,619 commenced on September 1, 2003.

At June 30, 2006 the rent receivable from HSAI amounted to \$523,917, which is recorded in the statement of net assets and the general fund within other receivables. Deferred revenue amounting to \$469,730 has been recorded in the general fund at June 30, 2006 since the rent receivable from HSAI is not considered a current available financial resource at fiscal year-end.

In October 2000, The Municipality acquired the facilities of REBMC. As part of the acquisition, on October 1, 2000, the Municipality entered into an administration agreement of REBMC with Advance Cardiology Center Corporation (ACCC), a private corporation. The agreement provides for semiannual rental payments of \$450,000 to be made to the Municipality on each April and October. However, although the Municipality has been performing strong and continuous collection efforts, no collections had been received, since the inception of the agreement through June 30, 2004.

During 2002 the Municipality condoned \$900,000 of past due rent charges related to the first year of operations of ACCC in REBMC, and agreed to renegotiate the past due rent and other charges through a payment plan by which ACCC would pay the rent charges related to the period between October 1, 2001 to date. At June 30, 2006, an accounts receivable from ACCC, amounting to \$11,140,968 has been recorded in the accompanying basic financial statements within other receivables. Such receivable includes a receivable of \$8,685,968 for utilities related to the Municipality REBMC's facilities, which were paid by the Municipality, however, ACCC and other subtenants of REBMC's facilities are contractually required to reimburse such amounts as incurred. Because of the uncertainty of its collection, the receivable from ACCC has been reserved with an allowance for uncollectible accounts of \$10,905,968 at June 30, 2006.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**7) Municipal Health Facilities (Continuation)**

The rental commitments included in the administration agreements with HSAI and ACCC have been accounted for as operating leases in the accompanying basic financial statements since such agreements: (1) allow the Municipality to terminate the leases at any time, (2) do not include bargain purchase options, (3) do not transfer the ownership of the leased assets at the end of the respective lease terms, and (4) limit the use of the leased assets for the purposes indicated in the agreements and only within the facilities of SAH and REBMC

The assets subject to these agreements are accounted for as capital assets and are depreciated in the accompanying GWFS. Such capital assets consist of the following:

Land and land improvements	\$ 760,294
Buildings, structures and improvements	13,629,541
Machinery and equipment	4,973,783
Licensed vehicles	343,727
Total capital assets in municipal health facilities, at cost	<u>19,707,345</u>
Less: accumulated depreciation and amortization	(8,514,269)
Total capital assets in municipal health facilities, net	<u>\$ 11,193,076</u>

Rental income related to the municipal health facilities referred to above amounted to \$1,200,000 for the fiscal year ended June 30, 2006. Rental income has been recorded within charges for services in the accompanying basic financial statements.

**COMMONWEALTH OF PUERTO RICO**  
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Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**8) Interfund Transactions**

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

Due to:	Due from:				
	Major funds				Total governmental funds
	General fund	Debt service fund	Permanent improvements fund	Nonmajor special revenue funds	
Major funds:					
General fund	\$ -	1,456,965	-	209,300	1,666,265
Head start special revenue fund	11,059	-	-	-	11,059
Debt service fund	96,321	-	-	-	96,321
Capital projects fund	119,108	-	-	-	119,108
Nonmajor funds:					
Permanent improvements bonds fund	652,000	-	-	70,000	722,000
Special revenue funds	2,282,919	-	-	691,395	2,974,314
<b>Total</b>	<b>\$3,161,407</b>	<b>1,456,965</b>	<b>-</b>	<b>970,695</b>	<b>\$ 5,589,067</b>

Transfers to:	Transfers from:				
	Major funds				Total governmental funds
	General fund	Debt service fund	Permanent improvements fund	Nonmajor special revenue funds	
Major funds:					
General fund	\$ 1,187,754	304,552	455,282	-	\$ 1,947,588
Debt service fund	1,761,182	-	-	103,335	1,864,517
Head start special revenue fund	873,895	-	-	-	873,895
Nonmajor funds:					
Permanent improvements bonds fund	-	-	-	6,607	6,607
Special revenue funds	782,912	-	-	1,365,758	2,148,670
<b>Total</b>	<b>\$ 4,605,743</b>	<b>304,552</b>	<b>455,282</b>	<b>1,475,700</b>	<b>\$ 6,841,277</b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**8) Interfund Transactions (Continuation)**

The principal purposes of interfund receivables and payables are:

- Recognize in the debt service fund the amounts due from the general fund to cover the principal and interest payments on certain bonds, amounting to \$1,456,965. These payments are due on July 1, 2006.
- Recognize in the general fund the outstanding balance of the short-term loans granted to the Mayagüez economic development fund (\$652,000) to provide mortgage loans to private entities under the Program for the Economic Development of Mayagüez (see note 6).
- Recognize in the general fund the outstanding balance of the loans granted to nonmajor special revenue funds (\$2,282,919) to temporarily cover the payroll and other operating costs of several federally and state funded programs.

The principal purposes of interfund transfers are to:

- Make a routinary transfer of interest income, amounting to \$304,552, from the debt service fund to the general fund, as permitted by law. This interest income is generated by the debt service fund's deposits and is transferred on a quarterly basis to the general fund.
- Make a routinary transfer of resources, amounting to \$1,761,182, from the general fund to the debt service fund to cover the principal and interest payments on certain bonds. These debt service payments were made in January and July 2006.
- Make a routinary transfer of matching contributions, amounting to \$873,895, from the general fund to the head start special revenue fund.
- Make a nonroutinary transfer of \$141,556 from the CDBG program fund to the Mayagüez economic development fund to provide future mortgage loans to private entities under the program for the economic development of Mayagüez (see note 6).
- Make a routinary transfer of interest income amounting to \$455,282, from the capital project funds to the general fund. This interest income is generated by certain capital project fund's deposits and is transferred on a monthly basis, as permitted by law.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers, which are considered by management to be fully realizable at June 30, 2006.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**9) Capital Assets**

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

	Balance at beginning of fiscal year,	Increases	Decreases	Reclassifications	Balance at end of year
Governmental activities					
Cost basis:					
Capital assets, not being depreciated/amortized:					
Land	\$ 14,532,555	-	-	-	\$ 14,532,555
Construction in progress	6,284,267	6,431,011	-	(1,889,124)	10,826,154
Total capital assets, not being depreciated/amortized	20,816,822	6,431,011	-	(1,889,124)	25,358,709
Capital assets, being depreciated/amortized:					
Land improvements	5,228,231	-	-	515,841	5,744,072
Buildings, structures, and improvements	41,104,258	-	(2,000,000)	394,392	39,498,650
Infrastructure	21,778,558	-	-	978,891	22,757,449
Other machinery and equipment, and furniture and fixtures	12,348,473	280,434	-	-	12,628,907
Machinery and equipment under capital leases	2,628,613	-	-	-	2,628,613
Licensed vehicles	10,008,028	177,709	-	-	10,185,737
Total capital assets, being depreciated/amortized	93,096,161	458,143	(2,000,000)	1,889,124	93,443,428
Total cost basis of capital assets	113,912,983	6,889,154	(2,000,000)	-	118,802,137
Less: accumulated depreciation and amortization:					
Land improvements	3,209,821	191,662	-	-	3,401,483
Buildings, structures, and improvements	12,077,562	857,620	-	-	12,935,182
Infrastructure	15,538,272	803,490	-	-	16,341,762
Other machinery and equipment, and furniture and fixtures	7,614,510	1,146,983	-	-	8,761,493
Machinery and equipment under capital leases	2,190,089	100,514	-	-	2,290,603
Licensed vehicles	7,267,315	668,385	-	-	7,935,700
Total accumulated depreciation and amortization	47,897,569	3,768,654	-	-	51,666,223
Net capital assets	<u>\$ 66,015,414</u>	<u>3,120,500</u>	<u>(2,000,000)</u>	<u>-</u>	<u>\$ 67,135,914</u>

Depreciation and amortization expense for the fiscal year ended June 30, 2006 was charged to functions/programs as follow:

Governmental activities	
General government	\$ 275,341
Public Safety	451,907
Economic and urban development	1,583,358
Health and sanitation	1,015,739
Public housing and welfare	77,851
Culture, recreation, and education	364,458
Total depreciation and amortization expense	<u>\$ 3,768,654</u>

At June 30, 2006 the estimated aggregate replacement cost of the Municipality's capital assets amounted to approximately \$255.0 million.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**10) Deferred Revenues**

At June 30, 2006, deferred revenues recorded in the GWFS and the GFFS are as follows:

Due/advances to:	Major governmental funds							Statement of net assets
	General fund	State legislative joint resolution special revenue fund	Head start special revenue fund	Debt service fund	Capital projects fund	Other governmental funds	Total governmental funds	
<i>Measurable but not available revenues:</i>								
Property taxes	\$ 5,600,886	-	-	1,465,580	-	-	7,066,466	\$ -
Municipal licenses	2,770,000	-	-	-	-	-	2,770,000	-
Rent and other charges	1,654,954	-	-	-	-	-	1,654,954	-
Intergovernmental grants and contributions	331,625	-	-	-	-	-	331,625	-
<b>Total measurable but not available revenue</b>	<b>10,357,465</b>	<b>-</b>	<b>-</b>	<b>1,465,580</b>	<b>-</b>	<b>-</b>	<b>11,823,045</b>	<b>-</b>
<i>Unearned revenues:</i>								
Municipal licenses	11,397,329	-	-	-	-	-	11,397,329	11,397,329
Intergovernmental grants and contributions:								
Commonwealth of Puerto Rico	-	13,461,456	-	-	-	-	13,461,456	13,461,456
U.S. Department of Health and Human Services	-	-	19,521	-	-	-	19,521	19,521
Other governmental agencies	-	-	-	-	-	1,474,212	1,474,212	1,474,212
<b>Total unearned revenues</b>	<b>11,397,329</b>	<b>13,461,456</b>	<b>19,521</b>	<b>-</b>	<b>-</b>	<b>1,474,212</b>	<b>26,352,518</b>	<b>26,352,518</b>
<b>Total deferred revenues</b>	<b>21,754,794</b>	<b>13,461,456</b>	<b>19,521</b>	<b>1,465,580</b>	<b>-</b>	<b>1,474,212</b>	<b>38,175,563</b>	<b>26,352,518</b>

**11) Long-Term Obligations**

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

	Balance at June 30, 2005	Borrowings or additions	Payments or deductions	Discount accretion	Balance at June 30, 2006	Balance due within one year
Bonds payable	\$ 60,936,000	1,360,000	(4,916,000)	-	57,380,000	\$ 5,498,000
Bond anticipation notes	2,158,192	-	(1,360,000)	-	798,192	-
Notes payable:						
CRIM	3,550,407	-	(441,795)	83,137	3,191,749	243,130
HUD	100,000	-	(100,000)	-	-	-
Obligation under capital leases	559,098	(106,371)	(100,306)	-	352,421	116,782
Estimated liability for municipal solid waste landfill closure and postclosure care costs	1,924,714	71,348	-	-	1,996,062	-
Compensated absences	7,537,969	2,420,090	(2,092,435)	-	7,865,624	3,823,006
Claims and judgments	738,576	3,419,174	-	-	4,157,750	-
<b>Total</b>	<b>\$ 77,504,956</b>	<b>7,164,241</b>	<b>(9,010,536)</b>	<b>83,137</b>	<b>75,741,798</b>	<b>\$ 9,680,918</b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

Historically, the general fund has been used to liquidate certain notes payable, compensated absences, claims and judgments, obligations under capital leases and any other long-term liabilities other than bonds.

**a) Debt Limitation**

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

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

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Total property assessed value at June 30, 2006 amounted to \$694,713,827. The Municipality's available legal debt margin amounted to \$21,697,148.

**b) Bonds Payable**

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

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

As described in Note 4, the Municipality levies an annual additional special tax of 1.40 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

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

	<b><u>Outstanding Balance</u></b>
<b><u>General obligation bonds:</u></b>	
1995 serial bonds, original issue amount of \$229,000, used in major capital improvements activities, due in annual principal installments ranging from \$9,000 to \$17,000 plus interest due in annual installments at 5.12 percent through January 1, 2020	\$ 177,000
1997 serial bonds, original issue amount of \$675,000, used in major capital improvements activities, due in annual principal installments ranging from \$15,000 to \$60,000 plus interest due in semiannual installments at variable rates not to exceed 6.56 percent (5.52 percent at June 30, 2006) through July 1, 2021	560,000
1998 serial bonds, original issue amount of \$1,645,000, used in major capital improvements activities, due in annual principal installments ranging from \$70,000 to \$160,000 plus interest due in semiannual installments at variable rates not to exceed 6.34 percent (5.29 percent at June 30, 2004) through July 1, 2016	1,225,000
2001 serial bonds, original issue amount of \$9,950,000, used for acquisition of REBMC and several capital improvements, due in annual principal installments ranging from \$200,000 to \$805,000 plus interest due in semiannual installments at variable rates not to exceed 6.69 percent (5.62 percent at June 30, 2006) through July 1, 2026	9,250,000
1999 serial bonds, original issue amount of \$4,055,000, used for major construction activities, due in annual principal installments ranging from \$315,000 to \$490,000 plus interest due in semiannual installments at variable rates not to exceed 4.40 percent (3.21 percent at June 30, 2006) through July 1, 2011	2,465,000
1999 serial bonds, original issue amount of \$930,000, used for the acquisition of certain land parcels, due in annual principal installments ranging from \$20,000 to \$80,000 plus interest due in semiannual installments at variable rates not to exceed 5.60 percent (3.21 percent at June 30, 2006) through July 1, 2024	835,000
1999 serial bonds, original issue amount of \$205,000, used for acquisition of certain land parcels and certain construction activities, due in annual principal installments ranging from \$5,000 to \$15,000 plus interest due in semiannual installments at variable rates not to exceed 5.60 percent (3.21 percent at June 30, 2006) through July 1, 2024	175,000

**COMMONWEALTH OF PUERTO RICO**  
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Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

	<b><u>Outstanding Balance</u></b>
<b><u>General obligations bonds (concluded):</u></b>	
1995 serial bonds, original issue amount of \$1,360,000, used for construction activities, due in annual principal installments ranging from \$28,000 to \$93,000 plus interest due in annual installments at fix rate of 5.12 percent through January 1, 2031	1,360,000
1999 serial bonds, original issue amount of \$4,060,000, used for major construction activities, due in annual principal installments ranging from \$250,000 to \$445,000 plus interest due in semiannual installments at variable rates not to exceed 4.61 percent (3.21 percent at June 30, 2006) through July 1, 2013	2,810,000
1999 serial bonds, original issue amount of \$1,310,000, used for acquisition of certain land parcels, due in annual principal installments ranging from \$30,000 to \$115,000 plus interest due in semiannual installments at variable rates not to exceed 12.00 percent (3.21 percent at June 30, 2006) through July 1, 2024	1,170,000
1997 serial bonds, original issue amount of \$4,565,000, used for major construction activities, due in annual principal installments ranging from \$445,000 to \$565,000 plus interest due in semiannual installments at variable rates not to exceed 5.69 percent (5.52 percent at June 30, 2006) through July 1, 2008	1,565,000
1998 serial bonds, original issue amount of \$3,525,000, used for several capital improvements, due in annual principal installments ranging from \$230,000 to \$395,000 plus interest due in semiannual installments at variable rates not to exceed 6.04 percent (5.52 percent at June 30, 2006) through July 1, 2012	2,225,000
2003 serial bonds, original issue amount of \$2,845,000, used for the acquisition of machinery and equipment, due in annual principal installments ranging from \$540,000 to \$625,000 plus interest due in semiannual installments at variable rates not to exceed 4.24 percent (4.23 percent at June 30, 2006) through July 1, 2008	1,790,000
2004 serial bonds, original issue amount of \$7,945,000, used for construction and major capital improvements activities, and for the payment to various suppliers, due in annual principal installments ranging from \$175,000 to \$540,000 plus interest due in semiannually installments at variable rates not to exceed 5.02 percent (4.23 percent at June 30, 2006) through July 1, 2028	<u>7,605,000</u>
Total general obligation bonds	33,212,000

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

	<b><u>Outstanding Balance</u></b>
<b><u>Special obligation bonds:</u></b>	
1996 serial bonds, original issue amount of \$400,000, used for the payment of certain operating expenses, due in annual principal installments ranging from \$15,000 to \$40,000 plus interest due in semiannual installments at variable rates not to exceed 7.25 percent (5.33 percent at June 30, 2006) through July 1, 2016	285,000
1997 serial bonds, original issue amount of \$7,510,000, used for the payment of certain operating expenses, due in annual principal installments ranging from \$280,000 to \$715,000 plus interest due in semiannual installments at variable rates not to exceed 7.50 percent (5.08 percent at June 30, 2006) through July 1, 2017	5,770,000
2000 serial bonds, original issue amount of \$2,865,000, used for the payment of certain operating expenses, due in annual principal installments ranging from \$270,000 to \$390,000 plus interest due in semiannual installments at variable rates not to exceed 8.00 percent (5.00 percent at June 30, 2006) through July 1, 2010	1,690,000
2004 serial bonds, original issue amount of \$80,000, used for the payment of professional services, due in annual principal installments ranging from \$10,000 to \$15,000 plus interest due in semiannual installments at variable rates not to exceed 7.50 (5.08 percent at June 30, 2006) through July 1, 2010	60,000
2004 serial bonds, original issue amount of \$355,000, used for the payment of professional services, due in annual principal installments ranging from \$50,000 to \$90,000 plus interest due in semiannual installments at variable rates not to exceed 7.50 (5.08 percent at June 30, 2006) through July 1, 2009	<u>305,000</u>
Total special obligation bonds	<u>8,110,000</u>
<b><u>Public improvement bonds:</u></b>	
1996 serial bonds, original issue amount of \$1,025,000, used for capital improvements to the Eugenio María de Hostos Law School, due in annual principal installments ranging from \$75,000 to \$110,000 plus interest due in semiannual installments at variable rates not to exceed 6.30 percent (6.00 percent at June 30, 2006) through July 1, 2010	480,000

**COMMONWEALTH OF PUERTO RICO  
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Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

	<b><u>Outstanding Balance</u></b>
<b><u>Public improvement bonds:</u></b>	
1994 serial bonds, original issue amount of \$9,950,000, used for the acquisition of machinery and equipment, due in annual principal installments ranging from \$885,000 to \$1,120,000 plus interest due in semiannual installments at variable rates not to exceed 7.41 percent (7.11 percent at June 30, 2006) through July 1, 2008	3,115,000
1988 serial bonds, original issue amount of \$6,000,000, used for major capital improvements, due in annual principal installments ranging from \$535,000 to \$640,000 plus interest due in semiannual installments at 8.20 percent through July 1, 2007	1,220,000
1994 serial bonds, original issue amount of \$1,170,000, used for major capital improvements, due in annual principal installments ranging from \$35,000 to \$110,000 plus interest due in semiannual installments at variable rates not to exceed 6.63 percent (6.00 percent at June 30 2006) through July 1, 2019	935,000
2003 serial bonds, original issue amount of \$3,510,000, used for major capital improvements due in annual principal installments ranging from \$75,000 to \$235,000 plus interest due in semiannually installments at 5.00 percent through July 1, 2028	3,360,000
1994 serial bonds, original issue amount of \$3,300,000, used for major capital improvements, due in annual principal installments ranging from \$162,000 to \$298,000 plus interest due in semiannual installments at variable rates not to exceed 5.02 percent (4.23 percent at June 30, 2006) through January 1, 2019	2,983,000
2005 serial bonds, original issue amount of \$3,965,000, used for major capital improvements, due in annual principal installments ranging from \$410,000 to \$590,000 plus interest due in semiannual installments at variable rate not to exceed 7.50 percent (5.08 percent at June 30, 2006) through January 1, 2013	<u>3,965,000</u>
Total public improvements bonds	<u>16,058,000</u>
Total bonds payable	<u>\$ 57,380,000</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

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

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

<b>Fiscal year ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2007	\$ 5,498,000	2,858,690	\$ 8,356,690
2008	5,902,000	2,635,669	8,537,669
2009	5,629,000	2,317,429	7,946,429
2010	3,945,000	2,080,566	6,025,566
2011	5,006,000	1,902,647	6,908,647
2012-2016	11,801,000	7,278,464	19,079,464
2017-2021	8,735,000	4,200,957	12,935,957
2022-2026	7,428,000	2,051,526	9,479,526
2027-2029	3,436,000	263,976	3,699,976
Totals	<u>\$ 57,380,000</u>	<u>25,589,924</u>	<u>\$82,969,924</u>

At June 30, 2006, accrued interest payable on bonds amounted to \$1,490,903.

**c) Bond Anticipation Notes**

Advances on bond anticipation notes (BAN) with the U.S. Department of Rural Development (USDRD) have been recorded within long-term obligations in the accompanying statement of net assets.

The Municipality has taken all the legal steps, and has the ability, to refinance such BAN on a long-term basis with future bond issuances through GDB. The agreement with USDRD and GDB permits that, after all approved advances under the financing agreement with USDRD are received by the Municipality, the BAN is refinanced on a long-term basis. The agreement with GDB is noncancelable and does not expire within one year after June 30, 2006. The obligations under the agreement are not callable during that period, except for violations of the provisions of the agreement, for which compliance is objectively determinable or measurable. At June 30, 2006, no violations of the agreement exist, and the available information indicates that a violation has not occurred thereafter prior to the issuance of the accompanying financial statements. At June 30, 2006, the outstanding balance of the advances received and the related unused amounts under the financing agreement with USDRD amounted to \$798,192 and \$711,808, respectively.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

*c) Bond Anticipation Notes*

According to the agreement with GDB, the Municipality will refinance, on a long-term basis, the aforementioned BAN through the issuance of one individual series of bonds denominated as general obligation bonds, with original issue amounts of \$1,510,000. These bond series will bear interest at rates to be determined by and agreed with GDB prior to the issuance of the bonds.

*d) Notes Payable to CRIM*

The Municipality had the following notes payables to CRIM at June 30, 2006:

- **Public Act No. 42** – The Commonwealth’s Pubic Act No. 42 of January 26, 2000 (Act No. 42) was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement authorized CRIM to finance a debt that the municipalities of Puerto Rico had with such entity, which arose from the difference between the yearly final settlements of property tax advances made by CRIM to the municipalities and the actual property tax collections received by CRIM from taxpayers through fiscal year 2000. The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth are assigned through Act No. 42 to repay such note. The increase in this subsidy was the result of Public Act No. 238 of August 15, 1999.

In addition, on December 16, 2002 the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$686,237 of excess of property tax advances from fiscal years 2000 and 2001. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each fiscal year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB (6.30 percent at June 30, 2006) but not exceeding 8.00 percent. Principal and interest payments on this financing agreement are accounted for in the general fund. The outstanding principal and accrued interest balances of this note amounted to \$646,118 and \$3,391, respectively, at June 30, 2006. The principal and interest maturities are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2007	\$ 10,190	40,402	\$ 50,592
2008	10,851	39,741	50,592
2009	11,554	39,038	50,592
2010	12,303	38,289	50,592
2011	13,101	37,491	50,592
2012-2016	79,401	173,559	252,960
2017-2021	108,699	144,260	252,959
2022-2026	148,810	104,150	252,960
2027-2031	203,720	49,240	252,960
2032	47,489	1,592	49,081
Totals	<u>\$ 646,118</u>	<u>667,762</u>	<u>\$ 1,313,880</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

*d) Notes Payable to CRIM*

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

The original face amount of the note allocated by CRIM to the Municipality was \$1,097,653, for a term not exceeding 30 years. The note bears interest at 6.50 percent during its first five years. Subsequently, from years 6 through 30, the loan shall bear variable interest at a rate of 125 points over the 5-year LIBOR rate, which will be adjusted every five years. During the first five years of the note, commenced on July 1, 2003, the Municipality shall pay only interest. At the end of the first five years of the note, the repayment terms and conditions of the note shall be renegotiated to allow the Municipality to pay the outstanding balance of the note in equal installments of principal plus interest, through maturity. Interest payments on this financing agreement are accounted for in the general fund.

The outstanding principal of the note payable to CRIM amounted to \$1,097,653, at June 30, 2006. The principal and interest maturities are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2007	\$ -	79,677	\$ 79,677
2008	-	79,677	79,677
2009	17,605	79,099	96,704
2010	18,926	77,778	96,704
2011	20,346	76,358	96,704
2012-2016	127,062	356,456	483,518
2017-2021	182,459	301,059	483,518
2021-2025	262,009	221,509	483,518
2026-2030	376,238	107,280	483,518
2031-2032	93,008	3,696	96,704
<b>Totals</b>	<b>\$1,097,653</b>	<b>1,382,589</b>	<b>\$2,480,242</b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

*d) Notes Payable to CRIM*

- **LIMS** – On October 17, 1996, CRIM entered into a financing agreement with Chicorp Financial Services, Inc. (CFSI) for the acquisition of a geographic information system known as *Land Information Management System (LIMS)* for the benefit of all of the municipalities of Puerto Rico. The total cost of LIMS was also allocated to all of the municipalities of Puerto Rico by CRIM. From fiscal year ended June 30, 1997 to fiscal year ended June 30, 2000, CRIM collected from the Municipality \$1,151,215 as payments under the financing agreement with CFSI.

On August 31, 2001, CRIM refinanced through GDB, the debt with CFSI for a term not exceeding 10 years, at no interest. The original face amount of the debt refinanced, which was allocated to the Municipality, was \$3,040,783. This note is payable in monthly installments of \$25,340 (accounted for in the general fund) through December 1, 2011.

This note has an imputed interest rate of 5.00 percent. The outstanding balance of this note, net of the unamortized discount of \$224,453, amounted to \$1,447,977 at June 30, 2006. Amortization of the note discount amounted to \$83,137 for the year ended June 30, 2006, which has been recorded as interest expense in the accompanying statement of activities.

The principal maturities and schedule amortization discount are as follows:

<u>Fiscal year ending June 30,</u>	<u>Principal</u>	<u>Discount accretion</u>	<u>Total</u>
2007	\$232,940	71,138	\$304,078
2008	245,590	58,488	304,078
2009	258,927	45,151	304,078
2010	272,989	31,089	304,078
2011	287,814	16,264	304,078
2012	149,717	2,323	152,040
Totals	<u>\$1,447,977</u>	<u>224,453</u>	<u>\$1,672,430</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

11) Long-Term Obligations (Continuation)

e) Notes Payable to HUD

The Municipality had the following notes payable to HUD at June 30, 2006:

- **Loan guarantee commitment** – The Municipality had a loan guarantee commitment of \$850,000 with HUD pursuant to an application under Section 108 of the Housing and Community Development Act of 1974 (Section 108). Section 108 commitments are required to be supported by a credit subsidy appropriation pursuant to the Federal Credit Reform Act of 1990 (Credit Reform Act) and implementing guidance issued by the U.S. Office of Management and Budget (OMB). Therefore, in connection with its guarantee of these notes, HUD obligated appropriated funds to cover the credit subsidy cost of the loan guarantee, as required under the Credit Reform Act. Under the Credit Reform Act procedures, such funds are disbursed into a financing account as loan proceeds are disbursed by the lender (a local commercial bank). The financing account is in some respects equivalent to an internal loss reserve for the federal government. Each disbursement into the financing account is equal to the loan advance times the credit subsidy rate, which is part of HUD's budget approved by OMB and the Congress.

Pursuant to the credit subsidy implementation guidance issued by OMB, the undisbursed balance of the credit subsidy obligation must be canceled on September 30<sup>th</sup> of the 5<sup>th</sup> fiscal year after the period of availability for obligation of a fixed appropriation account ends.

The proceeds of the loan guarantee commitment were used by the Municipality to provide low-income communities with another source of financing for the economic development, housing rehabilitation, public facilities and large-scale physical development projects. The notes on the loan guarantee commitment beared interest at various rates ranging from of 3.82 percent to 6.67 percent. The proceeds and uses of the loan guarantee commitment were accounted for in the Loan guarantee section 108 fund, a nonmajor special revenue fund. The loan guarantee commitment was repaid with grant awards received from of the Community Development Block Grant (CDBG) program, administered by HUD. Principal and interest on these notes are accounted for in the debt service fund. At June 30, 2006, the outstanding principal of the loan guarantee commitment amounted to \$100,000 was paid.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

*f) Lease Obligations*

- **Operating leases** – The Municipality leases building and office facilities under operating lease agreements with third parties. These lease agreements generally contain fiscal funding clauses and/or cancellation clauses that make the continuation of the agreements subject to future appropriations. Management has concluded that the likelihood of invoking the cancellation provisions is remote; therefore, the remaining terms of these leases will extend beyond one fiscal year. Total costs for such leases (minimum lease payments) were \$1,037,749 for the fiscal year ended June 30, 2006. The future minimum lease payments for these leases are as follows:

Fiscal year ending June 30,	Amount
2007	\$ 1,037,749
2008	1,037,749
2009	1,037,749
2010	1,037,749
2011	1,037,749
2012-2016	5,188,745
2017-2021	5,188,745
2022-2026	5,188,745
2027-2031	5,188,745
Totals	\$ 25,943,725

- **Capitalized Leases** - The Municipality is obligated under capital leases with third parties that expire through 2010 for the acquisition of machinery and equipment. At June 30, 2006, the capitalized costs and the related accumulated amortization of the leased machinery and equipment amounted to \$2,628,614 and \$2,290,603, respectively, which are accounted for as capital assets in the accompanying statement of net assets. Amortization charges applicable to capital leases and included within depreciation expense amounted to \$100,514 for the fiscal year ended June 30, 2006. The present value of the future minimum capital lease payments reported in the accompanying statement of net assets is as follows:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

Fiscal year ending June 30,	Amount
2007	124,200
2008	107,729
2009	107,733
2010	27,596
Total future minimum lease payments	367,258
Less: amounts representing future interest at rates ranging between 5.43 percent and 7.73 percent	14,837
Present value of minimum lease payments	352,421
Less:	
Current portion of obligation under capital leases	116,782
Obligation under capital leases, excluding current portion	\$ 235,639

**g) *Municipal Solid Waste Landfill Closure and Postclosure Care Costs***

According to the regulations set forth by the U.S. Environment Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991, the Municipality is required to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. The Municipality has performed a study of the activities that need to be implemented at the Municipality's solid waste landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality has recorded an estimated liability of \$1,996,062 in the accompanying GWFS, using current costs allocated, based on the actual landfill capacity used at June 30, 2006. The portion of the estimated current costs to be incurred in future years is approximately \$247,336, which has not been recorded yet in the accompanying GWFS. Actual costs may be different to the recorded estimated liability due to inflation, changes in technology, or changes in laws and regulations. At June 30, 2006, the Municipality's solid waste landfill is still operating and its remaining estimated useful life is approximately 5 years. Approximately 90 percent of the Municipality's total capacity has been used at June 30, 2006.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**11) Long-Term Obligations (Continuation)**

*h) Compensated Absences*

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

	<b>Due within one year</b>	<b>Due after one year</b>	<b>Total</b>
Vacations	\$2,045,874	938,267	\$2,984,141
Sick leave	1,218,615	3,104,351	4,322,966
Compensatory time	558,517	-	558,517
Total	\$3,823,006	4,042,618	\$7,865,624

**12) Employees' Retirement Systems**

*a) Plan Description*

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. Substantially all full-time employees of the Commonwealth and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed.

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

- *Retirement Annuity*

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

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

12) Employees' Retirement Systems (Continuation)

- *Merit Annuity*

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

- *Deferred Retirement Annuity*

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

- *Coordinated Plan*

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

- (a) \$165 per month, if retired with 55 years of age and 30 years of credited service
- (b) \$110 per month, if retired with less than 55 years of age and 30 years of credited service
- (c) All other between \$82 and \$100 per month.
- (d) Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over \$165 per month.

- *Non-Coordinated Plan*

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

- *Reversionary Annuity*

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

- *Occupational Disability Annuity*

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

12) Employees' Retirement Systems (Continuation)

- *Non-occupational Disability Annuity*

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

- *Death Benefits*

*Occupational:*

- (a) Surviving spouse – annuity equal to 50 percent of the participating employee's salary at the date of the death.
- (b) Children - \$10 per month for each child, minor or student, up to a maximum benefit per family of \$100.

*Non-occupational:*

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

*Post-retirement:*

Beneficiary with surviving spouse age 60 or over and a child, 18 or under, up to 30 percent (60 percent, if not covered under Title II of the Social Security Act) (increased to 50 percent effective January 1, 2004) of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

- *Refunds*

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

12) Employees' Retirement Systems (Continuation)

- *Cost of Living Adjustment for Pension Benefits*

Public Act No. 10 of May 21, 1992 (Act No. 10) provided for increases of 3 percent every three or more years of retirement. Act No. 10 requires further legislation to grant this increase every three years subject to the presentation of actuarial studies regarding its costs and the source of financing. To protect the financial health of ERS, the increase granted during 2001 and the one granted on January 1, 2004 are being financed by the Municipality and the other participating employers.

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

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

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

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

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

12) Employees' Retirement Systems (Continuation)

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

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

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

- *Recent Amendments to Act No. 447*

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

- (a) Increase in minimum monthly pension payments to \$300, effective January 1, 2004.
- (b) Triennial 3 percent increase in all pensions, effective January 1, 2004.
- (c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2004.

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

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

**b) Funding Policy**

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

Municipality and other employers	9.275 percent of applicable payroll
Employees:	
Coordination plan:	5.775 percent of gross salary up to \$6,600 per year, plus 8.275 percent gross salary in excess of \$6,600.
Supplementation plan:	8.275 percent of gross salary. This is the only choice available to policemen, firemen and majors

Effective January 27, 2000, participant contributions were increased to 9% of their compensation, as provided by Act No. 45 of 2000. The Commonwealth, as sponsor, matches the participants' contributions at a rate of 8.5% of the applicable payroll. Contributions are established by law and are not actuarially determined.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**12) Employees' Retirement Systems (Continuation)**

**b) Funding Policy (Continuation)**

Other relevant information on the Commonwealth's Retirement Systems is presented below (as of July 1, 2003 for ERS for latest valuation date):

	<b>ERS</b>
Retirees and beneficiaries currently receiving benefits	\$ 88,518
Current employees	161,947
Total	\$250,465

**c) Annual Pension Cost and Net Pension Obligation**

The Commonwealth's annual pension cost of ERS and System 2000 for the year ended June 30, 2005 (most recent available data), which includes the employees of the Municipality, the Commonwealth and other municipalities, have been recorded in the basis financial statements of the Commonwealth were are follows (expressed in thousands):

	<b>ERS</b>
Annual required contributions	\$ 578,387
Interest on net pension obligation	284,347
Adjustment to annual required sponsors' contributions	(210,482)
Annual pension cost	652,252
Statutory sponsors' contributions made	(389,554)
Increase in net pension obligation	262,698
Net pension obligation at beginning of year	3,652,617
Net pension obligation at end of year	\$ 3,915,315

The required contribution(s) rate in accordance with the funding policy, in dollars or as a percentage of the current year (Fiscal Year 2005-2006) covered payroll and any changes for or during the current year (describe):

Employer Contribution: 9.275% of Gross Salary

Required contribution in dollars:

ERS and System 2000 \$1,072,398

Actual contribution in dollars \$1,072,398

At June 30, 2006, the balance due to ERS and recorded in the basis financial statements amounted to \$210,728.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**12) Employees' Retirement Systems (Continuation)**

*d) Three-Year Trend Information*

The three-year trend information is as follows (most recent available official data: expressed in thousands):

<i>Annual Pension Cost (APC):</i>		
Year ended June 30, 2005	\$	652,252
Year ended June 30, 2004		652,252
Year ended June 30, 2003		860,082
 <i>Percentage of APC contributed:</i>		
Year ended June 30, 2005		59.7%
Year ended June 30, 2004		52.9
Year ended June 30, 2003		38.4
 <i>Net pension obligation:</i>		
Year ended June 30, 2005	\$	3,915,315
Year ended June 30, 2004		3,652,617
Year ended June 30, 2003		2,815,576

Contributions made by the Municipality and its participating employees to ERS and System 2000 were as follows during the last three years:

Fiscal Year Ended June 30	Employer Contributions	Employees Contributions
2004	\$1,146,912	\$ 964,491
2005	1,212,212	1,026,710
2006	1,072,399	911,161

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

13. Commitments and Contingencies

a) *Commitments*

The Municipality has several outstanding or planned non-cancelable construction projects amounting to \$11,102,835 at June 30, 2006, of which \$4,877,729 has been incurred, and \$6,225,106 remains outstanding to incur through the end of each project. These projects are evidenced by contractual commitments with contractors and are generally accounted for in the permanent improvements bonds fund.

The Municipality has reported, outstanding encumbrances amounting to \$1,376,457 in the general fund at June 30, 2006. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current fiscal year's budget during a lapse period that extends into the next fiscal year.

b) *Contingencies*

1. **Legal claims** - The Municipality is defendant in various claims and legal proceedings pertaining to matters incidental to the performance of routine governmental operations amounting to approximately \$167 millions of which \$150,000,000 are related to a law suit filed by Advance Cardiology Center requesting compensation for the alleged loss of private investors that the plaintiff has experienced as a result of the municipality's actions. The municipality filed a counterclaim seeking the eviction of Advanced Cardiology Center from the premises as well as the collection of \$7,000,000 in unpaid rent and utilities. Under Public Act No. 104 of June 25, 1995, as amended, persons are allowed to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Public Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation as well as assume the payment for any judgment that may be entered against them. However, there is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, the Municipality has reported liabilities amounting to \$4,157,750 for awarded and anticipated unfavorable judgments at June 30, 2006 of which \$1,400,000 are related with the gross volume of business tax claim described in part 3 of this note and \$2,000,000 related with questionable costs of the HOME and CDBG federal programs described in the following paragraph. This amount was included within long-term obligations in the accompanying statement of net assets, and represents the amount estimated as a probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment. It is management's opinion, based on the advice of its legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial condition nor the results of operations of the Municipality. In addition, management believes that the ultimate liability in excess of amounts recorded in the accompanying statement of net assets, if any, would not be material to the basic financial statements taken as a whole.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

13. Commitments and Contingencies (Continuation)

b) Contingencies (Continuation)

2. **Federal grants** -The Municipality receives financial assistance from the federal Government of the United States of America and the Commonwealth in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. Disallowance as a result of these audits may become liabilities of the Municipality. The "*Reports on Compliance and Internal Control in Accordance with Government Auditing Standards and the Requirements of OMB Circular A-133*" for the fiscal year ended June 30, 2006, disclosed various instances of noncompliance with applicable laws and regulations and with internal accounting and administrative controls. Additionally, the municipality of Mayagüez has unresolved monitoring findings from reviews conducted by the U.S. Department of Housing and Urban Development Program, the Community Development Block Grant (CDBG) and the Emergency Shelter Grant (ESG) programs. Management believes that the Municipality will be able to comply with the terms of corrective action plans that may be requested by the federal grantors, if any. Conversely, the accompanying basic financial statements include provisions for possible disallowed cost arising from the Single Audit and the review conducted by the U.S. Department of Housing and Urban Development.
3. **Municipal gross volume of business tax** - During fiscal year 2004-2005, the Commonwealth Court System reviewed de Municipality of Hormigueros legal suit against the Municipality of Mayagüez. The Municipality of Hormigueros is claiming the right to impose and collect the gross volume of business tax for certain business located at the Mayagüez Mall, because it is alleged that is located in the boundaries of both municipalities; Mayagüez and Hormigueros. Such legal suit also request for the reimbursement the year 1992 to present from the Municipality of Mayagüez.

On August 2005, the Court requested additional information before concluding the final sentence. Information is requested to the Municipal Property Tax Bureau, the Commonwealth Planning Board, and evidence about collections performed either by the Property Tax Bureau regarding property taxes and the Municipality of Mayagüez related to business volume tax sale collected from year 1997 to the present.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**14. Prior-period Adjustments and Restatements**

During the current fiscal year, the Municipality corrected certain accounting entries not reported in the prior fiscal year's GFFS. As a result, the Municipality recorded retroactively the following prior-period adjustment:

- Property tax on debt services fund was not recorded as revenues and intergovernmental receivables by \$1,120,863 in the prior fiscal year.

The following schedule reconciles the fund balances, as previously reported by the Municipality, to the beginning fund balances, as restated.

	<b>June 30, 2005 fund balances, as previously reported</b>	<b>Reclassifications and other adjustments</b>	<b>June 30, 2005 fund balances, as restated</b>
<i>Major governmental funds:</i>			
General fund	\$ 12,598,713	-	\$ 12,598,713
State legislative joint resolutions special revenue fund	15,432	-	15,432
Head start	418	-	418
Permanent improvements bonds	14,595,488	-	14,595,488
Debt service fund	6,088,752	1,120,863	7,209,615
	<u>33,298,803</u>	<u>1,120,863</u>	<u>34,419,666</u>
<i>Other governmental funds:</i>			
Other non mayor governmental funds	6,877,570	-	6,877,570
	<u>6,877,570</u>	<u>-</u>	<u>6,877,570</u>
Total governmental funds	<u>\$ 40,176,373</u>	<u>1,120,863</u>	<u>\$ 41,297,236</u>

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

<b>Net assets at beginning of fiscal year as previously reported</b>	<b>Unrecorded property tax revenues</b>	<b>Net assets at beginning of fiscal year as restated</b>
<u>\$41,001,843</u>	<u>1,120,863</u>	<u>\$42,122,706</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**15. Subsequent Events**

- On November 17, 2006, the Municipal Legislature approved the issuance of general obligation bonds amounting to \$12,610,000. The proceeds of these bonds will be used for construction and major capital improvements. The serial bond is dated July 1, 2007 and are due in annual principal installments and interest (at variables rates) due in biannual installments, through July 1, 2025.
- On October 25, 2006, the Municipal Legislature approved the imposition of a new 1.5% local sales and use tax on the sales or rent of certain property or services to be collected from customers. This sales and use tax was approved based on State Public Law 117 of July 4, 2006. Provisions and tax rates may change in the near future to a new rate between 1.0% and 1.5% if the lay amended by the State Legislature. For that reason no future revenues of this type can be estimated by the Municipality.

***COMMONWEALTH OF PUERTO RICO***  
***MUNICIPALITY OF MAYAGÜEZ***

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**ADDITIONAL REPORTS REQUIRED UNDER THE OMB CIRCULAR A-133**

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## **NIEVES VELAZQUEZ & CO., P.S.C.**

Certified Public Accountants and Financial Consultants

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

Mayor and Municipality Council  
Municipality of Mayagüez  
Mayagüez, Puerto Rico

We have audited the basic financial statements of **the Municipality of Mayagüez of the Commonwealth of Puerto Rico (The Municipality)** as of and for the year ended June 30, 2006, and have issued our unqualified report thereon dated December 22, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

#### **Compliance**

As part of obtaining reasonable assurance about whether **the Municipality's** basic financial statements are free of material misstatement, we performed test of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial 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 that are required to be reported under Government Auditing Standards.

#### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered **the Municipality's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that are consider to be material weaknesses.

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

(Continuation)

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

December 22, 2006  
San Juan, Puerto Rico

CPA Stamp #2076460 was affixed  
to the record copy of this report.

*Nieves Velazquez & Co., P.S.C.*





## NIEVES VELAZQUEZ & CO., P.S.C.

Certified Public Accountants and Financial Consultants

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

Mayor and Municipality Council  
Municipality of Mayagüez  
Mayagüez, Puerto Rico

#### Compliance

We have audited the compliance of **the Municipality of Mayagüez of the Commonwealth of Puerto Rico (The Municipality)** with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2006. **The Municipality's** major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of **the Municipality's** management. Our responsibility is to express an opinion on **the Municipality's** compliance based on our audit.

We conducted our audit of compliance 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; 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's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on **the Municipality's** compliance with those requirements.

In our opinion, **the Municipality** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Finding and Questioned Costs as Items 06-III-1, 06-III-2, 06-III-3, 06-III-4 and 06-III-5.

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

**Internal Control Over Compliance**

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect **the Municipality's** ability to administer a major federal program in accordance with the applicable requirements of laws regulations, contracts, and grants. Reportable conditions described in the accompanying schedule of findings and questioned costs as Items 06-III-1, 06-III-2, 06-III-3, 06-III-4 and 06-III-5.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above we consider items 06-III-1, 06-III-2, 06-III-3 and 06-III-4 to be material weaknesses.

**Schedule of Expenditures of Federal Awards**

We have audited the basic financial statements of **the Municipality** as of and for the year ended June 30, 2006, and have issued our unqualified report thereon dated December 22, 2006. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements of **the Municipality**. 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.

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

\* \* \*

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

January 31, 2007  
San Juan, Puerto Rico

*Nieves Velazquez & Co., P.S.C.*

CPA Stamp #2076461 was affixed  
to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2006**

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number (Note 2)</u>	<u>Pass-through Entity Identifying Number (Note 3)</u>	<u>Federal Expenditures (Notes 1 and 4)</u>
<b><u>U.S. Department of Housing &amp; Urban Development (HUD)</u></b>			
Major Programs:			
Direct Programs:			
Section 8 Housing Choice Vouchers	14.871	N/A	\$4,120,416
Home Investment Partnership Program	14.239	N/A	1,292,429
Non-Major Programs:			
Direct Programs:			
Community Development Block Grants-Entitlement Grants (CDBG)	14.218	N/A	3,690,552
Lower Income Housing Assistance Program: Emergency Shelter Grants Program	14.231	N/A	<u>133,356</u>
Total U.S. Department of Housing & Urban Development (HUD)			<u>9,236,753</u>
<b><u>U.S. Department of Health and Human Services (HHS)</u></b>			
Major Program:			
Direct Program:			
Head Start	93.600	N/A	8,041,470
Non-Major Programs:			
Passed-through the P.R. Governor Office:			
Special Programs for the Aging Title III-Part B	93.044	N/A	<u>60,548</u>
Total U.S. Department of Health and Human Services			<u>8,102,018</u>
<b><u>U.S. Department of Transportation (DOT)</u></b>			
Non-Major Program:			
Direct Programs:			
Federal Transit Capital Investment Grants	20.500	PR89-29-0616-526-F	102,700
State and Community Highway Safety	20.600	N/A	<u>6,956</u>
Total U.S. Department of Transportation			<u>109,656</u>
<b><u>U.S. Department of Agriculture (USDA)</u></b>			
Non-Major Programs:			
Passed-through the Puerto Rico Department of Education:			
Child and Adult Care Food Program (CACFP)	10.558	CCC-051	<u>728,255</u>
<b>Sub-total</b>			<b><u>18,176,682</u></b>

Continued-

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2006  
(Continuation)**

<i><u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u></i>	<i><u>Federal CFDA Number (Note 2)</u></i>	<i><u>Pass-through Entity Identifying Number (Note 3)</u></i>	<i><u>Federal Expenditures (Notes 1 and 4)</u></i>
<b>Sub-total carried forward</b>			<u>18,176,682</u>
<b><u>U.S. Department of Homeland Security (DHS)</u></b>			
Non-Major Programs:			
Direct Programs:			
Urban Areas Security Initiative	97.008	N/A	17,105
Homeland Security Grant Program	97.067	N/A	529,644
Public Assistance Grants	97.036	N/A	<u>462,684</u>
<b>Total U.S. Department of Homeland Security</b>			<u>1,009,433</u>
<b><u>U.S. Department of Justice (DOJ)</u></b>			
Major Programs:			
Direct Program:			
Public Safety Partnership and Community Policing Grants (COPS)	16.710	N/A	<u>937,888</u>
<b>Total Expenditures of Federal Awards</b>			<b><u>\$20,124,003</u></b>

See notes to the Schedule of Federal Financial Awards.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2006**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Government and Nonprofit Organizations.

**2. FEDERAL CFDA NUMBER**

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

**3. PASS-THROUGH ENTITY IDENTIFYING**

State or local government redistributions of federal awards to the Municipality, known as "pass-through awards", should be treated by the Municipality as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for federal awards received as a sub recipient. Number identified as N/A are not applicable or not available.

**4. RECONCILING OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE GENERAL PURPOSE FINANCIAL STATEMENTS**

Amounts included in the accompanying schedule agree with the amounts included in the basic financial statements as follows:

<u><i>Fund</i></u>	<u><i>Federal Assistance</i></u>	<u><i>Other Assistance</i></u>	<u><i>Financial Statements</i></u>
Head Start	\$ 8,041,470	2,812,554	10,854,024
Other Governmental Funds (including transfer out)	<u>12,082,533</u>	<u>3,596,942</u>	<u>15,679,475</u>
Totals	<u>\$20,124,003</u>	<u>6,409,496</u>	<u>26,533,499</u>

**5. FEMA-PUBLIC ASSISTANCE GRANTS**

During the fiscal year 2006, the Federal Emergency Management Agency approved additional funding of \$63,082 related with Hurricane Georges, for expenditures incurred in prior years.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section I. Summary of Audit Results**

**Part I. Financial Statements**

- |    |   |                            |                              |  |
|----|---|----------------------------|------------------------------|--|
| 1. | Type of audit report:                                 | <b>Unqualified opinion</b> |                              |  |
| 2. | Reportable conditions reported:                       |                            | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| 3. | Reportable conditions reported as material weaknesses |                            | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
| 4. | Material noncompliance disclosed                      |                            | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

**Part II. Federal Awards**

- |    |   |                            |   |                             |
|----|---|----------------------------|---|-----------------------------|
| 1. | Reportable conditions reported:   |                            | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| 2. | Reportable conditions reported as material weaknesses                         |                            | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| 3. | Type of report on compliance for major programs                               | <b>Unqualified opinion</b> |   |                             |
| 4. | Audit findings required to be reported under Section 510(a) of Circular A-133 |                            | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |

5. Identification of major programs:

<u><i>Name of Federal Program or Cluster</i></u>	<u><i>CFDA Number (s)</i></u>
Head Start	93.600
Section 8 Housing Choice Vouchers	14.871
Home Investment Partnership Program	14.239
Public Safety Partnership and Community Policing Grants (COPS)	16.710

- |    |   |  |   |                             |
|----|---|--|---|-----------------------------|
| 6. | Dollar threshold used to distinguish between Type A and Type B programs |  |   | \$672,166                   |
| 7. | Low-risk audited  |  | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006

Section II. Financial Statement Findings

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
		There were no financial statement findings.	

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006

Section III Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
HOME	06-III-1	<b>Sub-recipient Monitoring</b>	

Criteria and Condition

The OMB Circular 133, Part 4-III, Compliance Requirement M requires that the auditor determine if the local government (participant) is entering into written agreements with sub-recipients which contain the provisions in 24 CFR, Section 92.504. Also the local government must conduct reviews and audits of the sub-recipients as may be necessary or proper to determine whether the sub-recipient has committed and expended the HOME Funds as required by 24 CFR, Section 92.500 and has met HOME Program requirements particularly as they relate to eligible activities, income targeting allow ability and matching contribution requirements 24 CFR, Section 92.201.

The Municipality entered into a written agreement with the sub-recipient (developer) but is not reviewing nor auditing the sub-recipient's performance and, consequently, granting the sub-recipient the opportunity to avoid compliance with program procedures and requirements.

Cause

The assigned employee of the program to perform the monitoring of the sub-recipient performed the initial monitoring however, he has not performed any other since then.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006

Section III Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
HOME	06-III-1	<p><b>Sub-recipient Monitoring (Continuation)</b></p> <p><u>Effect</u></p> <p>The Municipality is not in compliance with the OMB Circular A-133, Part M requirement and failed to detect that the sub-recipient did not file the monthly progress report for the year, that the project had been delayed for approximately six months because the financing institution had suspended the financing and that it was not complying with certain clauses of the construction contract.</p> <p><u>Recommendations</u></p> <p>We recommend that the Municipality officials monitor closely the sub-recipient and strongly evaluate the continuation of the project with such sub-recipient.</p> <p><u>Managements Comments</u></p> <p>We conducted a review monitoring the CHDO's compliance with HOME program requirements for the fiscal year 2005-2006, but were unable to finish our report in time for the independent auditor's evaluation.</p>	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
HOME	06-III-2	<p><b>Activities &amp; Costs Allowed or Unallowed</b></p> <p><u>Criteria and Condition</u></p> <p>The OMB Circular A-133, Part 3 Compliance Request A &amp; B requires that the program expend the moneys in allowable activities. However, it was noted that \$119,272 were used in unallowable activities and are questioned as follows:</p> <p>a. Professional Services billed during the period February – May 2006 the project has been delayed by the financing institution. \$ 36,000</p> <p>b. Illumination lamp over billed. 61,672</p> <p>c. Administrative expenses in excess of maximum permitted 21,600</p>	\$119,272

Cause

The assigned employee of the program to perform the monitoring of the sub-recipient performed the initial monitoring however, he has not performed any one since then.

Effect

The program expended in unallowable activities and, therefore, did not comply with the OMB Circular A-133.

Recommendation

The Program should expend the federal awards in allowable activities.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006

Section III Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
HOME	06-III-2	<p><b>Activities &amp; Costs Allowed or Unallowed (Continuation)</b></p> <p><u>Management Comments</u></p> <p>The following are the management comments regarding this finding:</p> <ol style="list-style-type: none"><li>a. The CHDO had some construction delays during the dates in question due to project financing issues. The professional services billed during that period were for services rendered to secure new financing.</li><li>b. We are in the process of conducting an investigation with the supplier in question to clear this matter.</li><li>c. No administrative expenses have been paid to the CHDO since the year 2002; the amounts in question have been paid as project related soft costs.</li></ol>	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
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<b>HOME</b>	<b>06-III-3</b>	<b>Eligibility Test and Special Test</b>	
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Criteria and Condition

The OMB Circular A-133 states that only low income or very low-income participants can receive housing assistance which must follow certain procedures and obtain certain documents to determine the eligibility of an applicant. We selected a sample of 22 participants from the housing projects to test their compliance and found the following documents were not on file or missing for our examination.

<u>Requirement for Eligibility</u>	<u>Number of Cases</u>
Social Security	1
ASUME Certification	4
Good Standing Certification	7
CRIM Certification	4
Treasury Debt Certification	13
Employer Verification	2
Income Tax Certification	9
Real Estimate Purchase Contract	2

Cause

The programs administrative personnel are not reviewing adequately the participant's files to maintain them current.

Effect

The applicant's eligibility could not be verified completely due to the missing documents and the lack of evidence of the selecting procedure required.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006

Section III Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
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HOME	06-III-3	Eligibility Test and Special Test (Continuation)	
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Recommendations

We recommend the Municipality to comply with the program rules, policies and procedures regarding the evaluation and review of each participant's file. All the personnel responsible for the review and evaluation process of each of the applicants record should follow all program rules, policies and procedures. Also, the Municipality officials should evaluate the performance of these personnel periodically in order to ensure the highest level of compliance with the policies and procedure of the program. Finally, a technical training to the selected personnel is highly recommended.

Management Comments

In most cases the documents missing from the participants files were in the custody of our office personnel for review or update at the time of the independent auditor's test, the exceptions are being investigated.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>																																				
HOME-	06-III-4	<p><b>Disapproval of Required Corrective Action for the Fiscal Year 2006 by HUD</b></p> <p><u>Criteria and Condition</u></p> <p>On letter dated October 26, 2006, HUD indicated the reasons for the disapproval of the Required Corrective Action for fiscal year 2006 Consolidated Plan/Action Plan of the HOME program. The following is a summary of the question costs, Disallowed Cost and reimbursable amounts among other significant issues included in the letter.</p> <p><b><u>A. Procurement Question Costs</u></b></p> <table border="0" style="width: 100%;"> <tr> <td style="width: 80%;">1. Estancias del Río-Project Costs</td> <td style="text-align: right;">\$174,357</td> <td></td> </tr> <tr> <td>2. Professional Services</td> <td style="text-align: right;">34,502</td> <td></td> </tr> <tr> <td>3. Professional Services</td> <td style="text-align: right;">32,550</td> <td></td> </tr> <tr> <td>4. Accounting System</td> <td style="text-align: right;"><u>5,000</u></td> <td style="text-align: right;">\$ 246,409</td> </tr> </table> <p><b><u>B. Disallowed Costs</u></b></p> <table border="0" style="width: 100%;"> <tr> <td style="width: 80%;">1. Felices Días-Project Costs</td> <td style="text-align: right;">655,438</td> <td></td> </tr> <tr> <td>2. Villas de Felisa</td> <td style="text-align: right;">837,200</td> <td></td> </tr> <tr> <td>3. Professional Services</td> <td style="text-align: right;">23,500</td> <td></td> </tr> <tr> <td>4. Tenant Income Substitution</td> <td style="text-align: right;">24,378</td> <td></td> </tr> <tr> <td>5. Estancias del Río</td> <td style="text-align: right;">1,820</td> <td></td> </tr> <tr> <td>6. Construction Unit Not Completed</td> <td style="text-align: right;"><u>137,776</u></td> <td style="text-align: right;">1,680,112</td> </tr> </table> <p><b><u>C. Agreement to Reimburse</u></b></p> <table border="0" style="width: 100%;"> <tr> <td style="width: 80%;">1. Luck of income eligibility</td> <td style="text-align: right;">182,000</td> <td></td> </tr> <tr> <td>2. Disallowed Costs</td> <td style="text-align: right;"><u>1,892</u></td> <td style="text-align: right;">183,892</td> </tr> </table>	1. Estancias del Río-Project Costs	\$174,357		2. Professional Services	34,502		3. Professional Services	32,550		4. Accounting System	<u>5,000</u>	\$ 246,409	1. Felices Días-Project Costs	655,438		2. Villas de Felisa	837,200		3. Professional Services	23,500		4. Tenant Income Substitution	24,378		5. Estancias del Río	1,820		6. Construction Unit Not Completed	<u>137,776</u>	1,680,112	1. Luck of income eligibility	182,000		2. Disallowed Costs	<u>1,892</u>	183,892	
1. Estancias del Río-Project Costs	\$174,357																																						
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1. Luck of income eligibility	182,000																																						
2. Disallowed Costs	<u>1,892</u>	183,892																																					

Cause

The Program Administrative officials did not follow up properly the HUD recommendations that resulted from the monitoring findings for the fiscal years 1994, 2001 and 2002.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006

Section III Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
HOME-	06-III-4	<p><b>Disapproval of Required Corrective Action for the Fiscal Year 2006 by HUD (Continuation)</b></p> <p><u>Effect</u></p> <p>HUD Administration did not approve the FY 2006 HOME Program Certification.</p> <p><u>Recommendation</u></p> <p>We recommend that all unresolved findings must be resolved by the Municipality officials to HUD satisfaction in order to approve the FY 2006 HOME Program Certification. Also, as we indicated before the Municipality should reevaluate the continuance of the CHDO.</p> <p><u>Management Comments</u></p> <p>Municipality officials prepared and submitted to HUD a partial Corrective Action Plan dated February 28, 2007 and we are awaiting a favorable outcome.</p>	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
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**Section 8-  
Voucher**

**06-III-5**

**Eligibility**

Criteria and Condition

The OMB Circular A-133 and 24 CFR states that the Payment of Housing Assistant (PHA) required to follow certain procedures and obtain certain documents to determine the eligibility of an applicant. We selected a sample of 25 participants from a total of approximately 800 participants to test their compliance and found the following information were not in file or missing for our examination.

- |                                |    |
|--------------------------------|----|
| a. Request for Tenant approval | 22 |
| b. Citizenship Declaration     | 18 |
| c. Hap Contract                | 13 |
| d. ASUME Certification         | 9  |
| e. Income Certification        | 6  |
| f. Utility Allowance           | 13 |
| g. HQS Inspections             | 6  |

Cause

The programs administrative personnel are not reviewing adequately the participant's files to maintain them current.

Effect

The applicant's eligibility could not be verified completely due to the missing documents and the lack of evidence of the selecting procedure required.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006

Section III Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
Section 8-Voucher	06-III-5	<p><u>Eligibility (Continuation)</u></p> <p><u>Recommendations</u></p> <p>We recommend the Municipality to comply with the program rules, policies and procedures regarding the evaluation and review of each participant's file. All the personnel responsible for the review and evaluation process of each of the applicants record should follow all program rules, policies and procedures.</p> <p><u>Management Comments</u></p> <p>In most cases the documents missing from the participants files were in the custody of our office personnel for review or update at the time of the independent auditor's test, the exceptions are being investigated.</p>	
		<b>TOTAL QUESTIONED COSTS</b>	<b><u>\$2,229,685</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
For the year ended June 30, 2006**

<u>Single Audit Report</u>	<u>Program</u>	<u>Finding No.</u>	<u>Finding</u>	<u>Current Status</u>
06/30/2005	CDBG COPS Head Start	05-III-1	<u>Cash Management</u>  The Cash Management General Requirement of Circular OMB 102 requires that funds should include procedure to minimize the time elapsed between the transfer of funds from the U.S. Treasury and the disbursement of funds by the Treasury and the disbursement of funds by the grantee. During our examination of the cash received and disbursement of the CDBG federal program we noted disbursements elapsing between 1 to 16 days between 1-76 days COPS and between 6 to 21 days (Head Start).	Finding still prevails.
	COPS	05-III-2	<u>Reporting</u>  The OMB Circular A-133, Compliance Supplement 4 and F42002 Technology FAQ sheets state that grantees are required to submit Quarterly Financial States Report (SF-269) for the calendar year even if funds have not been drawn down. The grantee submitted only one FSR for the quarter ended June 30, 2005.	All quarterly reports were submitted in the current year.
06/30/2004	CDBG	04-III-1	<u>Cash Management</u>  The Cash Management General Requirement of Circular OMB 102 requires that funds should include procedures to minimize the time elapsed between the transfer of funds from the U.S. Treasury and the disbursement of funds by the Treasury and the disbursement of funds by the grantee. During our examination of the cash received and disbursements of the CDBG federal program we noted disbursements elapsing between 5 to 51 days.	Finding still prevails based on a limited test performed.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
For the year ended June 30, 2006**

<u>Single Audit Report</u>	<u>Program</u>	<u>Finding No.</u>	<u>Finding</u>	<u>Current Status</u>
6/30/2003	FEMA	03-III-2	<u>Period of Availability of Federal Funds</u>  The OMB Circular A-133 (Revised) compliance H, states that the programs may charge allowable costs resulting from obligations incurred during the funding period up to the approved grant amount. In addition, entities should liquidate all obligations incurred under the award not later than 90 days after the end of the funding period. During our examination of FEMA funds, we noted that there is a balance of \$2.3 millions on obligations balances for more that 3 years. This debt is related with serious physical damages caused by the Hurricane Georges in September 1998.	Finding still prevails. Legal claims before Puerto Rico Courts have not been resolved.
6/30/2002	CDBG	02-II-1	<u>Accounting Records</u>  The Municipality does not maintain complete accounting records related with general journal nor general ledger to prepare correct monthly, quarterly and year-end financial statements.	Finding still prevails. The Municipality has improved its accounting record reporting but, it cannot provide a set of financial statement of the program.
6/30/2002	Section 8	02-III-2	<u>Special Test and Provisions- Waiting List</u>  The Municipality was not following the procedures required by Section 982.07 of 24 CFR in admitting new tenants participants.	As per our Eligibility Test, the Municipality has improved the procedures required during the fiscal year 2005-2006.



Estado Libre Asociado de Puerto Rico  
 Gobierno Municipal de Mayagüez  
 Departamento de Vivienda y Programas Federales



OFICINA DEL COMISIONADO  
 DE ASUNTOS MUNICIPALES  
 2007 APR -2 AM 8:17  
 RECEBIDO  
 UNIDAD DE CORREO

29 de marzo de 2007

Sr. Luis Olivares López  
 Director, Departamento de Finanzas

*Luis Olivares*

*J.R. Rosario Burgos*

Jaime L. Rosario Burgos  
 Director de Monitoría  
 Departamento de Vivienda  
 y Programas Federales

*Maribel Pérez Ortiz*

Maribel Pérez Ortiz  
 Administradora  
 Departamento de Vivienda  
 y Programas Federales

07 APR -2 AM 10:01  
 DEPARTAMENTO DE VIVIENDA  
 E INTERVENCIÓN

**SEÑALAMIENTOS INCLUIDOS EN INFORME DE AUDITORIA (SINGLE AUDIT), AÑO FISCAL TERMINADO JUNIO 30, 2006; PROGRAMAS CDBG, HOME Y SECCION 8 DE HUD**

Reciba un saludo cordial de nuestra parte al recibo de esta comunicación.

Hacemos referencia al Informe Final de Auditoría (Single Audit) para el año fiscal terminado al 30 de junio de 2006; conducido por la firma de Contadores Públicos Autorizados, Nieves Velázquez y Co., para el Municipio de Mayagüez. En este se incluyeron señalamientos en relación a los programas CDBG, HOME y Sección 8 de HUD; administrados por nuestro Departamento.

Le incluimos para su revisión, análisis y el trámite administrativo que corresponda nuestras contestaciones y Plan de Acción Correctiva en relación a este asunto.

Puede comunicarse con quienes suscriben, de tener dudas y/o necesitar información adicional en relación a este asunto.

/arr

fc: Lcda. Edna Rodríguez Valentín/Srta. Magaly Crespo Martínez/Srta. Marisol Jusino Rivera/  
 Sr. Elliot Irizarry Otero/Sra. Awilda Rodríguez Aponte/Expediente Single Audit 2005-2006

*4/18/07 EEO- Raymond*

**Responses and Corrective Actions to  
Findings Included in Single Audit Report for  
Fiscal Year Ended June 30, 2006;  
CDBG, HOME and Section 8  
HUD Programs**

**Program: HOME**

**Finding Number: 06-III-1 Findings/Non Compliance: Sub-recipient Monitoring**

**Question Costs: 0**

The assigned employee of the program to perform the monitoring of the sub-recipient performed the initial monitoring however; he has not performed any other since them.

**Responses and Corrective Actions:**

We disagree with finding 06-III-1; nevertheless we agree auditor's recommendations regarding the continuous evaluation of the subrecipient performance and continuation of the project with such sub-recipient.

The Municipality of Mayaguez through its Housing and Federal Programs Department developed an Annual Monitoring Plan. That Plan is also included in the Municipality of Mayaguez Annual Action Plan, who is submitted to HUD. That Monitoring Plan includes monitoring reviews for all grantee sub-recipients.

We conducted a review monitoring to the CHDO compliance with HOME program requirements for the fiscal year 2005-2006, but were unable to finish our report on time for the independent auditor's evaluation:

**Program: HOME**

**Finding Number: 06-III-2**

**Finding/Non compliance: Activities and Costs allowed or unhallowed**

**Questioned Costs: \$119,272.00**

The OMB Circular Letter A-133, Part 3 Compliance Request A and B require that the program expend the moneys in allowable activities. However, it was noted that \$119,272.00 were used in unallowable activities and are questioned as follow.

- a. Professional Services billed during the period February-May 2006 the project has been delayed by the financing institution \$36,000.00
- b. Illumination lamp overbilled \$61,672.00
- c. Administrative expenses in excess of maximum permitted \$21,600.00

**Responses and Corrective Actions:**

We disagree with finding 06-III-2.

Regarding the professional services billed during the period February to May, 2006, charged to project related soft costs, not to administrative cost are allowable, justifiable and necessary to secure a new financing for the project. The CHDO had some construction delays during the dates in question due to the project financing issues. The professional services billed during that period were for services rendered to secure new financing.

Regarding the Illumination lamp overbilled; we are already in the process of conducting an investigation with the supplier in question to clean this matter. Nevertheless, we understand that this finding is totally incorrect.

1. The total amount of lamps to be installed in the project is 37, not 29.
2. The total cost to supply and install the lamp is \$159,834; \$129,713.12 corresponds to the direct cost of the supplies and \$30,120.88 to the contractor indirect costs and profits.
3. The payment certifications submitted for payment total amount from the contractor was \$130,675.14; who corresponds to thirty (30) lamps. In the project was installed twenty nine (29), and one (1) in the access road, for a total of thirty (30) lamps.
4. The remaining amount of seven (7) lamps, in wich we have a remaining balance to pay of \$29,158.96. Those lamps (7), are in the custody of the supplier and will be installed as soon as the posts will be installed in the project.

Regarding the administrative expenses in excess of maximum permitted; no administrative expenses have been paid to CHDO since the year 2002. The amounts in question have been paid as project related soft costs, and corresponds to services directly rendered to the project such as project inspection, financing consulting services to secure a new financing for the project, project secretary services, among others.

Those services were billed and charged to project related soft costs; according to the requirements of 24 CFR, Part 92, section 92.206 (d) (Eligible Project Costs, Related Soft Costs), HUD CPD Notice 96-9 (Administrative Costs, Project Related Soft Costs, and Community Development Housing Organization (CHDO Operating Expenses Under HOME Program) and related OMB Circular Letters.

**Program: HOME**

**Finding Number: 06-III-3**

**Findings/Non Compliance: Eligibility Test and Special Test**

**Question Costs: 0**

The OMB Circular A-133 states that only low income or very low income participants can receive housing assistance which must follow certain procedures and obtain certain documents to determine the eligibility of an applicant. We selected a sample of 22 participants from the housing projects to test their compliance and found the following documents were not in file or missing four our examination.

<u>Requirement for Eligibility</u>	<u>Number of Cases</u>
Social Security	1
ASUME Certification	4
Good Standing Certification	7
CRIM Certification	4
Treasury Debt Certification	13
Employees Verification	2
Income Tax Certification	9
Real Estimate Purchase Contract	2

The programs administrative personnel are not reviewing adequately the participant's files to maintain them current.

**Responses and Corrective Actions:**

We disagree with finding 06-III-3.

In most of the cases reviewed by the auditor's, the documents missing from the participants files were in the custody of the HOME Program personnel for review or update at the time of the independent auditor's test, the exceptions are being investigated by the program personnel.

We have to state that the program personnel are highly qualify and certainly follow all program rules, policies and procedures for the review and evaluation process of each of the applicants records, in order to ensure the highest level of compliance with the policies and procedures of the program. Significant improvement were made in the last five years regarding program participants evaluation and qualification process.

The Municipality of Mayaguez as part of the personnel policies and procedures; evaluate periodically the performance of all its employees. The performance of our Department personnel including the HOME Program staff are periodically evaluated. Training and Technical assistance to the program personnel staff were coordinated and provided by HUD and other external resources to improve their capabilities and knowledge of HOME program rules and regulations.

As a matter of fact; we are in the process of developing as requested by HUD, a Management Plan for the HOME Program. Among other things; that Plan will include specific strategies to improve program and program staff capabilities such as provide additional staff and training and technical assistance in all program issues, rules and regulations.

**Program: HOME**

**Finding Number; 06-III-4**

**Finding/Non Compliance: Disapproval of Required Corrective Actions for the Fiscal Year 2006 By HUD**

**Question Costs: \$2,110,413**

On letter dated October, 26, 2006, HUD indicated the reasons for disapproval of the Required Corrective Action for fiscal year 2006, Consolidated Action Plan of the HOME Programs. The following is a summary of the question costs, disallowed costs and reimbursable amounts among other significant issues included in the letter.

**A. Procurement Question Costs**

1. Estancias del Río Project Costs	\$174,357
2. Professional Services	34,502
3. Professional Services	32,550
4. Accounting System	5,000
	<u>\$246,409</u>

**B. Disallowed Costs**

1. Felices Días Project Costs	\$ 655,438
2. Villas de Felisa	837,200
3. Professional Services	23,500
4. Tenant Income Substitution	24,378
5. Estancias del Río	1,820
6. Construction Unit not completed	137,776
	<u>\$1,680,112</u>

### **C. Agreement to Reimbursed**

1. Lock of income eligibility	\$ 182,000
2. Disallowed Costs	1,892
	<u>\$ 183,892</u>

The program administrative officials did not follow up properly the HUD recommendations that resulted from the monitoring findings for fiscal years 1994, 2001 and 2002.

#### **Responses and Corrective Action Plan:**

We disagree with finding 06-III-4; regarding auditor's conclusion that the program administrative officials did not follow up properly HUD recommendations that resulted from the monitoring findings for the fiscal year 1994, 2001 and 2002.

As a matter of fact; the Municipality of Mayaguez prepared and submitted to HUD a Corrective Action Plan dated February, 28, 2007. We are awaiting a favorable outcome from HUD officials. Nevertheless; the Municipality in order to resolve all the program pending issues and findings, previously started meetings conversations and negotiations with HUD officials to establish the process to resolve its.

At the program level; the staff already took the necessary measures and corrective actions to improve the program performance and procedures.

**Program: Section 8**  
**Finding Number: 06-III-5**  
**Finding/Non Compliance: Eligibility**  
**Questioned Costs: 0**

The OMB Circular A-133 and 24 CFR states that payment of Housing Assistance (PHA) required to follow certain documents to determine the eligibility of an applicant. We selected a sample of 25 participants from a total of approximately 800 participants to test their compliance and found the following information were not in file or missing for examination.

a) Request for Tenant Approval	22
b) Citizenship Declaration	18
c) HAP Contract	13
d) ASUME Certification	9
e) Income Certification	13
f) HQS Inspection	6

The program administrative personnel are not reviewing adequately the participants files to maintain them current.

#### **Responses and corrective actions:**

We disagree with finding 06-III-5.

In all the cases reviewed; the missing documents from the participants files were in the custody of our office personnel for review or update at the time of the independent auditor's test. All the personnel of the program are highly qualify and well trained, and follow all program rules, policies and procedures for the review and evaluation process of applicants records.

**Prior years Findings and Questioned Costs**

**Program: CDBG**

**Finding Number: 04-III-1, 05-III-1**

**Finding/Non Compliance: Cash Management**

We agree with findings 04-III-1 and 05-III-1

At the program level; the Department of Housing and Federal Program in charge of the Administration of CDBG and other HUD Programs, already took the necessary measures to comply with the requirements of OMB Circular Letter A-102. We request money through IDIS System; and it takes about three or four days for the money to be available at the Bank Account. Meanwhile; we prepared the payment documents one voucher; and obtained all the correspondent sings to process the payment. Ass soon as the money be available in the bank account we notify to the Municipality Finance Department, in charge of the final emission of the payment.

Nevertheless; we are in the process of meetings, coordination and conversations with the Municipality Finance Department in order to establish specific strategies to secure compliance with cash managements requirements of OMB Circular Letter A-102.

**Program: CDBG**

**Finding Number: 02-III-1**

**Finding/Non Compliance: Accounting Records**

The Municipality does not maintain complete accounting records related with general journal non general ledger to prepare correct monthly quarterly and year end statements responses and corrective actions:

We disagree with finding 02-III-1

Those Accounting Records were assigned to two accountants at the program Fiscal Unit. Those records are updated and available for revision.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**  
**(CONTINUATION)**

Another significant portion of net assets (\$19,711,350) at June 30, 2006, represents resources that are subject to external restrictions on how they may be used, such as: (1) debt service (\$7,737,727), (2) permanent improvements bonds (\$1,616,551), (3) mortgage loans and notes (\$1,641,948) and (4) other purposes, principally to finance federally and state funded programs (\$8,715,124).

The remaining component of total net assets consists of an unrestricted liabilities amounting to \$10,591,600 at June 30, 2006. This unrestricted liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as solid waste landfill closure and postclosure care costs, bonds and notes payable, compensated absences, claims and judgments, certain obligations under capital leases, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality increased by \$330,332 for the fiscal year ended June 30, 2006. Such increase is due to the excess of total revenues (\$79,681,101) over expenses (\$79,350,769) for the fiscal year ended June 30, 2006 and is principally composed as follows:

- An increase of \$3,605,827 in net assets invested in capital assets, net of related debt. The increase in this net asset category is due to the combination of: (1) the excess of current year additions (\$6,889,154) over depreciation/amortization of capital assets (\$3,768,654), (2) the net increase of \$3,266,650 in outstanding debt related to the acquisition, construction or improvement of capital assets, and (3) and the net decrease of \$2,758,782 in the unspent proceeds of debt associated with the acquisition, construction or improvement of capital assets.
- A decrease of \$1,009,860 in restricted net assets due principally to a decrease of \$3,030,058 in net assets restricted to finance federally and state funded programs, which are mainly supported with intergovernmental grants and contributions, and an increase in general fund restricted net assets of \$1,918,056.
- A increase of \$1,442,772 in unrestricted net liabilities due to: (1) an increase of \$71,348 in the estimated liability for solid waste landfill closure and postclosure care costs, (2) an increase in \$3,419,174 in accrued legal claims and judgments, (3) a decrease of \$668,179 in property taxes receivable, (4) a decrease of \$3,426,422 in intergovernmental receivables of unrestricted resources, and (5) a decrease of \$87,409 in other receivables.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(CONTINUATION)**

The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS:

**Statement of Activities  
Governmental Activities  
Fiscal Years Ended June 30, 2006 and 2005**

	<b>2006</b>	<b>2005, as restated (note 14)</b>
<b>Program revenues:</b>		
Program-specific operating grants and contributions	\$ 19,979,651	\$ 18,124,247
Program-specific capital grants and contributions	4,215,104	9,573,245
Charges for services	2,983,718	3,646,425
Total programs revenues	\$ 27,178,473	\$ 31,343,917
<b>General revenues:</b>		
Property taxes	26,708,931	25,414,939
Municipal license taxes	13,596,515	14,110,503
Unrestricted grants and contributions	6,683,304	8,475,008
Other general revenues (various sources)	5,513,878	3,908,978
Total general revenues	52,502,628	51,909,428
Total revenues	79,681,101	83,253,345
<b>Program expenses:</b>		
General government	18,035,902	23,837,538
Public safety	7,726,094	5,242,116
Urban economic development	10,230,352	8,423,422
Health and sanitation	11,751,780	9,655,800
Culture, recreation and education	15,552,549	15,873,843
Public housing and welfare	12,243,755	12,864,235
Interest on long-term obligations	3,810,337	3,008,808
Total expenses	79,350,769	78,905,762
<b>Net increase in assets</b>	330,332	4,347,583
<b>Net assets, at beginning of fiscal year</b>	42,122,706	37,775,123
<b>Net assets, at end of fiscal year</b>	\$ 42,453,038	\$ 42,122,706

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**  
**(CONTINUATION)**

As previously mentioned, the Municipality's net assets increased by \$330,331 or .78 percent during current fiscal year. Approximately 65.90 percent (\$52,502,628) of the Municipality's total revenues for the current fiscal year came from property, municipal license and construction excise taxes, while 30.44 percent (\$24,194,755) resulted from restricted and unrestricted capital and operating grants and contributions. Charges for services and other revenues, amounting to \$2,983,718, provided 3.70 percent of the total revenues for the current fiscal year.

There was a significant decrease of \$2,896,388 (89.76 percent) in the net change in net assets for the Municipality as a whole, when operations for the fiscal current year are compared to those of the prior fiscal year. This occurred because the decrease of \$2,451,381 in total revenues was not sufficient to offset the increase in total expenses of \$445,007. The most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

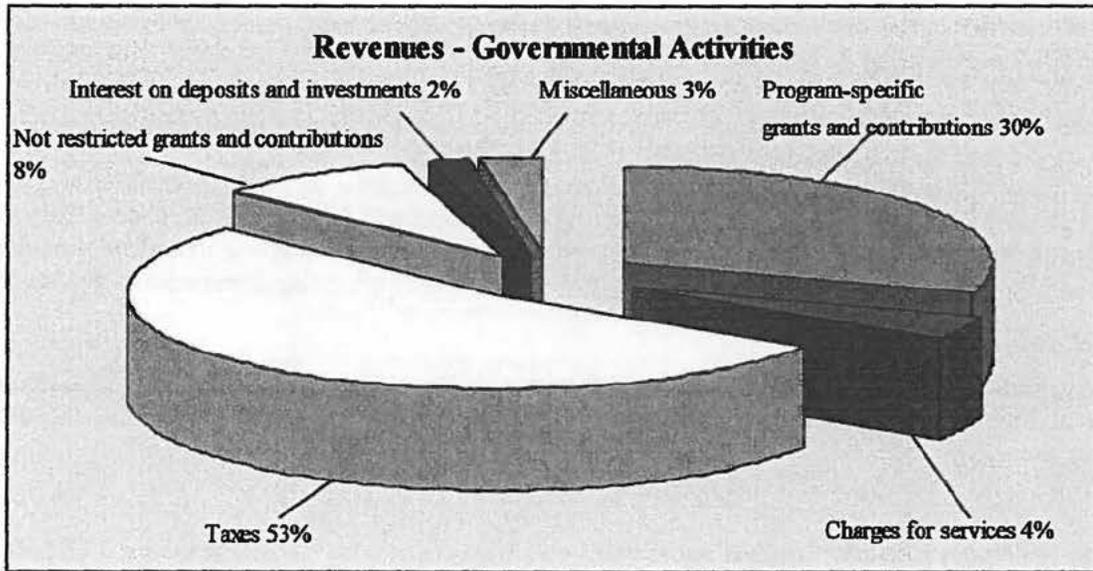
- Municipal license revenues decrease by \$513,988 during the fiscal year. The increase in municipal license taxes is also due to the increase of \$400,756 in deferred municipal licenses (corresponding to fiscal year 2006-2007 and collected in advance), and the overall economic condition of the west region of the Commonwealth.
- Program-specific capital an operating grants and contributions increased by \$3,502,737 principally due to: (1) a decrease of \$1,393,290 in grants revenues received from HUD under the Home Program (2) an increase of \$493,130 in grant revenues received from U.S. Department of Justice under the Community Oriented Policing Services Grant and Home Land Security Grant, (3) an increase in other grant revenues amounting to \$4,467,153 which were received during current fiscal year.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(CONTINUATION)**

The following table presents the composition of revenues for the fiscal year ended June 30, 2006:



The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2006 were related to: (1) general administrating and operating costs (\$18,035,902), which were classified as "general government" and accounted for 22.73 percent of total expenses, (2) public safety (\$7,726,094) which accounted for 9.74 percent of total expenses, (3) urban and economic development (\$10,230,352), which accounted for 12.89 percent of total expenses, (4) health and sanitation (\$11,751,780), which accounted for 14.81 percent of total expenses, and (5) culture, recreation and education (\$15,552,549), which accounted for 19.60 percent of total expenses, and (6) public housing and welfare (\$12,343,755), which accounted for 15.43 percent of total expenses.

The most significant fluctuations between the current fiscal year's expenses and those of the prior fiscal year occurred in the following functions/activities:

- General government expenses decrease due to a decrease in direct services to citizens.
- Urban and economic development expenses increased by \$1,806,930 because during current year the Municipality increased its urban development activities by increasing its investment in public permanent improvements, supported principally by resources received from HUD, under the CDBG program, and proceeds from bonds.
- Public safety expenses increased by \$2,438,978 because the Municipality increased its municipal police force by adding 30 additional officers to enable the implementation of the Public Order Code and to increase the public safety of its citizens.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

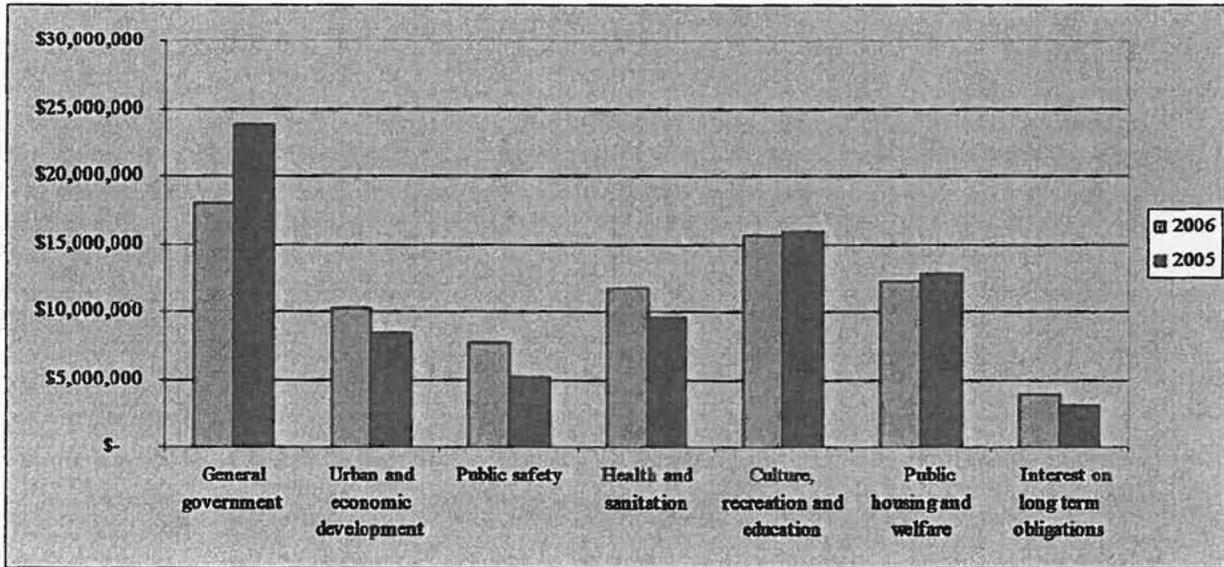
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(CONTINUATION)**

- Health and sanitation expenses increased by \$2,095,980 mainly because: (1) during current fiscal year the Municipality established an environmental police department to ensure the compliance of all applicable environmental laws and regulations in the Municipality, and (2) during current fiscal year the Municipality renegotiated its solid-waste disposal contract with a private entity.
- Interest on long-term obligations decreased by \$801,529 in comparison with the prior fiscal year principally for the net decrease of \$2,758,782 in bonds cash balance associated with the uses of funds to finances capital projects during the current fiscal year.

The following table presents the composition of expenses for the fiscal years ended June 30, 2006 and 2005:

**Expenses by Functions/Program  
Fiscal Year Ended June 2006 and 2005**



**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**

**Comparative Condensed Balance Sheet - Governmental Funds**  
**June 30, 2006 and 2005**

	2006	2005 (as restated) (note 14)
<b>Assets:</b>		
Total assets - major governmental funds	\$ 79,861,947	\$ 85,701,516
Total assets - other governmental funds	11,499,084	12,574,859
Combined total assets	91,361,031	98,276,375
<b>Liabilities:</b>		
Total liabilities - major governmental funds	49,933,301	51,281,850
Total liabilities - other governmental funds	6,020,799	5,697,289
Combined total liabilities	55,954,100	56,979,139
<b>Fund balances:</b>		
Reserved - major governmental funds	23,862,604	25,126,703
Reserved - other governmental funds	5,478,285	6,877,570
Unreserved - major governmental funds	6,066,042	9,292,963
Combined total fund balances	35,406,931	41,297,236
<b>Total liabilities and fund balances</b>	<b>\$ 91,361,031</b>	<b>\$ 98,276,375</b>

**Analysis of Financial Position of Governmental Funds**

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

At June 30, 2006, the total assets of governmental funds decreased by \$6,915,344 (7.04 percent) in comparison with the prior fiscal year principally for: (1) the decrease of \$5,248,616 in restricted cash, (2) the increase in unrestricted cash and cash equivalents of \$695,843, (3) the increase of \$1,500,000 in long-term investments in certificates of deposit (4) the decrease of \$84,144 in other receivables, and (5) the decrease of \$3,426,422 in intergovernmental receivables.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Financial Position of Governmental Funds (Continuation)**

At June 30, 2006, the total liabilities of governmental funds decreased by \$1,025,039 (1.80 percent) in comparison with the prior fiscal year principally for: (1) the decrease of \$768,008 in accounts payable and accrued liabilities, (2) the increase in matured bonds due and payable of \$545,000, (3) and the decrease of \$1,980,153 in deferred revenues.

For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most of these fluctuations has been made.

At the end of the current fiscal year, total unreserved fund balances of the governmental funds amounted to \$6,066,042, while total fund balance reached \$36,406,931. The total fund balances decreased by \$5,890,305 during the current fiscal year. The most significant fluctuation in total fund balances occurred in the permanent improvements bonds fund, which decreased by 23.07 percent (\$2,861,760).

The following is a detailed financial analysis of the Municipality's governmental funds:

**Major Governmental Funds**

**General fund (GF)** - The GF's is the principal operating fund of the Municipality. The GF's total assets amounted to \$38,860,668 at June 30, 2006. Such assets consist of: (1) unrestricted and restricted cash and cash equivalents (\$16,166,081), (2) investments in certificates of deposit (\$7,292,400), (3) property and municipal license tax receivables (\$9,872,932), (4) short-term and long-term amounts due from other funds (\$3,161,407), and (5) intergovernmental grants and contribution receivable (1,491,979).

The GF's total liabilities amounted to \$27,570,720 at June 30, 2006. Such liabilities are composed mainly of: (1) deferred revenues (\$21,754,794), and (2) accounts payable and accrued liabilities, including amounts due to other governments (\$5,815,926).

At the end of the current fiscal year, unreserved fund balance of the GF's amounted to \$6,066,042, while total fund balance reached \$11,269,948. As a measure of the GF's liquidity it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 22.00 percent of the total GF's expenditures, while total fund balance represents 40.94 percent of that same amount.

**Debt service fund (DSF)**- The DSF's total assets amounted to \$14,921,479 at June 30, 2006, which consist mainly of restricted cash in fiscal agent (\$10,403,957) and restricted property taxes receivable (\$3,027,142). The DSF's total liabilities amounted to \$8,342,804 at June 30, 2006, which is mainly composed of: (1) matured bonds due and payable (\$5,290,000), (2) matured interest due and payable (\$1,490,903) and (3) deferred revenues (\$1,456,580). At the end of the current fiscal year, DSF's total and reserved fund balance reached \$6,578,675.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Major Governmental Funds (Continuation)**

**State legislative joint resolutions special revenue fund (SLJRSRF)** - The SLJRSRF's total assets amounted to \$13,606,290 at June 30, 2006, which consist of restricted cash in commercial banks. The SLJRSRF's total liabilities amounted to \$13,583,612 at June 30, 2006, which are mainly composed of deferred revenues (\$13,583,612). At the end of the current fiscal year, SLJRSRF's total and reserved fund balance reached \$22,678.

**Head start special revenue fund (HSSRF)**- The HSSRF's total assets amounted to \$107,740 at June 30, 2006, which consist mainly of restricted cash in commercial banks (\$44,192). The HSSRF's total liabilities amounted to \$107,072 at June 30, 2006, which are mainly composed of deferred revenues (\$19,521). At the end of the current fiscal year, HSSRF's total and reserved fund balance reached \$668.

**Permanent improvements bonds fund** - The PIBF's total assets amounted to \$12,365,770, which consist mainly of restricted cash in fiscal agent and commercial banks (\$12,296,490). The PIBF's total liabilities amounted to (\$329,093) at June 30, 2006, which are mainly composed of accounts payable and accrued liabilities (\$209,983). At the end of the current fiscal year, PIBF's total and reserved fund balance reached \$12,036,677.

**Other governmental funds (OGF)**- The OGF's total assets amounted to \$11,499,084 at June 30, 2006, which consist mainly of restricted cash in fiscal agent (\$5,686,521) and receivables from intergovernmental grants and contributions (\$3,199,416). The OGF's total liabilities amounted to \$6,020,799 at June 30, 2006, which are mainly composed of deferred revenues (\$1,474,212) and short-term and long-term amounts due to other funds (\$970,695). At the end of the current fiscal year, OGF's total and reserved fund balance reached \$6,020,799.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**Condensed Statement of Revenues, Expenditures and Changes  
in Fund Balances - Governmental Funds  
Fiscal Year Ended June 30, 2006 and 2005**

	<b>2006</b>	<b>2005 (as restated) (note 14)</b>
<i><b>Revenues:</b></i>		
Total revenues - major governmental funds	\$ 67,564,868	\$ 69,117,216
Total revenues - other governmental funds	12,124,912	13,539,762
Combined total revenues	79,689,780	82,656,978
<i><b>Expenditures:</b></i>		
Total expenditures - major governmental funds	71,376,309	80,991,418
Total expenditures - other governmental funds	14,203,774	13,657,987
Combined total expenditures	85,580,083	94,649,405
<i><b>Excess of expenditures over revenues</b></i>	<i>(5,890,303)</i>	<i>(11,992,427)</i>
<i><b>Other financing sources (uses), net:</b></i>		
Other financing sources, net - major governmental funds	(679,577)	7,709,188
Other financing sources (uses), net - other governmental funds	679,577	695,209
Combined other financing sources (uses), net	-	8,404,397
<i><b>Net change in fund balance</b></i>	<i>(5,890,303)</i>	<i>(3,588,030)</i>
<i><b>Fund balance at beginning of fiscal year</b></i>	41,297,236	44,885,266
<i><b>Fund balance, at end of fiscal year</b></i>	<i>\$ 35,406,933</i>	<i>\$ 41,297,236</i>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Operating Results of Governmental Funds**

**Major Governmental Funds**

**General fund** - The total fund balance of the GF decreased by \$1,308,765 or 10.38 percent during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$47,981,279, \$46,631,889 and \$2,668,155, respectively, for the fiscal year ended June 30, 2006.

Approximately 80.00 percent (\$38,471,011) of the GF's total revenues for the current fiscal year came from property, municipal license and construction excise taxes, while 14.50 percent (\$6,968,445) resulted from intergovernmental grants and contributions. Miscellaneous revenues, amounting to \$1,830,335, provided 3.81 percent of the total revenues for the current fiscal year.

There was a decrease of \$1,551,922 (63.79 percent) in the GF's net change in fund balance when operations for the current fiscal year are compared to those of the prior fiscal year. This occurred because the increase of \$4,339,101 in total expenditures increase in total revenues of \$30,216 was not sufficient to offset the increase in other financing uses (net) of \$2,658,155.

The GF's most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

- Miscellaneous revenues increased by \$845,136 due to, (1) the collections of past due property taxes amnesty and incentive plan approved last year by the Commonwealth's Legislature through Public Act No. 74 of March 1, 2004.
- Municipal license revenues decreased by \$745,136 due to the net change in deferred municipal license revenues and the overall economic conditions of the west region of Puerto Rico in comparison with the prior fiscal year.
- Charges for services increased by \$240,309 mainly due to the collection of rents of San Antonio Hospital of \$250,000, Mayagüez Medical Center of \$965,000.
- Property taxes increased by \$843,201 and construction excise taxes increased by \$322,743.

The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the general government and public housing and welfare expenditures, which decreased by \$5,279,313 because, as previously discussed, the Municipality implemented a strong cost reduction initiative during current fiscal year. This initiative emphasized in reducing general and administrative costs while increasing direct services to citizens. A detailed explanation of these cost reduction initiatives are described in the previous financial analysis of government-wide financial statements. The decrease in general government and public housing and welfare expenditures was partially offset by increases in the following expenditures: (1) health and sanitation (\$1,683,290), (2) public safety (\$1,603,754). Other financing uses (net) decreased by \$5,919,239 mainly due to the decrease of \$4,320,000 of the proceeds from issuance of bonds in comparison with the prior fiscal year.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Operating Results of Governmental Funds**

**Major Governmental Funds (Continuation)**

**Debt service fund (DSF)** - The total fund balance of the DSF decreased by \$6,301,940 or 20.34 percent during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$9,974,162, \$9,165,067 and \$1,559,965, respectively, for the fiscal year ended June 30, 2006.

Approximately 95.63 percent (\$6,669,160) of DSF's total revenues for the current fiscal year came from restricted property taxes. There was a significant decrease of \$630,940 in the DSF's net change in fund balance when operations for the current fiscal year are compared to those of the prior fiscal year. This occurred because of the increase in total revenues (\$2,174,512) and other net financing sources (\$1,119,573). These increases were partially offset by an increase of \$42,550 in total expenditures.

The increase in total DSF's revenues is mainly due to the increase of 15.87 percent (\$913,604) in property tax revenues. The decrease in other financing sources (net) is mainly due to the decrease of 29.46 percent (\$459,618) in amounts transferred-out to other funds.

**State legislative joint resolutions special revenue fund (SLJRSRF)** - The total fund balance of the SLJRSRF increased by \$7,246 or 46.95 percent during current fiscal year. Total revenues and expenditures, amounted to \$1,728,337 and \$1,721,091, respectively, for the fiscal year ended June 30, 2006.

Approximately 99.58 percent (\$1,721,091) of SLJRSRF's total revenues for the current fiscal year came from intergovernmental grants. There was an decrease of \$2,002,650 in the SLJRSRF's total revenues (mainly on intergovernmental grants), while total expenditures increased by \$2,002,468 (mainly on direct benefits to citizens).

**Head start (HSSRF)** - The total fund balance of the HSSRF increased by \$250 or 59.80 percent during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$9,980,379, \$10,854,024 and \$873,895, respectively, for the fiscal year ended June 30, 2006.

Approximately 99.73 percent (\$9,953,911) of HSSRF's total revenues for the current fiscal year came from intergovernmental grants. There was an increase of \$551,138 in the HSSRF's total revenues (mainly on intergovernmental grants), while total expenditures increased by \$636,874 (mainly on direct benefits to citizens). Other financing sources (net) increased by \$85,886.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS (CONTINUATION)**

**Analysis of Operating Results of Governmental Funds**

**Major Governmental Funds (Continuation)**

**Other governmental funds (OGF)** - The total fund balance of the OGF increased by \$1,399,285 or 20.34 percent during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$12,124,912, \$14,203,774 and \$579,577, respectively, for the fiscal year ended June 30, 2006.

Approximately 97.21 percent (\$11,786,849) of OGF's total revenues for the current fiscal year came from intergovernmental grants. There was a decrease of \$1,873,348 in the OGF's total revenues (mainly on intergovernmental grants), while total expenditures increased by \$545,787 (mainly on direct benefits to citizens and capital outlays). Other financing sources (net) decreased by \$15,632.

**BUDGETARY HIGHLIGHTS**

**a) General Fund**

The original budget of the general fund for the fiscal year ended June 30, 2006 amounted to \$52,077,470. Actual revenues decreased final budget revenues by \$4,805,066. The total variance was primarily attributed to revenue derived by municipal license taxes \$2,889,988, charges for services \$766,257, miscellaneous for \$332,665, and others for \$816,156.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were \$47,272,404, which is 9.23 percent (\$4,805,066) less than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were \$48,015,656, which is 7.08 percent (\$3,688,704) less than the budgeted expenditures. Furthermore, the total actual other financing uses (budgetary basis) of the general fund for the fiscal year ended June 30, 2006 were \$1,782,836, which is 3.42 percent (\$1,409,726) higher than the budgeted other financing uses (net).

The total variance in expenditures was principally due to a strong cost reduction initiative implemented by the Municipality during current fiscal year, which emphasized in reducing general and administrative costs while increasing direct services to citizens.

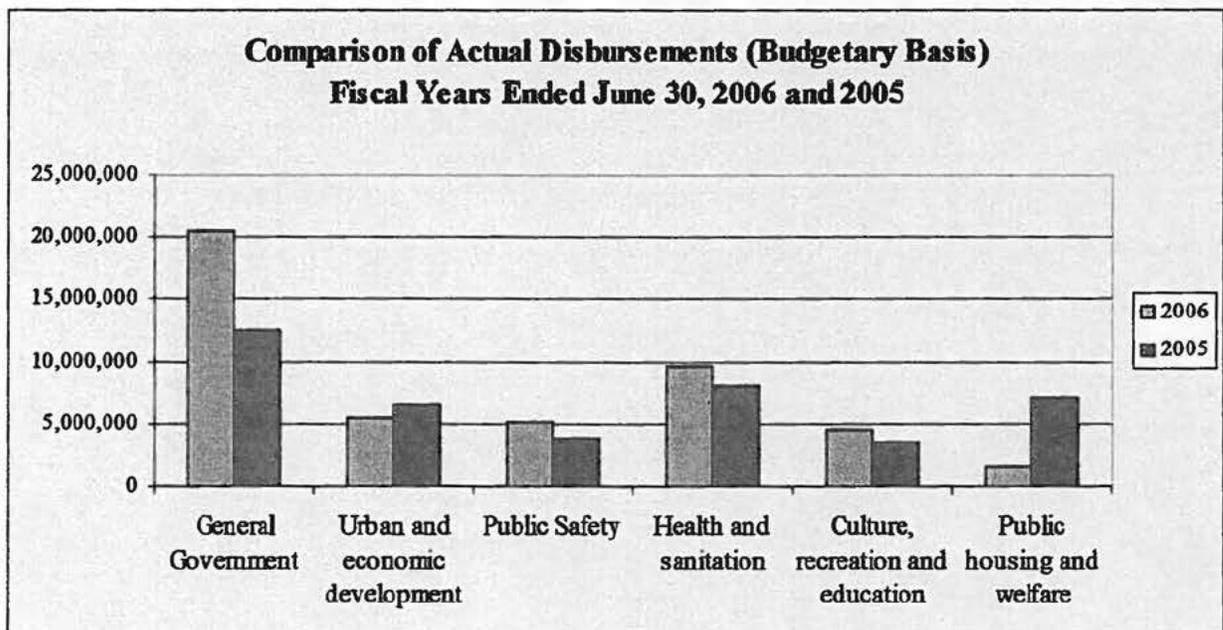
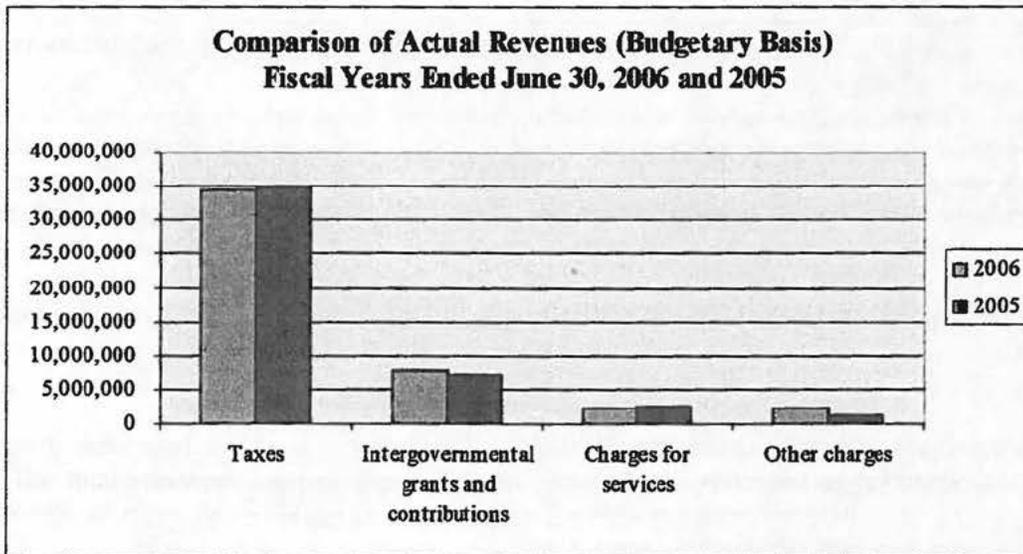
**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**BUDGETARY HIGHLIGHTS (CONTINUATION)**

**a) General Fund**

The following tables present the actual revenues and expenditures (budgetary basis) of the GF for the fiscal year ended June 30, 2006:



**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**a) Capital Assets**

The Municipality has invested \$118,802,137 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$51,666,223 at June 30, 2006. The total capital assets increased by \$1,120,500 during the current fiscal year mainly due to the current fiscal year's capital additions (\$6,889,154), which were partially offset by the depreciation and amortization expense (\$3,768,654), and reserve for impairment asset by (\$2,000,000) for the same period.

Approximately 93.35 percent of the total capital additions made to capital assets during the fiscal year ended June 30, 2006 were related to construction in progress (\$6,431,011). The major capital additions for the fiscal year ended June 30, 2006 were the following:

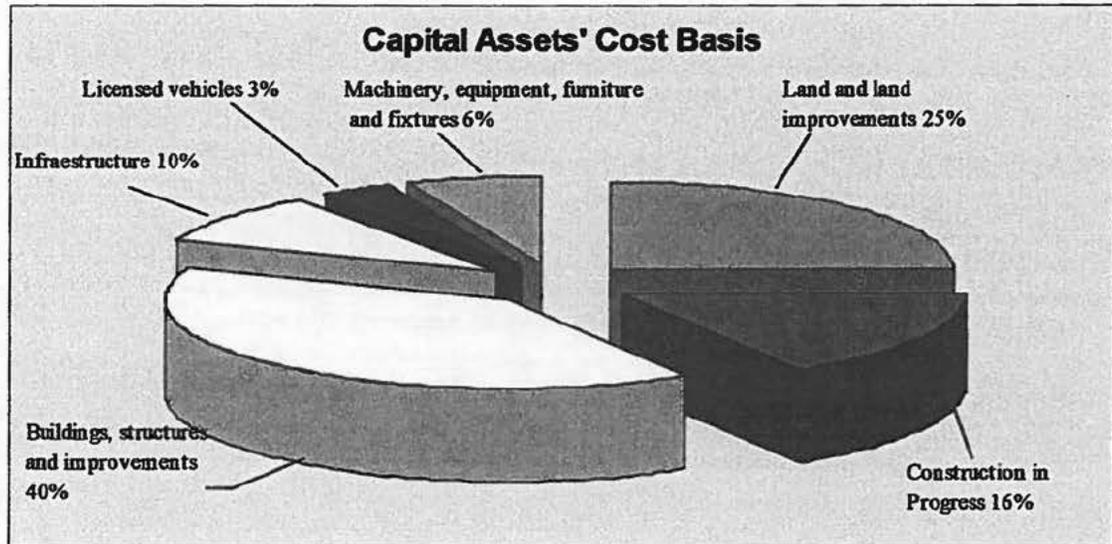
Improvements to Yagüez Theater	\$ 867,716
Improvements to Mayagüez City Hall	278,081
Construction of El Batey del Delfin park	151,711
Construction of the Discovery Square	363,916
Construction of recreational facilities at Paris Community	46,000
Design and construction of equestrian park	572,850
Improvements to recreational facilities for Las Carmelitas	228,069
Construction of Bridge at El Guallo Community	<u>33,852</u>
 Total major capital additions for the fiscal year ended June 30, 2005	 <u>\$2,542,195</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUATION)**

**a) Capital Assets (Continuation)**



**b) Debt Administration**

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

At June 30, 2006, the Municipality's total bonded debt amounted to \$58,178,192, consisting of bonds (\$57,380,000) and bond anticipation notes (\$798,192). Such debt is backed by the full faith and credit of the Municipality. The following is a summary of the debt activity for the fiscal year ended June 30, 2006:

- The Municipality has also certain outstanding notes payable due the Municipal Revenue Collection Center (\$3,191,749). Such notes payable decreased by \$441,795 during the current fiscal year mainly due to the principal payment made during the same period.

The total property assessed value the Municipality amounted to \$694,731,827 at June 30, 2005. The Municipality's legal debt margin amounted to \$21,697,148 at the current fiscal year-end.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2006

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

The territory of Mayagüez covers an area of approximately 77 square miles. Mayagüez is the municipality with the highest population density in the Region, with a population density of 1,267.9 habitants per square mile, which is equivalent to 20 percent of the total population of the Region.

Mayagüez is characterized by being the economic integration center of the Region since it is considered the principal source of jobs and services of commercial, educational and health nature in the Region. From the industrial perspective, Mayagüez accounts for 17 percent of the manufacturing jobs, 25 percent of the finance-related jobs and 21 percent of the service-related jobs in the Region.

Of the total population of the Municipality, 51 percent or approximately 51,000 persons are considered to live under the poverty level. This rate is lower than the overall rate for the region (54 percent) but higher than the overall rate for Puerto Rico (48 percent). Approximately 20 percent of the population of the Municipality receives public financial assistance as their principal source of income.

The municipalities of Añasco, Cabo Rojo, Hormigueros, San Germán, Sabana Grande and Mayagüez constitute the employment market area (EMA) of Mayagüez, as defined by the Department of Labor and Human Resources of Puerto Rico. Of the total 78,000 jobs in this Region, Mayagüez participates in 63 percent of them. This figure is lower than the corresponding EMA of the Ponce region (55 percent), but higher than the EMA of the San Juan region (24 percent). However, 82 percent of the workers of the Municipality are residents of Mayagüez, while the corresponding percentage for Ponce and San Juan are 86 percent and 75 percent, respectively.

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

Those factors were considered when preparing the Municipality's budget for the 2005-2006 fiscal year. There were no significant changes between the budgets for fiscal year 2004-2005 and the budgets for fiscal year 2005-2006. The budgets of the GF and the DSF for the fiscal year 2005-2006 amounted to \$52,024,970 and \$5,550,275, respectively. These amounts represent a decrease of \$174,721 (.33 percent) in the total budgeted revenues of the GF, and a decrease of \$551,874 (9.04 percent) in the total budgeted revenues of the DSF in comparison with the prior fiscal year.

**REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Mayagüez, Department of Finance and Budget, P. O. Box 945, Mayagüez, Puerto Rico, 00681.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Statement of Net Assets

June 30, 2006

Assets	Governmental activities
<b>Current assets:</b>	
Cash in commercial banks, including cash equivalents of \$6,000,000.00	\$ 12,318,632
Accounts receivable, net of allowance for doubtful accounts of \$25,061,828	
Taxes:	
Property taxes:	\$ 5,816,175
Municipal license taxes	4,056,757
Accrued interest on deposits and investments	74,836
Intergovernmental grants and contributions	1,491,979
Other	838,612
Total accounts receivable	12,278,359
Inventories and other current assets	175,970
Investments in certificate of deposits	7,292,400
<b>Restricted assets:</b>	
Cash in commercial banks	19,368,704
Cash in fiscal agent	26,547,896
Property taxes, net of allowance for doubtful accounts of \$3,978,936	3,027,142
Current portion of mortgage loans and notes	335,537
Accrued interest on deposits and investments	33,919
Intergovernmental grants and contributions	3,259,699
Other	3,265
Total restricted assets	52,576,162
Total current assets	84,641,523
<b>Noncurrent assets:</b>	
Restricted assets - mortgage loans and notes, excluding current portion	1,306,411
<b>Capital assets, at cost:</b>	
Depreciable capital assets	93,443,428
Nondepreciable capital assets	25,358,709
Total capital assets, at cost	118,802,137
Less: accumulated depreciation and amortization	(51,666,223)
Total capital assets, net of accumulated depreciation and amortization	67,135,914
Deferred charges, net of accumulated amortization of \$209,853	199,069
Total noncurrent assets	68,641,394
Total assets	\$ 153,282,917

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

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

**Liabilities and net assets**

	<u>Governmental activities</u>
<b>Current liabilities (due within one year):</b>	
Accounts payable and accrued liabilities	\$ 5,350,086
Unearned revenue	11,397,329
<b>Liabilities payable from restricted assets:</b>	
Accounts payable and accrued liabilities, including accrued interest of \$1,508,278	\$ 2,222,265
Intergovernmental payables	1,163,211
Unearned revenue	14,955,190
Current portion of long-term obligations:	116,782
Bonds payable	5,498,000
Notes payable	243,130
Compensated absences	3,823,006
Total current portion of long-term obligations	28,021,584
Total current liabilities	44,768,999
 <b>Restricted noncurrent liabilities, excluding current portion (due in more than one year):</b>	
Bonds payable	52,680,192
Notes payable	2,948,619
Obligations under capital leases	235,639
Compensated absences	4,042,618
Estimated liability for municipal solid waste landfill closure and postclosure care costs	1,996,062
Claim and judgments	4,157,750
Total noncurrent liabilities	66,060,880
Total liabilities	110,829,879
 <b>Net assets (deficit):</b>	
Invested in capital assets, net of related debt	33,333,288
Restricted for:	
Debt service	7,737,727
Permanent improvements bonds	1,616,551
Mortgage loans and notes-non expendable	1,641,948
State legislative joint resolutions	22,678
Other specified purposes	8,692,446
Total restricted net assets	19,711,350
Unrestricted deficit	(10,591,600)
Total net assets	\$ 42,453,038

Commitments and contingencies (note 13)

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Activities  
Fiscal Year Ended June 30, 2006

Function/programs	Program revenues				Net (expenses) and changes in net assets
	Expenses	Charges for services	Program- specific operating grants and contributions	Program- specific capital grants and contributions	
<b>Governmental activities:</b>					
General government	\$ 18,035,902	-	425,038	215,092	\$ (17,395,772)
Urban and economic development	10,230,352	2,979,833	2,927,910	1,745,560	(2,577,049)
Public safety	7,726,094	3,885	971,377	468,389	(6,282,443)
Health and sanitation	11,751,780	-	-	-	(11,751,780)
Culture, recreation and education	15,552,549	-	9,917,708	-	(5,634,841)
Public housing and welfare	12,243,755	-	5,737,618	1,786,063	(4,720,074)
Interest on long-term obligations	3,810,337	-	-	-	(3,810,337)
<b>Total governmental activities</b>	<b>\$ 79,350,769</b>	<b>2,983,718</b>	<b>19,979,651</b>	<b>4,215,104</b>	<b>(52,172,296)</b>
<b>General revenues</b>					
<b>Taxes:</b>					
Property taxes					26,708,931
Municipal license taxes					13,596,515
Construction excise taxes					1,861,988
<b>Total taxes</b>					<b>42,167,434</b>
Intergovernmental grants and contributions, not restricted to specified programs					6,683,304
Interest on deposits and investments					1,530,039
Miscellaneous					2,121,851
<b>Total general revenues</b>					<b>52,502,628</b>
Net change in net assets					330,332
Net assets at beginning of fiscal year					41,001,843
Net assets restatement					1,120,863
Net assets at restated					42,122,706
Net assets at end of year					<b>\$ 42,453,038</b>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
 Balance Sheet – Governmental Funds  
 June 30, 2006

	Major governmental funds						Total governmental funds
	General fund	State legislative joint resolutions special revenue fund	Head start special revenue fund	Permanent improvements bonds fund	Debt service fund	Other governmental funds	
<b>Assets</b>							
Cash in commercial banks, including cash equivalents of \$6,000,000	\$ 12,318,632	-	-	-	-	-	\$ 12,318,632
Account receivable, net of allowance for doubtful accounts of \$25,061,828							
Taxes:							
Property taxes	5,816,175	-	-	-	-	-	5,816,175
Municipal license taxes	4,056,757	-	-	-	-	-	4,056,757
Accrued interest on deposits and investments	37,257	-	-	37,579	-	-	74,836
Intergovernmental grants and contributions	1,491,979	-	-	-	-	-	1,491,979
Due from other funds	3,161,407	-	-	-	-	-	3,161,407
Other	838,612	-	-	-	-	-	838,612
Investment in certificates of deposits	7,292,400	-	-	-	-	-	7,292,400
Restricted assets:							
Cash in commercial banks	-	13,606,290	44,192	31,701	-	5,686,521	19,368,704
Cash in fiscal agent	3,847,449	-	-	12,296,490	10,403,957	-	26,547,896
Property taxes receivable, net of allowance for doubtful accounts of \$3,978,936	-	-	-	-	3,027,142	-	3,027,142
Mortgage loans and notes, net of allowance for doubtful accounts of \$382,500	-	-	-	-	-	1,641,948	1,641,948
Accrued interest on deposits and investments	-	-	-	-	33,415	504	33,919
Intergovernmental grants and contributions	-	-	60,283	-	-	3,199,416	3,259,699
Due from other funds	-	-	-	-	1,456,965	970,695	2,427,660
Advances to other funds	-	-	3,265	-	-	-	3,265
Total assets	\$ 38,860,668	13,606,290	107,740	12,365,770	14,921,479	11,499,084	\$ 91,361,031
<b>Liabilities</b>							
Accounts payable and accrued liabilities	\$ 3,141,981	-	-	-	-	-	\$ 3,141,981
Intergovernmental payable and accrued liabilities	1,007,678	-	-	-	-	-	1,007,678
Due to other funds	1,666,267	-	-	-	-	-	1,666,267
Deferred revenues	21,754,794	-	-	-	-	-	21,754,794
Liabilities payable from restricted assets:							
Accounts payable and accrued liabilities	-	122,156	76,492	209,983	-	835,948	1,244,579
Intergovernmental payable and accrued liabilities	-	-	-	-	-	14,326	14,326
Due to other funds	-	-	11,059	119,110	96,321	3,696,313	3,922,803
Deferred revenues	-	13,461,456	19,521	-	1,465,580	1,474,212	16,420,769
Matured bonds due and payable	-	-	-	-	5,290,000	-	5,290,000
Matured interest due and payable	-	-	-	-	1,490,903	-	1,490,903
Total liabilities	27,570,720	13,583,612	107,072	329,093	8,342,804	6,020,799	55,954,100
<b>Fund balances</b>							
Reserved for:							
Encumbrances	1,376,457	-	-	-	-	-	1,376,457
Debt service	-	-	-	-	6,578,675	-	6,578,675
Permanent improvements bonds	-	-	-	12,036,677	-	368,465	12,405,142
Advances and long-term receivables	-	-	-	-	-	1,641,948	1,641,948
Other specified purposes	3,847,449	22,678	668	-	-	3,467,872	7,338,667
Unreserved	6,066,042	-	-	-	-	-	6,066,042
Total fund balances	11,289,948	22,678	668	12,036,677	6,578,675	5,478,285	35,406,931
Total liabilities and fund balances	\$ 38,860,668	13,606,290	107,740	12,365,770	14,921,479	11,499,084	\$ 91,361,031

Commitments and contingencies (note 13)

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Reconciliation of the Balance Sheet – Governmental Funds  
to the Statement of Net Assets  
June 30, 2006

The amounts of governmental activities reported in the statement of net assets and the balance sheet – governmental funds, are different for the following reasons:

Total fund balance reported in the balance sheet – governmental funds	\$ 35,406,931
Add (Deduct):	
Inventories and other current assets are not available to pay the current fiscal year expenditures, therefore are not reported in the governmental funds.	175,970
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds (see note 9). This is the carrying amount of capital assets, net of accumulated depreciation at June 30, 2006.	67,135,914
Certain deferred revenues in the governmental funds are recognized as revenues in the statement of activities. This is the amount of revenues that are measurable but not available at June 30, 2006 (property taxes, municipal licenses, intergovernmental grants and contributions, charges for services and certain miscellaneous revenues) (see note 10).	11,823,044
Debt issued by the Municipality has associated costs (debt issued costs) that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets and reported net of accumulated amortization.	199,069
The following liabilities are not due (mature) in the current fiscal year, therefore are not reported in the governmental funds at June 30, 2006. (see note 11):	
Bonds payable and bonds anticipation notes	(52,888,192)
Notes payable	(3,191,749)
Obligation under capital leases	(352,421)
Compensated absences	(7,865,624)
Claims and judgments	(4,157,750)
Estimated liability for municipal solid waste landfill closure and postclosure care costs	(1,996,062)
Accrued liabilities, including amounts due to other governments	(1,836,092)
<u>Net assets – governmental activities, as reported in the statement of net assets</u>	<u>\$ 42,453,038</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Revenues, Expenditures and  
Changes in Fund Balances – Governmental Funds  
Fiscal Year Ended June 30, 2006

**Major governmental funds**

	General fund	State legislative joint resolutions special revenue fund	Head start special revenue fund	Permanent improvements bonds fund	Debt service fund	Other governmental funds	Total governmental funds
<b>Revenues:</b>							
Taxes:							
Property taxes	\$ 20,974,727	-	-	-	6,669,610	-	\$ 27,644,337
Municipal license taxes	12,941,636	-	-	-	-	-	12,941,636
Construction excise taxes	1,861,988	-	-	-	-	-	1,861,988
Charges for services	2,692,660	-	-	-	-	21,544	2,714,204
Intergovernmental grants and contributions:							
United States of America	-	-	7,956,378	-	-	10,712,071	18,668,449
Commonwealth of Puerto Rico	6,968,445	1,721,091	1,997,533	445,429	-	1,074,778	12,207,226
Interest on deposits and investments	711,488	7,246	72	455,282	304,552	51,399	1,530,039
Miscellaneous	1,830,335	-	26,396	-	-	265,120	2,121,851
<b>Total revenues</b>	<b>47,981,279</b>	<b>1,728,337</b>	<b>9,980,379</b>	<b>900,711</b>	<b>6,974,162</b>	<b>12,124,912</b>	<b>79,689,780</b>
<b>Expenditures:</b>							
Current:							
General government	18,107,464	2,441	-	14,271	-	1,053,731	\$ 19,177,906
Urban and economic development	5,466,146	-	-	-	-	1,472,945	6,939,091
Public safety	6,589,467	-	-	-	-	1,165,810	7,755,277
Health and sanitation	10,125,326	-	-	-	-	-	10,125,326
Culture, recreation and education	3,483,114	-	10,854,024	-	-	556,520	14,893,658
Public housing and welfare	1,569,561	67,739	-	560,120	-	7,657,017	9,854,437
Debt service:							
Principal	565,335	-	-	-	5,561,000	-	6,126,335
Interest	214,831	-	-	-	3,604,067	-	3,818,898
Capital outlays:	510,645	1,650,911	-	2,429,847	-	2,297,751	6,889,154
<b>Total expenditures</b>	<b>46,631,889</b>	<b>1,721,091</b>	<b>10,854,024</b>	<b>3,004,238</b>	<b>9,165,067</b>	<b>14,203,774</b>	<b>85,580,083</b>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<b>1,349,390</b>	<b>7,246</b>	<b>(873,645)</b>	<b>(2,103,527)</b>	<b>(2,190,905)</b>	<b>(2,078,862)</b>	<b>(5,890,300)</b>
<b>Other financing sources (uses):</b>							
Transfers-in from other funds	1,947,588	-	873,895	-	1,864,517	2,155,277	6,841,277
Transfers-out to other funds	(4,605,743)	-	-	(455,282)	(304,552)	(1,475,700)	(6,841,277)
<b>Total other financing sources (uses), net</b>	<b>(2,658,155)</b>	<b>-</b>	<b>873,895</b>	<b>(455,282)</b>	<b>1,559,965</b>	<b>679,577</b>	<b>-</b>
<b>Net change in fund balance</b>	<b>(1,308,765)</b>	<b>7,246</b>	<b>250</b>	<b>(2,558,809)</b>	<b>(630,940)</b>	<b>(1,399,285)</b>	<b>(5,890,300)</b>
<b>Fund balance at beginning of fiscal year</b>	<b>12,598,714</b>	<b>15,432</b>	<b>418</b>	<b>14,595,486</b>	<b>6,088,752</b>	<b>6,877,571</b>	<b>40,176,373</b>
<b>Fund balance restatement</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,120,863</b>	<b>-</b>	<b>1,120,863</b>
<b>Fund balance, as restated</b>	<b>12,598,714</b>	<b>15,432</b>	<b>418</b>	<b>14,595,486</b>	<b>7,209,615</b>	<b>6,877,571</b>	<b>41,297,230</b>
<b>Fund balance at end of fiscal year</b>	<b>\$ 11,289,949</b>	<b>22,678</b>	<b>668</b>	<b>12,036,677</b>	<b>6,578,675</b>	<b>5,478,286</b>	<b>\$ 35,406,933</b>

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

*Handwritten signature and date:*  
09/24/2007

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
 Reconciliation of Statement of Revenues, Expenditures and Changes  
 in Fund Balances - Governmental Funds to the Statement of Activities  
 Fiscal Year ended June 30, 2006

The amounts of governmental activities reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances are different for the following reasons:

Net change in fund balances reported in the statement of revenues, expenditures and changes in fund balances – governmental funds \$(5,890,303)  
 Add (Deduct):

The following revenues recorded in the statement of activities do not provide current financial resources, therefore, are deferred in the governmental funds. This is the net change in deferred revenues of the following revenues items, which are measurable but not available at fiscal year end:

Property taxes	525,357
Municipal license taxes	654,879
Intergovernmental grants and contributions	2,333
Charges for services	(27,015)

Governmental funds report capital outlays as expenditures. However in the statement of activities the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expense. This is the amount by which capital outlay expenditures (\$6,889,154) exceeded depreciation and amortization expense (\$3,768,654) and reserve for impairment asset (\$2,000,000) for the fiscal year ended June 30, 2006. 1,120,500

Repayment of principal of long-term obligations is reported as an expenditure in the governmental funds, however, the repayment reduces long-term liabilities in the statement of net assets (see note 11). 6,126,335

Certain accrued interest expense reported in the statement of activities do not required the use of current financial resources, therefore, are not reported as expenditures in the governmental funds. (17,375)

Amortization of deferred charges reported in the statement of activities does not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds. (22,920)

Some expenses reported in the statement of activities require the use of current financial resources, therefore, are not reported as expenditures in the statement of governmental funds. (2,223,258)

Generally, inventory and other current assets are recorded as expenditures in the governmental funds when paid rather than capitalized as an asset. However, these assets are capitalized in the statement of net assets. This amount represents the net change in these assets for the current fiscal year. 81,799

Net increase in net assets, as reported in statement of activities \$ 330,332

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Revenues and Expenditures – Budget and  
Actual – Budgetary Basis – General Fund  
Fiscal Year Ended June 30, 2006

	Budgeted amounts		Actual amounts (budgetary basis) (see note 1)	Variance with final budget- over (under)
	Original	Final		
<b>Revenues:</b>				
Taxes:				
Property taxes	\$ 19,794,067	19,794,067	19,794,067	-
Municipal license taxes	15,800,000	15,800,000	12,910,012	(2,889,988)
Construction excise taxes	2,050,000	2,050,000	1,861,988	(188,012)
Charges for services	3,127,061	3,127,061	2,360,804	(766,257)
Intergovernmental grants and contributions	8,243,342	8,243,342	7,910,636	(332,706)
Interest on deposits and investments	900,000	900,000	604,562	(295,438)
Miscellaneous	2,163,000	2,163,000	1,830,335	(332,665)
<b>Total revenues</b>	<b>52,077,470</b>	<b>52,077,470</b>	<b>47,272,404</b>	<b>(4,805,066)</b>
<b>Expenditures:</b>				
Current:				
General government	20,676,157	21,604,489	20,538,923	(1,065,566)
Public Safety	5,931,536	5,753,716	5,059,145	(694,571)
Urban and economic development	6,139,127	5,927,319	5,444,714	(482,605)
Health and sanitation	10,360,653	10,017,186	9,608,837	(408,349)
Culture, recreation and education	4,914,251	5,215,688	4,494,243	(721,445)
Public housing and welfare	1,954,925	1,895,331	1,579,163	(316,168)
Debt service:				
Principal	565,335	565,335	565,335	-
Interest	214,831	214,831	214,831	-
Capital outlays	-	510,465	510,465	-
<b>Total expenditures</b>	<b>50,756,815</b>	<b>51,704,360</b>	<b>48,015,656</b>	<b>(3,688,704)</b>
<b>Excess of revenues over expenditures</b>	<b>1,320,655</b>	<b>373,110</b>	<b>(743,252)</b>	<b>(1,116,362)</b>
<b>Other financing sources (uses):</b>				
Transfers-in from other funds	-	-	-	-
Transfers-out to other funds	(1,320,655)	(1,784,174)	(1,782,836)	1,338
Budgetary surplus of previous fiscal year	-	1,411,064	-	(1,411,064)
<b>Total other financing sources (uses), net</b>	<b>(1,320,655)</b>	<b>(373,110)</b>	<b>(1,782,836)</b>	<b>(1,409,726)</b>
<b>Excess of revenues and other financing sources over expenditures and other financing sources</b>	<b>\$ -</b>	<b>-</b>	<b>(2,526,088)</b>	<b>(2,526,088)</b>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies**

The Municipality of Mayagüez (the Municipality) is a local municipal government constituted on July 29, 1760 in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

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

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

**a) Financial Reporting Model**

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the fiscal year ended June 30, 2006, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

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

RSI is information presented along with, but separate from, the Municipality's basic financial statements. RSI is composed of the following elements: (1) Management's Discussion and Analysis (MD&A) and (2) Schedule of Funding Progress – Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS).

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

**a) Financial Reporting Model (Continuation)**

*The Schedule of Funding Progress – Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities* provides a three-year trend information (using latest published data available) of the funding status of ERS, which is a multi-employer cost-sharing retirement system in which the Municipality is a participating employer (see note 12).

Other supplementary information presented in this report for purposes of additional analysis consist of: (1) combining and individual nonmajor governmental fund financial statements, (2) budgetary comparison schedule – debt service fund, and (3) schedules of capital assets used in the operations of governmental funds, as listed in the accompanying table of contents.

**b) Financial Reporting Entity**

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

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14), as amended, has set forth criteria to be considered in determining financial accountability for financial reporting purposes. These criteria include appointing a voting majority of an organization's governing body and: (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

***b) Financial Reporting Entity (Continuation)***

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

- a) The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b) The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c) The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2006.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

*c) Government-wide Financial Statements*

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

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

- **Invested in capital assets, net of related debt** – This net asset category consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net assets** – This net asset category consists of net resources restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

1) Summary of Significant Accounting Policies (Continuation)

c) Government-wide Financial Statements (Continuation)

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

- (1) *Debt service* – Represent net resources available to cover future debt service payments of bonds and notes payable.
  - (2) *Permanent improvements fund* – Represent net resources available to finance the acquisition, construction or improvement of major capital assets under contracts and other commitments.
  - (3) *Mortgage loans and notes* – Represent net resources available from grants provided by the U.S. Department of Housing and Urban Development (HUD), which have been set aside to provide construction mortgage loans to private business enterprises doing business in the Municipality (see note 6).
  - (4) *State legislative joint resolutions* – Represent net resources available from certain state grants, which have been set aside different purposes. Generally to provide multipurpose services and donations, construction or improvements of certain capital assets, other than accounted in permanent improvements bonds fund, and partially subsidy qualified administrative and operational activities.
  - (5) *Other specified purposes* – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs. Also represent net resources available for the payment of certain accounts payable and commitments approved by the Government Development Bank for Puerto Rico (GDB), a component unit of the Commonwealth and fiscal agent of the Municipality.
- **Unrestricted deficit** – This category consists of the excess of liabilities over related assets that are neither externally nor legally restricted, neither invested in capital assets. However, assets reported within unrestricted deficit often are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints that are imposed by management but can be removed or modified.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**

Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2006

**1) Summary of Significant Accounting Policies (Continuation)**

**c) Government-wide Financial Statements (Continuation)**

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

**General government:**

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of legal affairs
- Department of internal audit
- Department of management of information systems
- Department of administrative services
- Department of press and communications

**Public safety:**

- Department of civil defense
- Department of municipal police
- Department of fire control

**Urban and economic development:**

- Department of planning and development
- Department of urban development
- Department of conservation and ornate

**Health and sanitation**

- Department of health
- Department of sanitation
- Department of environmental control

**Culture, recreation and education:**

- Department of culture and tourism
- Department of recreation and sports
- Department of education

**Public housing and welfare:**

- Department of housing
- Office of services to citizens
- Department of elderly services and day care center