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AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL
AREA DE ARCHIVO DIGITAL

MUNICIPIO DE PEÑUELAS
AUDITORIA 2004-2005
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS
SINGLE AUDIT REPORT
YEAR ENDED JUNE 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2005

CONTENTS

	Page
<u>BASIC FINANCIAL STATEMENTS</u>	
Independent Auditor's Report	1-2
Required Supplemental Information (Part 1) Management's Discussion and Analysis	3-11
Government-Wide Financial Statements:	
Statement of Net Assets	12
Statement of Activities	13
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	14
Statement of Revenues, Expenditures and Changes in Fund Balances	15
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	16
Notes to basic financial statements	17-39
<u>SUPPLEMENTARY INFORMATION</u>	
Required Supplemental Information (Part II):	
Budgetary Comparison Schedule-General Fund	40
Notes to Budgetary Comparison Schedule-General Fund	41
Schedule of expenditures of federal awards	42-43
Notes to the schedule of expenditures of federal awards	44
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u>	
Independent auditor's report on compliance and on internal control over financial reporting based on an audit of basic financial statements performed in accordance with <i>Government Auditing Standards</i>	45-46

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2005

CONTENTS - (CONTINUED)

	Page
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)</u>	
Independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A- 133	47-49
<u>FINDINGS AND QUESTIONED COSTS</u>	
Schedule of findings and questioned cost	50-72
Summary schedule of prior year audit findings	73-78



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Peñuelas, Puerto Rico**, as of and for the year ended June 30, 2005, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As discussed in Note 12 to the financial statements, the **Municipality** has not maintained complete and adequate records in order to obtain sufficient and competent evidential matter related to the Capital Assets reported in the governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonably determinable.

In our opinion, because of the effects of the matter discussed in the third paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the **Municipality of Peñuelas, Puerto Rico**, as of June 30, 2005, and the changes in financial position, thereof for the year then ended.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of each major fund, and the aggregate remaining fund information of the **Municipality of Peñuelas, Puerto Rico**, as of June 30, 2005, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 11 and the Budgetary Comparison Schedule-General Fund on page 40 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2005 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
October 25, 2005

Stamp No. 2106112 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2005

This discussion and analysis of the Municipality of Peñuelas (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2005. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2003, first year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements - and Management's Discussion and Analysis-for State and Local Governments.*" This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following mayor information:

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

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2005 deserve special mention:

1. Total assets of the Municipality amounted to \$33,664,916 which represents an increase of 40% compared to prior fiscal year.
2. At the end of fiscal year 2005, total liabilities amounted to \$34,576,593. Out of said amount, \$25,599,505 corresponded to long-term liabilities of which \$20,826,000 represented the outstanding balance of bonds issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues.
3. Total net assets deficiency of the Municipality amounted to (\$911,677) which represents a decrease of 85% compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$23,316,200, derived from the following sources: \$78,348 charges for services; \$6,643,600 from operating grants and contributions; \$3,108,845 from capital grants and contributions obtained from other sources, and \$13,485,407 from general revenues available.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$18,318,208;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$4,997,992.
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$11,425,130.
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$164,096, compared to a fund balance of (\$18,271) in the prior fiscal year.
9. The actual General Fund budgetary activities resulted in a favorable balance of \$177,879, caused mainly due to unexpected variances in revenue collections from miscellaneous sources.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2005. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

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

FINANCIAL STATEMENTS COMPONENTS

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

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

A brief review of The Statements of Activities of the Municipality at June 30, 2005, shows total expenses incurred to afford the cost of all functions and programs amounted to \$18,318,208. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$9,830,793 was derived from the following sources: \$78,348 charges for services; \$6,643,600 from operating grants and contributions; and \$3,108,845 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$13,485,407. When such figure is added to the \$9,830,793 previously mentioned, total revenues available for the financing of activities amounted to \$23,316,200. There was an excess of revenues over expenses in the amount of \$4,997,992 which contributed with an increase to the figure of net assets attained at the end of the fiscal year.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Peñuelas, primary government liabilities exceeded total assets by \$911,677 at the end of 2005, compared to \$5,909,669 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

Condensed Statement of Net Assets	2005	2004	Change	%
Assets				
Current assets	\$ 20,185,042	\$ 12,855,919	\$ 7,329,123	57%
Capital assets	<u>13,479,874</u>	<u>11,176,787</u>	<u>2,303,087</u>	<u>21%</u>
Total assets	<u>33,664,916</u>	<u>24,032,706</u>	<u>9,632,210</u>	<u>40%</u>
Liabilities				
Current liabilities	8,977,088	5,526,620	3,450,468	62%
Non-current liabilities:	<u>25,599,505</u>	<u>24,415,523</u>	<u>1,183,982</u>	<u>5%</u>
Total liabilities	<u>34,576,593</u>	<u>29,942,143</u>	<u>4,634,450</u>	<u>15%</u>
Net Assets				
Invested in capital assets, net of related debt	1,541,624	2,617,537	(1,075,913)	-41%
Restricted	11,043,858	7,311,029	3,732,829	51%
Unrestricted (deficit)	<u>(13,497,159)</u>	<u>(15,838,235)</u>	<u>2,341,076</u>	<u>-15%</u>
Total net assets	<u>\$ (911,677)</u>	<u>\$ (5,909,669)</u>	<u>\$ 4,997,992</u>	<u>-85%</u>

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2005, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$4,997,992 increase in the Municipality's net assets. Approximately 35 percent of the Municipality's total revenue came from taxes, while 53 percent resulted from grants and contributions, including federal aid. Charges for Services and other miscellaneous revenues provided 1 percent of the total revenues. Special item, which represent the gain in the refunding of long term debts of \$2,627,754, represent the 11 percent of the Municipality's total revenue. The Municipality's expenses cover a range of services. The largest expenses were for general government, health and welfare services, public works, and community development. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Condensed Statement of Activities	2005	2004	Change	%
REVENUES				
Program Revenues:				
Charges for Services	\$ 78,348	\$ 349,256	\$ (270,908)	-77.57%
Operating Grants and Contributions	6,643,600	6,063,309	580,291	9.57%
Capital Grants and Contributions	3,108,845	2,866,246	242,599	8.46%
Total Program Revenues	<u>9,830,793</u>	<u>9,278,811</u>	<u>551,982</u>	5.95%
General Revenues and Special Items:				
Property taxes	4,533,839	4,776,411	(242,572)	-5.08%
Municipal license tax	2,577,699	2,579,026	(1,327)	-0.05%
Other local taxes	921,362	400,059	521,303	130.31%
Grants and contributions not restricted to specific programs	2,599,801	3,999,113	(1,399,312)	-34.99%
Interest and investment earnings	113,559	151,163	(37,604)	-24.88%
Miscellaneous	111,393	111,486	(93)	-0.08%
Special items	2,627,754		2,627,754	100.00%
Total General Revenues and Special Items	<u>13,485,407</u>	<u>12,017,258</u>	<u>1,468,149</u>	12.22%
Total Revenues	<u>23,316,200</u>	<u>21,296,069</u>	<u>2,020,131</u>	9.49%
EXPENSES				
General government	5,133,015	\$ 3,945,441	1,187,574	30.00%
Public safety	812,050	822,844	(10,794)	-1.31%
Public works	2,469,904	4,405,351	(1,935,447)	-43.93%
Health and welfare	5,456,083	5,458,764	(2,681)	-0.05%
Culture and recreation	1,181,973	4,676,782	(3,494,809)	-74.73%
Economic development	577,466	581,436	(3,970)	-0.68%
Community development	1,119,419	1,189,055	(69,636)	-5.86%
Education	253,340	260,073	(6,733)	-3.00%
Public lighting	734,157	654,257	79,900	12.21%
Interest on long-term debt	580,801	593,485	(12,684)	-2.14%
Total Expenses	<u>18,318,208</u>	<u>22,587,488</u>	<u>(4,269,280)</u>	-19.00%
Change in net assets	4,997,992	(1,291,419)	6,289,411	-487.00%
Net assets (deficit) - beginning, as restated	(5,909,669)	(4,618,250)	(1,291,419)	27.96%
Net assets (deficit) - ending	<u>\$ (911,677)</u>	<u>\$(5,909,669)</u>	<u>\$4,997,992</u>	-85.00%

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

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 financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$11,425,130, an increase of \$3,818,283 in comparison with the prior year. There are reservations of fund balance amounting to \$11,583,896. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$73,747), 2) to pay debt service (\$2,766,421), 3) to pay for capital projects (\$7,535,362), 4) for other purposes (\$959,251) in other governmental funds and 5) (\$249,115) reserved for long-term advances.

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2005, the general fund has an undesignated fund balance of (158,766).

GENERAL FUND BUDGETARY HIGHLIGHTS

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

The actual General Fund budgetary activities resulted in an unfavorable balance of \$177,879, caused mainly due to unexpected variances in revenue collections from miscellaneous sources.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has not maintained complete and adequate records related to the Capital Assets acquired and constructed in the past years, but the Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets, and then, comply with such requirement. The Municipal Administration expects to develop a broad and comprehensive identification and assessments project of all fixed assets owned by the local government in order to capitalize them in its Statement of Net Assets, and then, reflects the correct net assets figure of the Municipality as a whole.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

The Municipality's investment in capital assets as of June 30, 2005, amounts to \$22,380,004, net of accumulated depreciation of \$8,900,129 (including depreciation charges for the year totaled \$820,150), leaving a net book value of \$13,479,875. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2005, the Municipality has \$3,621,504 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

DEBT ADMINISTRATION

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

YEAR ENDED JUNE 30, 2005

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2005-2006.

FINAL COMMENTS

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

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2005. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 10, Peñuelas, Puerto Rico 00624-0010, or call (787) 836-1218.

Commonwealth of Puerto Rico
Municipality of Peñuelas
Statement of Net Assets
June 30, 2005

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 6,134,531
Cash with fiscal agent	3,173,021
Accounts receivable:	
Municipal license tax	200,450
Property tax	454,009
Intergovernmental	9,182,684
Federal	1,026,261
Other	14,086
Capital assets	
Land, improvements, and construction in progress	3,594,718
Other capital assets, net of depreciation	9,885,156
Total capital assets	13,479,874
 Total assets	 33,664,916
 Liabilities	
Accounts payable and accrued liabilities	1,120,703
Due to other governmental entities	4,310,481
Deferred revenues:	
Municipal license tax	2,613,119
Federal grant revenues	715,609
Interest payable	217,176
Noncurrent liabilities:	
Due within one year	635,927
Due in more than one year	24,963,578
 Total liabilities	 34,576,593
 Net Assets	
Invested in capital assets, net of related debt	1,541,624
Restricted for:	
Capital projects	7,535,362
Debt service	2,549,245
Other purposes	959,251
Unrestricted (deficit)	(13,497,159)
 Total net assets	 \$ (911,677)

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

Commonwealth of Puerto Rico
Municipality of Peñuelas
Statement of Activities
For the Year Ended June 30, 2005

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 5,133,015	\$ -	\$ 187,015	\$ 1,440	\$ (4,944,560)
Public safety	812,050		-	200,000	(612,050)
Public works	2,469,904	64,448	5,259	1,845,434	(554,763)
Health and welfare	5,456,083		4,596,453	100,000	(759,630)
Culture and recreation	1,181,973	13,900	70,300	296,053	(801,720)
Economic development	577,466		577,466		-
Community development	1,119,419		253,168	665,918	(200,333)
Education	253,340		255,592		2,252
Public lighting	734,157		698,347		(35,810)
Interest on long-term debt	580,801				(580,801)
Total governmental activities	\$ 18,318,208	\$ 78,348	\$ 6,643,600	\$ 3,108,845	(8,487,415)

General revenues and special items:

Property taxes	4,533,839
Municipal license tax	2,577,699
Other local taxes	921,362
Grants and contributions not restricted to specific programs	2,599,801
Interest and investment earnings	113,559
Miscellaneous	111,393
Special items	2,627,754

Total general revenues	13,485,407
Change in net assets	4,997,992
Net assets (deficit) - beginning, as restated	(5,909,669)
Net assets (deficit) - ending	\$ (911,677)

Commonwealth of Puerto Rico
Municipality of Peñuelas
Balance Sheet
Governmental Funds
June 30, 2005

	General Fund	Special Revenue Fund Head Start	Capital Projects Fund - Local, State & Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets						
Cash and cash equivalents	\$ 763,137	\$ 271,126	\$ 3,248,915	\$ -	\$ 1,851,353	\$ 6,134,531
Cash with fiscal agent	68,870		776,164	2,320,569	7,418	3,173,021
Accounts receivable:						
Intergovernmental	4,806,000	555,217	3,913,858	454,009	933,870	10,662,954
Other	210,100			4,436		214,536
Advances from other funds	249,115					249,115
Due from other funds	1,399,863					1,399,863
Total assets	\$ 7,497,085	\$ 826,343	\$ 7,938,937	\$ 2,779,014	\$ 2,792,641	\$ 21,834,020
Liabilities and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 409,389	\$ 113,869	\$ 304,976	\$ -	\$ 292,469	\$ 1,120,703
Due to other governmental entities	4,310,481					4,310,481
Advances to other funds					249,115	249,115
Due to other funds		607,155	98,599	12,593	681,516	1,399,863
Deferred revenues:						
Municipal license tax	2,613,119					2,613,119
Federal grant revenues		105,319			610,290	715,609
Total liabilities	7,332,989	826,343	403,575	12,593	1,833,390	10,408,890
Fund balances:						
Reserved for:						
Encumbrances	73,747					73,747
Capital projects			7,535,362			7,535,362
Debt service fund				2,766,421		2,766,421
Reserve for long-term advances	249,115					249,115
Reserved reported in nonmajor funds:						
Other purposes					959,251	959,251
Unreserved:						
Undesignated (Deficit)	(158,766)					(158,766)
Total fund balances	164,096	-	7,535,362	2,766,421	959,251	11,425,130
Total liabilities and fund balances	\$ 7,497,085	\$ 826,343	\$ 7,938,937	\$ 2,779,014	\$ 2,792,641	

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

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	13,479,874
Long-term liabilities, including accrued interests, are not due and payable in the current period, and therefore, are not reported in the funds	(25,816,681)
Net assets of governmental activities	\$ (911,677)

Commonwealth of Puerto Rico
Municipality of Peñuelas
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2005

	General Fund	Special Revenue Fund Head Start	Capital Project Fund - Local, State & Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 3,362,025	\$ -	\$ -	\$ 1,171,814	\$ -	\$ 4,533,839
Municipal license taxes	2,577,699					2,577,699
Licenses, permits and other local taxes	922,512					922,512
Charges for services	78,348					78,348
Intergovernmental	3,730,041		2,413,859		894,011	7,037,911
Interest	113,559					113,559
Federal grants		3,674,658			1,639,677	5,314,335
Miscellaneous	110,095				148	110,243
Total revenues	10,894,279	3,674,658	2,413,859	1,171,814	2,533,836	20,688,446
Expenditures						
Current:						
General government	9,237,979		14,288		205,206	9,457,473
Public safety	826,237					826,237
Public works	3,404,047		1,265,158		221,731	4,890,936
Health and welfare	847,820	3,674,658			928,772	5,451,250
Culture and recreation	846,046		671,937		261,167	1,779,150
Economic development					577,466	577,466
Community development					1,146,555	1,146,555
Education	101,825				140,470	242,295
Debt service:						
Principal				356,000		356,000
Interest				580,801		580,801
Total expenditures	15,263,954	3,674,658	1,951,383	936,801	3,481,367	25,308,163
Excess (deficiency) of revenues over (under) expenditures	(4,369,675)	-	462,476	235,013	(947,531)	(4,619,717)
Other financing sources (uses)						
Transfers in				235,500		235,500
Transfers out	(235,500)					(235,500)
Long-term debt issued	4,751,000		3,685,000			8,436,000
Total other financing sources (uses)	4,515,500	-	3,685,000	235,500	-	8,436,000
Net change in fund balances	145,825		4,147,476	470,513	(947,531)	3,816,283
Fund balance beginning, as restated	18,271		3,387,886	2,295,908	1,906,782	7,608,847
Fund balance, ending	\$ 164,096	\$ -	\$ 7,535,362	\$ 2,766,421	\$ 959,251	\$ 11,425,130

Commonwealth of Puerto Rico
Municipality of Peñuelas
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2005

Net Change in Fund Balances - Total Governmental Funds **\$ 3,816,283**

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 3,123,237

Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. (820,150)

Interest expense on long-term debt was reported in the Government-Wide Statement of Activities and Change in Net Assets, but it did not require the use of current financial resources. Therefore, interest expense was not reported as expenditures in Governmental Funds. The following amount represented the change in accrued interest from prior year. 62,604

Bonds and notes proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments. (8,080,000)

Repayment of long term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long-term property tax advance debt in the Government-Wide Statement of Net Assets. This is the amount paid in the current period. 4,858,911

Claims paid by the Treasury Department on behalf of the Municipality of Peñuelas increase long-term liabilities in the Government-Wide statement of Net Assets. (116,033)

Gain in refunding long term property tax advance debt is not recognize in Governmental Funds, but the gain reduces long-term property tax advance debt in the Government-Wide Statement of Net Assets 2,627,754

Long term property tax advance debt for the fiscal year 2004-2005 is not recognized as expenditure in Governmental Funds, but it is recognized as a long-term property tax advance debt in the Government-Wide Statement of Net Assets because it will be pay during fiscal year 2006-2007. (318,435)

Repayment of long term Treasury Department debt is an expenditure in Governmental Funds, but the repayment reduces long-term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Treasury Department from prior year. 91,158

Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represents the change in long-term compensated absences from prior year. (440,320)

Long-term claims and judgments are reported in the Governmental-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, claims and judgments are not reported as expenditures in Government Funds. The following amount represents the change in long-term claims and judgments from prior year. 192,983

Change in Net Assets of Governmental Activities **\$ 4,997,992**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Peñuelas** (the Municipality) was founded on the year 1793. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a fourteen member Municipal Legislature who are elected for a four-year term.

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

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

A. Component Units

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

B. Government-wide and fund financial statements

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

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

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

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

Special Revenue Fund - Head Start- Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

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

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

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

Special Revenue Fund - Section 8 - Special Revenue Funds are used to account for revenues derived from section 8 choice voucher program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Head Start - Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

D. Measurement focus, basis of accounting and financial presentation

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

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

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

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

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

E. Assets, liabilities and net assets

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

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the General Fund represent Government Development Bank Loan proceeds. Intergovernmental receivable in the Special Revenue or Capital Project Funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

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

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

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

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

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

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:
- a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
 - b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
 - c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
 - d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:
- a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
10. **Risk financing-** The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2005 amounted to approximately \$147,059. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$346,937 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets</u> <u>Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 13,479,874	
Deduct:		
Bonds Payable	<u>(11,938,250)</u>	\$ 1,541,624
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		7,535,362
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balance	\$ 2,766,421	
Deduct:		
Interest payable	<u>(217,176)</u>	2,549,245
<u>Net assets restricted for other purposes</u>		
Other governmental funds- fund balance restricted for other purpose		959,251
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 164,096	
Deduct:		
Bonds Payable	(8,887,751)	
Treasury Department - Claims	(145,430)	
Property Tax Debt	(2,647,957)	
Compensated Absences	<u>(1,980,117)</u>	<u>(13,497,159)</u>
Total net assets - governmental activities		<u>(\$ 911,677)</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

2. DEPOSITS

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

The Municipality's bank balances in commercial banks of approximately \$763,137 in the general fund, \$271,126 in the special revenue fund - head start, \$3,248,915 in the capital project fund - local, state and federal grants were fully collateralized at June 30, 2005. In the other governmental funds there were deposits with commercial banks of approximately \$1,851,353 that were fully collateralized.

The deposits at GDB of approximately \$68,870, that is restricted for other purposes in the general fund, the \$776,164 that is restricted principally for capital projects in the capital project fund - local, state and federal grants, the \$2,320,569 in the debt service fund and the \$7,418 in the other governmental funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality impose a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2005, the tax rates were as follows:

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

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2005, net of allowance for uncollectible.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

3. RECEIVABLES (CONTINUED)

B. *Intergovernmental Receivables*- Intergovernmental receivables in the general fund principally consist of the amount due from the Government Development Bank for Puerto Rico (GDB) related to a bond authorized by the Municipal Assembly and GDB for approximately \$4,751,000 and disbursed by the GDB on July 14, 2005 to pay debt owned by the Municipality to the Treasury Department of the Commonwealth of Puerto Rico resulting from the excess of property tax collections before 1972 over advances and to pay claims and judgments to third parties disbursed by the Treasury Department and related to claims and judgments unfavorable outcomes or final settlements against the Municipality. In addition, intergovernmental receivables in the general fund consist of the amount owed by the Department of Education of the Commonwealth of Puerto Rico resulting for transportation services rendered by the Municipality. The amount receivable from governmental entities is as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Government Development Bank for Puerto Rico ("GDB")	\$ 4,751,000
Department of Education	<u>55,000</u>
Total	<u>\$ 4,806,000</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable of \$555,217 in special revenue fund – Head Start represent expenditures incurred not yet reimbursed by the pass-through grantor.

Intergovernmental receivable in capital project fund – local, state and federal grants represent expenditures incurred not yet reimbursed by another governmental entity. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Government Development Bank for Puerto Rico	\$ 3,685,000
Rural Development Corporation	<u>228,858</u>
Total	<u>\$ 3,913,858</u>

Intergovernmental receivable in the debt service fund represents the amounts due from the CRIM resulting from the excess of current year property tax collections over current year advances. Following is a detail of the intergovernmental receivables:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	<u>\$ 454,009</u>
Total	<u>\$ 454,009</u>

Intergovernmental receivable in other governmental funds – represent expenditures incurred not yet reimbursed by the state government, federal government or the pass-through grantor. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Department of Labor and Human Resources– Law 52 Grant	\$ 462,826
Community Development Block Grant	453,806
Public Assistance Grant	5,768
Community Service Block Grant	6,332
Edward Byrne Memorial	638
Hazard Mitigation	<u>4,500</u>
Total	<u>\$ 933,870</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2005, and interfund transfers during the fiscal year ended at June 30, 2005, are summarized as follows:

a. Due from/to other fund and advances from/ to other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund - Head Start	Payroll and related accruals paid and not reimbursed.	607,155
General Fund	Capital Projects Fund - Local, State and Federal Grants	Reimbursable expenditures	98,599
General Fund	Debt Service Fund	Interest Revenue	12,593
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	<u>930,631</u>
Total			<u>\$ 1,648,978</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt retirement	<u>\$ 235,500</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2005, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Transfers</u>	<u>Balance</u> <u>June 30, 2005</u>
Capital asset, not being depreciated:				
Land	\$ 659,123	\$	\$	\$ 659,123
Construction in progress	<u>3,149,072</u>	<u>2,935,595</u>	<u>(3,149,072)</u>	<u>2,935,595</u>
Total capital assets not being depreciated	<u>\$ 3,808,195</u>	<u>\$ 2,935,595</u>	<u>\$ (3,149,072)</u>	<u>\$ 3,594,718</u>
Capital assets, being depreciated:				
Buildings	\$ 5,706,896	\$	\$ 1,748,062	\$ 7,454,958
Buildings improvements				
Infrastructure	4,429,863		1,401,010	5,830,873
Infrastructure improvements	228,502			228,502
Equipment	1,235,421	82,705		1,318,126
Furnishing				
Computers				
Vehicles	<u>3,847,889</u>	<u>104,937</u>	<u>-</u>	<u>3,952,826</u>
Total capital assets being depreciated	<u>\$ 15,448,571</u>	<u>\$ 187,642</u>	<u>\$ 3,149,072</u>	<u>\$ 18,785,285</u>
Less accumulated depreciation for:				
Buildings	\$ (2,384,398)	\$ (246,936)	\$	\$ (2,631,334)
Buildings improvements				
Infrastructure	(2,119,369)	(249,382)		(2,368,751)
Infrastructure improvements	(96,118)	(10,415)		(106,533)
Equipment	(920,342)	(99,574)		(1,019,916)
Vehicles	<u>(2,559,752)</u>	<u>(213,843)</u>	<u>-</u>	<u>(2,773,595)</u>
Total accumulated depreciation	<u>\$ (8,079,979)</u>	<u>\$ (820,150)</u>	<u>\$ -</u>	<u>\$ (8,900,129)</u>
Total capital assets being depreciated, net	<u>\$ 7,368,592</u>	<u>\$ (632,508)</u>	<u>\$ 3,149,072</u>	<u>\$ 9,885,156</u>
Governmental activities capital assets, net	<u>\$ 11,176,787</u>	<u>\$ 2,303,087</u>	<u>\$ -</u>	<u>\$ 13,479,874</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 480,971
Public safety	43,314
Public works	174,027
Culture and recreation	74,410
Education	16,194
Health and welfare	<u>31,234</u>
Total depreciation expense-governmental activities	<u>\$ 820,150</u>

6. PROPERTY TAXES

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

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

During the fiscal year 2004-2005 the Municipality entered into an agreement with the Commonwealth of Puerto Rico to refunding the long term property tax advance debt of \$4,100,984 and the balance owed to the Treasury Department for payments of claims and judgments to third parties of \$2,779,623. Both long term liabilities were not interest bearing debts. The Municipality paid the present value of \$4,252,853 for both debts discounted to the approximately interest rate of 6%. These debts were paid with the proceed of two bonds

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

6. PROPERTY TAXES (CONTINUED)

issuance authorized by the Municipality Assembly. A gain in the refunding of debts of \$2,627,754 was recognized in the statement of activities as a special item.

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years.

Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26 1997, Public Law Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The government-wide statement of net assets includes an outstanding debt balance of \$1,554,449 and \$775,073 related to Law 42 and Law 146, respectively at June 30, 2005.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

6. PROPERTY TAXES (CONTINUED)

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

The annual tax rate is 8.33% for real property and 6.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

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

<u>Governmental Entity</u>	<u>Amount</u>
Treasury Department	\$ 4,252,854
Government Development Bank for Puerto Rico	19,719
Department of Labor	18,889
Puerto Rico Aqueduct and Sewer Authority	10,945
General Services Administration	<u>8,074</u>
Total	<u>\$ 4,310,481</u>

8. DEFERRED REVENUES

A. Municipal License Tax- The deferred revenues of approximately \$2,613,119 in the general fund relates to municipal license tax collected in fiscal year 2004-05 that will be earned in fiscal year 2005-06.

Federal Government- The deferred revenues presented in the special revenue fund - head start represents the portion of federal grant received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Child and Adult Care Food Program	<u>\$ 105,319</u>
Total	<u>\$ 105,319</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

8. DEFERRED REVENUES (CONTINUED)

The deferred revenues presented in the other governmental funds represent the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Voucher	\$ 376,344
Public Safety Partnership and Community Policing Grant	113,647
Emergency Management - State and Local Assistance	10,586
Public Assistance Grant	46,376
Local Law Enforcement Block Grant	2,661
Others	<u>60,676</u>
Total	<u>\$ 610,290</u>

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2005, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$12,746,000	\$ 8,436,000	\$ (356,000)	\$20,826,000	\$ 410,000
Property Tax Debt	6,761,971	318,435	(4,432,449)	2,647,957	91,158
Treasury Department- Claims	3,174,771	116,034	(3,145,375)	145,430	35,207
Compensated Absences	1,539,798	1,663,726	(1,223,406)	1,980,118	99,562
Claims and judgments	<u>192,983</u>	<u>-</u>	<u>(192,983)</u>	<u>-</u>	<u>-</u>
Total	<u>\$24,415,523</u>	<u>\$10,534,195</u>	<u>\$(9,350,213)</u>	<u>\$25,599,505</u>	<u>\$ 635,927</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

9. LONG-TERM LIABILITIES (CONTINUED)

2. Bonds payable- The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. During the current year, the Municipality Assembly authorized a bonds issuance for approximately \$8,436,000, as described in the Note 3 (B). Bonds payable outstanding at June 30, 2005 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2005</u>
1999-Series	7-1-2018	\$ 2,630,000	5.00% to 7.81%	2,255,000
2000-Series	7-1-2026	1,760,000	5.00% to 7.00%	1,410,000
2001-Series	7-1-2010	1,300,000	5.00% to 8.00%	1,155,000
2001-Series	7-1-2017	1,070,000	5.00% to 8.00%	935,000
2002-Series	7-1-2026	135,000	5.00% to 7.00%	120,000
2002-Series	7-1-2021	475,000	5.00% to 7.00%	440,000
2002-Series	7-1-2026	1,965,000	5.00% to 7.00%	1,865,000
2002-Series	7-1-2026	2,085,000	5.00% to 7.00%	1,935,000
2004-Series	7-1-2027	1,115,000	5.00% to 6.50%	1,080,000
2004-Series	7-1-2014	1,195,000	5.00%	1,195,000
2005-Series	7-1-2031	1,730,000	5.00%	1,730,000
2005-Series	7-1-2031	3,021,000	5.00%	3,021,000
2005-Series	7-1-2031	3,685,000	5.00%	<u>3,685,000</u>
Total general obligation bonds				<u>\$ 20,826,000</u>

These bonds, except the \$1,760,000 Bonds 2000 Series, \$ 2,085,000 Bonds 2002 Series and the \$3,021,000 Bonds 2005 Series, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 410,000	\$ 754,160
2007	550,000	1,157,636
2008	590,000	1,089,559
2009	620,000	1,091,657
2010	675,000	1,052,842
2011-2015	4,095,000	4,583,277
2016-2020	4,695,000	3,202,262
2021-2025	4,705,000	1,876,038
2026-2030	3,835,000	538,750
2031-2035	<u>651,000</u>	<u>14,400</u>
Total	<u>\$ 20,826,000</u>	<u>\$ 15,360,581</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

9. LONG-TERM LIABILITIES (CONTINUED)

3. **Property Tax Debt-** These amounts represent the balance owned to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2005 as described in Note 6.
4. **Treasury Department Debt-** These amounts represent the balance owned to the Treasury Department at June 30, 2005, for payments of claims and judgments to third parties disbursed by the Treasury Department and related to claims and judgments unfavorable outcomes or final settlements against the Municipality. The Municipality agreed with the treasury Department to reimburse to it such amount in monthly installments to be retained by the Municipal Revenue Collection Center from the monthly property tax advances.
5. **Compensated absences-** The government-wide statement of net assets includes approximately \$1,296,154 of accrued sick leave benefits, and approximately \$683,964 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

10. PENSION PLAN

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

10. PENSION PLAN (CONTINUED)

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2005 amounted to approximately \$273,464 and \$306,511, respectively.

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

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

Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2005, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

11. RISK MANAGEMENT

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

12. CAPITAL ASSETS REPORTED VALUE:

The Municipality has not maintained complete and adequate records related to the Capital Assets reported in governmental activities of the government-wide financial statements and, therefore, such condition would affect the amounts of assets, net assets, and expenses of the governmental activities. The Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets.

13. CONTINGENCIES

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

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$146,010 in the fund financial statements for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as 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 the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

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

YEAR ENDED JUNE 30, 2005

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis) (See Note 1)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES AND OTHER FINANCING SOURCES:				
Property taxes	\$ 3,039,328	\$ 3,362,025	\$ 3,362,025	\$ -
Municipal license tax	2,139,374	2,346,780	2,380,900	34,120
Licenses, permits and other local taxes	901,750	901,750	933,584	31,834
Charges for service	39,400	33,300	80,755	47,455
Intergovernmental	3,030,301	3,069,295	3,059,194	(10,101)
Interest	100,000	100,000	214,513	114,513
Public lighting	706,698	706,698	698,347	(8,351)
Miscellaneous	<u>42,200</u>	<u>322,588</u>	<u>589,673</u>	<u>267,085</u>
Total revenues and other financing sources	<u>\$ 9,999,051</u>	<u>\$ 10,842,436</u>	<u>\$ 11,318,991</u>	<u>\$ 476,555</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	\$ 3,441,201	\$ 3,891,861	\$ 4,102,226	\$ (210,365)
Public safety	920,452	827,155	826,698	457
Public works	2,880,377	3,424,826	3,418,436	6,390
Health and welfare	877,915	848,184	861,009	(12,825)
Culture and recreation	805,087	855,317	861,260	(5,943)
Education	105,377	101,825	101,825	-
Public lighting	657,768	657,768	734,158	(76,390)
Operating transfer to other funds	<u>310,875</u>	<u>235,500</u>	<u>235,500</u>	<u>-</u>
Total expenditures, encumbrances and other financing uses	<u>\$ 9,999,051</u>	<u>\$ 10,842,436</u>	<u>\$ 11,141,112</u>	<u>(\$ 298,676)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>-</u>	<u>-</u>	<u>177,879</u>	<u>177,879</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 11,318,991
Differences-budget to GAAP:				
Collection of prior year accounts receivable				(714,689)
No budgeted revenues				<u>289,977</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,894,279</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 11,141,112
Differences-budget to GAAP:				
GAAP adjustments to expenditures:				
Adjustment to expenditures - operational loans				4,342,864
Prior year encumbrances recorded as current year expenditures for GAAP basis				89,225
Current year encumbrances recorded as expenditures for budgetary basis				(73,747)
Transfer out recognized as other financing sources (uses)				<u>(235,500)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 15,263,954</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO THE BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2005

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

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

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2005 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2005.

B. Excess Expenditures, Encumbrances and Other Financial Sources Over Budget

The Municipality's General Fund had excess of expenditures, encumbrances and other financial uses over appropriations at the legal level of budgetary control in the following functions\programs:

<u>Expenditures, Encumbrances and Other Financing Uses:</u>	<u>Appropriations</u>	<u>Actual Amounts</u>	<u>Excess</u>
General Government	\$ 3,891,861	\$ 4,102,226	\$(210,365)
Health and welfare	848,184	861,009	(12,825)
Culture and recreation	855,317	861,260	(5,943)
Public lighting	657,768	734,158	(76,390)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico - Department of Education: Child and Adult Care Food Program	10.558	Not Available	\$ 288,637
Total U.S. Department of Agriculture			<u>288,637</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program: Section 8 Housing Choice Vouchers	14.871		880,075
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioners of Municipal Affairs: Community Development Block Grant - State's Program	14.228	01-FD-51 02-AB-FC-51 03-AB-FC-51 04-AB-FC-51	665,918
Total U.S. Department of Housing and Urban Development			<u>1,545,993</u>
U.S DEPARTMENT OF JUSTICE:			
Pass-through the Commonwealth of Puerto Rico - Department of Justice: Edward Byrne Memorial	16.580	Not Available	20,346
Total U.S. Department of Justice			<u>20,346</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2005

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Pass-through the Commonwealth of Puerto Rico - Administration for Children and Families:			
Community Services Block Grant	93.569	Not Available	41,714
Head Start Program	93.600	02-CH-483-22	<u>3,386,021</u>
Total U.S. Department of Health and Human Services			<u>3,427,735</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Pass-through the Commonwealth of Puerto Rico - Emergency Management Agency:			
Emergency Management Performance Grant	83.552	Not Available	8,790
Citizen Corps	97.053	Not Available	2,556
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Public Assistance Grant	83.544	1247-DRPR	9,872
Hazard Mitigation Grant	83.548	1247-DRPR	<u>10,406</u>
Total U.S. Department of Homeland Security			<u>31,624</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 5,314,335</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

1. BASIS OF PRESENTATION:

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

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

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

Description	Special Revenue Fund Head Start	Other Governmental Funds	Total
Expenditures of Federal Awards per Fund	\$ 3,674,658	\$ 1,639,677	\$ 5,314,335
Non federal expenditures per Fund		1,841,690	1,841,690
Total expenditures per Fund	\$ 3,674,658	\$ 3,481,367	\$ 7,156,025



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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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

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

We have audited the basic financial statements of the **Municipality of Peñuelas** as of and for the year ended June 30, 2005, and have issued our report thereon dated October 25, 2005, which was unqualified at the fund financial statements level, but adverse at the government-wide financial statements level because we were unable to obtain competent evidential matter related to the Capital Assets reported in the governmental activities. Except as discussed in the preceding sentence, 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 of Peñuelas's** basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of basic 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 of Peñuelas's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Peñuelas's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items **05-01** and **05-02**.

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 (CONTINUED)

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 basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose reportable conditions that are also considered to be material weaknesses. However, we believe **item 05-01** of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs is a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the **Municipality of Peñuelas** in a separate letter dated October 25, 2005.

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

Lopez Vega, CPA, PSC
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
October 25, 2005

Stamp No. 2106113 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.





López-Vega, CPA, PSC

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

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

Compliance

We have audited the compliance of the **Municipality of Peñuelas** 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, 2005. The **Municipality of Peñuelas's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Peñuelas's** management. Our responsibility is to express an opinion on the **Municipality of Peñuelas's** compliance based on our audit.

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

In our opinion, the **Municipality of Peñuelas's** 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, 2005. 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 are described in the accompanying schedule of findings and questioned costs as items, **05-03** through **05-12**.

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

Internal Control Over Compliance

The management of the **Municipality of Peñuelas's** 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 of Peñuelas's** internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality of Peñuelas's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items **05-03** through **05-12**.

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 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 on 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 material weakness. However, of the reportable conditions described above we consider items **05-03**, **05-04**, **05-06** through **05-09** and **05-11** to be material weaknesses.



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

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Peñuelas** in a separate letter dated March 1, 2006.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 1, 2006

Stamp No. 2106114 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2005

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued: **Unqualified, except for adverse
for government-wide financial
statements**

Internal control over financial reporting:

Material weakness identified? Yes No

Reportable conditions identified not considered to
be material weaknesses? Yes None reported

Noncompliance material to financial statements
noted? Yes No

Federal awards

Internal Control over major programs:

Material weakness identified? Yes No

Reportable conditions identified not considered to
be material weaknesses? Yes None reported

Type of auditor’s report issued on compliance
for major programs: **Unqualified**

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

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
14.228	Community Development Block Grant-State Program
14.871	Section 8 Housing Choice Voucher Program
93.600	Head Start Program

Dollar threshold used to distinguish
between Type A and Type B programs

\$ 300,000

Auditee qualified as low-risk auditee? Yes No

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II - Financial Statements Findings

Finding Reference	05-01
Requirement	Fixed\ Capital Assets and Expenditures - Subsidiary Ledger
Statement of Condition	The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.
Criteria	Chapter IX, Article 9.002 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain updated property accounting records. Also, the GASB Statement No. 34 requires that all capital assets, including infrastructure, must be presented in the Statement of Net Assets and that these assets must be depreciated during its useful life.
Cause of Condition	Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.
Effect of Condition	The Municipality's Government Wide Financial Statements do not present fairly, the financial position of the governmental activities, and the change in financial position of the Municipality.
Recommendation	We recommend that the Municipality should continue the compilation of documents to support the value, completeness and ownership of its capital assets, to comply with the requirements of the GASB Statement No. 34.
Questioned Costs	None
Management Response and Corrective Action	Actually, the Municipality's Finance Department staffs are updating the capital assets subsidiary ledger with the support of our financial consultants in order to comply with the GASB No. 34 capital assets requirements for the fiscal year ended on June 30, 2006.

Implementation Date: June 30, 2006

Responsible Person: Mr. Arnaldo Rivera Aguirre
Finance Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

Finding Reference	05-02
Requirement	Financial Reporting – Accounting Records
Statement of Condition	During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds.
Criteria	Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.
Cause of Condition	The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.
Effect of Condition	The Municipality's accounting system did not provide updated and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.
Recommendation	We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.
Questioned Cost	None.
Management Response and Corrective Action	The Municipality maintains two set of accounting records; a manual system and a computerized system provided in the past by the Office of the Commissioner of Municipal Affairs (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II - Financial Statements Findings

Finding Reference 05-02 (Continued)

Some of the manual accounting records maintained by the Municipality consist of the following records, which provide information based on cash and budgetary basis:

- a. Cash Receipt Books - To record all receipts issued by the Official and Auxiliary Cash Collectors; each receipt is posted under each account of fund column title, and at the end of the month each column total is posted to the General Ledger.
- b. Cash Disbursement Book - To record all cash disbursements made by the Official Payer; each cash disbursement is charged to an account or to a fund, and at the end of the month each account or fund total is posted to the General Ledger.
- c. General Ledger - To summarize monthly cash receipt and cash disbursement transactions charged to each account or fund.
- d. Purchase Orders and Contracts Register - To record purchase orders and contracts issued against the budgeted amounts for each account or fund.

The computerized accounting records consist of the following modules; (a) Budget module, (b) Disbursements module, (c) General accounting module, (d) Volume of business tax module, (e) Accounts Receivable module, (f) Cash receipts module, and (g) Payroll module. All of these modules are in full operation, but as described in the first paragraph, the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation.

But, the Office of the Commissioner of Municipal Affairs (OCAM) is considering alternatives to improve our accounting system, including the acquisition of new accounting software, and therefore, we will hope to solve our accounting system condition in a near future.

Implementation Date: June 30, 2007

Responsible Person: Mr. Arnaldo Rivera Aguirre
Finance Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-03
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Financial Administration–Standard for Financial Management System Reporting
Statement of Condition	During our audit, we noted that Municipality did not maintained a set of manual accounting records for the fiscal year ended June 30, 2005, to present properly the financial position and the results of operations of the Program.
Criteria	<p>Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.</p> <p>The Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20, Financial Management, states the financial record keeping and management requirements with respect to Housing Assistance Payments Program Projects under annual contribution contracts.</p>
Cause of Condition	The employees named for the accounting position during the last years confronted problems with the Section 8 Housing Choice Vouchers Program accounting policies and procedures.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart C, Part 85.20 (b) (2) and with the Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20.
Recommendation	We recommended Management to instruct the program accountant to follow financial management and accounting procedures established in the Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-03 (continued)

Questioned Cost None.

**Management Response
and Corrective Action**

To correct the condition reported by the external auditors, we are going to modify our Program accounting records and to provide adequate training to our program Accountant with the support of our financial consultants in order to assure that the accounting records present the financial position and the results of operation in sufficient detail to permit an easily audit trial of financial reports to the accounting records.

Implementation Date: June 30, 2006

Responsible Person: Zelideth Colón Laboy
Section 8 Program Coordinator

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-04
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Cash Management
Statement of Condition	We realized a Cash Management Test and after our procedures, we found that the Municipality maintained during the current fiscal year, an average cash balance in books of approximately \$335,347. At June 30, 2005, the cash balance in books was \$391,205. Of these funds, \$59,175 was from HUD overpayment during the fiscal year 2004-05, as determined in the preliminary year-end settlement; \$47,444 was from operating reserve at June 30, 2005, as determined in the preliminary year-end settlement; and the remaining \$284,586 was not identified by us with respects to its origin.
Criteria	OMB Common Rules, Subpart C, Section 85.20 (b) (7), which requires a cash management system, in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by the grantee.
Cause of Condition	The condition may be caused by cumulative effect of accounting errors in the past years and current years; errors such as reporting portability administered by the Municipality as HAP expenditures in the year-end settlements, non recognition of portability administrative fee earned in the year-end settlements, non recognition of recoveries from tenants and owners in the year-end settlements, non recognition of interest earned on operating reserve in the year-end settlement, etc.
Effect of Condition	The Municipality did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).
Recommendation	We recommend to the Municipality's Management to instruct the program accountant to review the accounting records and related transactions supporting documents for the current and past years in order to identify the cash balance respects to its origin, and later, to make any necessary adjusting journal entries to correct accounting records.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-04 (Continued)

Questioned Cost None.

Management Response

and Corrective Action To correct the condition reported by the external auditors, we gave instructions to Program's accountant to revise past cash transactions and, to post in the books any accounting adjustment necessary to properly present the financial position and the results of operation of the Program. This revision must include evaluation of the following transactions: (a) the portability move-in transactions, (b) interest income transactions, (c) cancelled checks, (4) and recoveries from tenants and owners.

Implementation Date: June 30, 2006

Responsible Person: Zelideth Colón Laboy
Section 8 Program Coordinator

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-05
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Reporting- Special Reporting
Statement of Condition	We performed a special reporting test over fifteen (15) participant files and found the following exception: In three (3) cases, there was no evidence in the file of the Form HUD-50058, Family Report (OMB No. 2577-0083) completed for a new admissions during the fiscal year.
Criteria	Code of Federal Regulations 24, part 908 and section 982.158 states that the PHA is required to submit HUD-50058, Family Report (OMB No. 2577-0083) form electronically to HUD each time the PHA completes an admission, annual reexamination, interim reexamination, portability move-in, or other change of unit for a family. The PHA must also submit the Family Report when a family ends participation in the program or moves out of the PHA's jurisdiction under portability.
Cause of Condition	The Municipality controls and procedures failed in provide evidence of the submissions of the HUD-50058, Family Report.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, part 908 and section 982.158.
Recommendation	We recommend the Municipality strengthen it's procedures in order to assure that the evidence of the submissions of the HUD-50058, Family Report are included in the participant's files.
Questioned Costs	None
Management Response and Corrective Action	To correct the condition reported by the external auditors, we will strength our controls and procedures in order to print out and maintain in file all of electronically submitted Form HUD-50058, Family Report (OMB No. 2577-0083) each time the we completes an admission, annual reexamination, interim reexamination, portability move-in, or other change of unit for a family.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-05 (Continued)**

Implementation Date: April 30, 2006

Responsible Person: Zelideth Colón Laboy
Section 8 Program Coordinator

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-06
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Utility Allowance Schedule
Statement of Condition	The Municipality did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2005. There is no evidence of the last time that an Utility Allowance Schedule was actualized.
Criteria	Code of Federal Regulations, 24 CFR Section 982.517 states that the Municipality must maintain an up-to-date utility allowance schedule. The Municipality must review utility rate data for each utility category each year and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category or fuel type since the last time utility allowance was revised.
Cause of Condition	The Municipality did not follow the procedures established to review utility rate data each year.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations, 24 CFR Section 982.517.
Recommendation	The Municipality should evaluate utility allowance rate each year as established in the federal regulations.
Questioned Costs	None.
Management Response and Corrective Action	To correct the condition reported by the external auditors, we will review utility rate data for each utility category in order to determine any adjustment necessary to the utility allowance schedule in force. To do so, the Municipality's Section 8 program Coordinator will be working with the Program staff to conduct a utility survey obtaining information from tenants about each tenant-paid utilities (excluding telephone). In order to conduct a complete survey, the Program staff expects to analyze the last three months of utility billings. Also, the Program staff expects to conduct on an annual basis a utility survey during the month of July and the rates will become effective beginning on October of each year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-06 (Continued)**

Implementation Date: July 31, 2006

Responsible Person: Zelideth Colón Laboy
Section 8 Program Coordinator

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-07
Program	Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Financial Administration–Standard for Financial Management System Reporting
Statement of Condition	During our audit, we noted that for the fiscal year ended on June 30, 2005, the Municipality did not record in its manual accounting records the transactions related to Community Development Block Grant–State’s Program. Such condition did not permit us to trace the amounts included in the Financial Quarterly Reports. Also, for the periods ended 9/30/2004, 3/31/05 and 6/30/05, we did not obtain sufficient evidence to assure us that the Financial Quarterly Reports were submitted on time to the Office of Commissioner of Municipal Affairs.
Criteria	Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirement must be available for Federal inspection and must: (i) be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions; (ii) ensure that the funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of state and local governments. Also, the Grant Agreement provisions have established that the Municipality should submit all of the reports required by the Pass-through Grantor.
Cause of Condition	The accounting records maintained by the Program accountant consist only of a budgetary control register designed using the chart of account adopted by the Municipality in its computerized accounting system, instead of a set of accounting records adapted to the pass-through grantor budgetary level and reporting requirements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-07 (Continued)
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) and with the Grant Agreement.
Recommendation	We recommend that the Municipality should request technical support to the Office of the Commissioner of Municipal Affairs (OCAM) to train the program accountant in order to actualize and to maintain an accurate set of manual accounting records.
Questioned Costs	None
Management Response and Corrective Action	<p>To correct the condition reported by the external auditors, we are going to actualize our Program manual accounting records and to provide adequate training to our program Accountant with the support of our financial consultants and the Office of the Commissioner of Municipal Affairs (OCAM) in order to assure that the accounting records present the financial position and the results of operation in sufficient detail to permit an easily audit trial of financial reports to the accounting records.</p> <p>Also, as a prospective measure, we are going to give specific instructions to our Program Accountant to maintain in file reasonable evidence of each report submission.</p> <p>Implementation Date: September 30, 2006</p> <p>Responsible Person: Mr. José Luis Camacho Federal Programs Department Director</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-08
Program	Community Development Block Grants – State’s Program (CFDA No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Davis-Bacon Act
Statement of Condition	During our Davis-Bacon Act test, we noted that for the construction project 01-FD-51-007, related to streets improvement activities, the Municipality did not perform procedures in order to determine if the contractors complied with the dispositions established in the Davis Bacon Act; contractor’s laborers interviews were not made and contractor’s weekly payrolls were not requested during construction period.
Criteria	Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7)
Cause of Condition	The Municipality’s controls and procedures failed to apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Recommendation	We recommend management to follow monitoring system procedures developed, including obtaining contractor’s and subcontractor’s weekly payrolls to be reviewed on a weekly basis by the responsible municipal employee, and interview contractor’s and subcontractor’s laborers periodically (up to ten percent (10%) of the workers on long term projects) to establish the degree of compliance and the nature and extend of violations, if any, and then, communicate contractors, promptly, about any failure in the payroll process.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-08 (Continued)

Management Response
and Corrective Action

The Municipality of Peñuelas was developing multiple community development projects during the fiscal year ended on June 30, 2005, including road pavement improvement projects, which were projects realized in a short term period, situation that affect the application of our Davis-Bacon Act monitoring procedures.

But, to correct the condition reported by the external auditors we are going to instruct our Program labor standards officer to take particular attention to these projects to apply effectively the procedures adopted by us in order to assure compliance with the Davis-Bacon Act requirements.

Implementation Date: April 30, 2006

Responsible Person: Mr. José Luis Camacho
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-09
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Equipment and Real Property Management
Statement of Condition	Section II - Financial Statements Findings - Finding Reference 05-01

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-10
Program	Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Procurement
Statement of Condition	<p>During our contract provisions test, we identified the following conditions:</p> <ul style="list-style-type: none">a. One (1) contract did not include a provision with contractual legal remedies when contractor violates contract term, and provide for such sanctions and penalties as may be appropriate;b. Two (2) contracts did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours & Safety Standards Act;c. Two (2) contracts did not include a provision for granting access, to GAO or other federal agency, to books and other documentation;d. Two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act;e. Two (2) contracts did not include a provision for compliance with the Copeland “Anti-Kickback”;f. Two (2) contracts did not include a provision about contractor debarment and suspension certification.
Criteria	Code of Federal Regulations 24, Subpart I, Section 570.489 (g) requires that all purchase orders and contracts include all clauses required by Federal Statutes, executive orders and implementing regulations.
Cause of Condition	The Municipality’s internal control and procedures failed to detect the exclusion of certain contract clauses in the procurement process.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-10 (Continued)**

Effect of Condition The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Section 570.489 (g).

Recommendation We recommend that the Municipality should strengthen its procedures in order to assure that the contracts contain all provisions requested by federal agencies.

Questioned Costs None

Management Response and Corrective Action To correct the condition reported by the external auditors, we are going to prepare a uniform Federal required contract clauses attachment in order to attach it to each contract granted and related to Federal grants.

Implementation Date: June 30, 2006

Responsible Person: Mr. José Luis Camacho
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-11
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico-Administration for Care and Integral Development of Childhood (ACUDEN)
Requirement	Allowable Costs/Cost Principles
Statement of Condition	During the fiscal year 2003-2004, the program made a lease contract with the Puerto Rico Industrial Development Company (PRIDCO) to rent a local that will be the new administrative office of Head Start Program. The lease amount is of \$4,236 by month, for the first five (5) years. As of June 30 2005, the program had paid the amount \$101,670 (\$50,835 paid during the fiscal year 2004-2005) and still has not yet moved to the new facilities.
Criteria	OMB Circular A-87, Attachment C, states that to be allowable under Federal awards, costs must meet the some general criteria, including the following: (a) be necessary and reasonable for proper and efficient performance and administration of Federal awards.
Cause of Condition	The Agency did not obtain the approval of funds in the “Program Improvement” proposal for the fiscal year 2002-2003 for the reason that the Administration for Children’s and Families of the Department of Health and Human Services, Region II- New York, the program’s grantor, did not assigned funds for that activity in the Region.
Effect of Condition	The Municipality is not in compliance with OMB Circular A-87.
Recommendation	We recommend to the Municipality’s Management to request external funds or to assign local funds to realize promptly the improvements to the new facilities to relocate the administrative office of the Head Start Program.
Questioned Costs	\$50,835

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-11 (Continued)**

**Management Response
and Corrective Action**

During the fiscal year 2002-2003, we submitted a “Program Improvement” proposal requesting approval of funds for rehabilitation of a building leased to Puerto Rico Industrial Development Company (PRIDCO) to be used as our program principal office. For this year, program improvement funds were not awarded to the Region by the Administration for Children’s and Families of the Department of Health and Human Services, Region II Office.

Since the building leasing date, the Puerto Rico Administration for Children’s and Families (ADFAN), actually know as the Puerto Rico Child Care and Development Administration (ACUDEN) has approved funds to us for payment of leasing contract described above, and we are using this facilities temporally to storage program equipments and materials.

Actually, we are awarding for approval of program improvement funds for rehabilitation of this building in order to move our program principal office as soon possible.

Implementation Date: Pending to public improvement funds approval

Responsible Person: Mrs. Wanda B. Jaime
Head Start Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-12
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico-Administration for Care and Integral Development of Childhood (ACUDEN)
Requirement	Cash Management
Statement of Condition	During our Cash Management test, we noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$125,767 was maintained during the fiscal year ended June 30, 2005.
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (7) states that the Municipality must maintain procedures for minimizing the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by grantees and sub grantees whenever advance payment procedures are used.
Cause of Condition	The cash advance procedures established by the Administration for Care and Integral Development of Childhood-(ACUDEN) through grant agreement provide for only an advance per month.
Effect of Condition	The Municipality requested funds in excess of immediate needs and for that reason it's not in compliance with Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to continue strengthen it's procedures to minimize the time elapsed between the transfer of funds from the Administration for Care and Integral Development of Childhood-(ACUDEN) and the disbursements made by the Municipality.
Questioned Costs	None
Management Response and Corrective Action	The requisition of funds system established by the Commonwealth of Puerto Rico Child Care and Development Administration (ACUDEN) has been designed to request funds monthly. Therefore, each month, we complete and submit the request of funds form provided by ACUDEN requesting funds based on cash received to date, cash outlay obligations a forecast of expenditures for the next month (payroll, fringe benefits, contractual services, etc.).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference

05-12 (Continued)

The funds requested and received from ACUDEN each month are disbursed during each month period principally to pay the payroll and fringe benefits or to reimburse it to the General Fund, to pay the monthly portion of contractual services, and to pay for other expenditures related to the Program administrative and programmatic activities.

Therefore, is our opinion that the requisition of funds system established by the Pass-through Grantor, that is the non-federal entity that should exercise sound cash management in funds transfers to sub grantees, has been followed by us in compliance with the grant agreement clauses.

Implementation Date: Pending to pass-through grantor comment

Responsible Person: Mrs. Wanda B. Jaime
Head Start Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-03	14.871	<p><u>During the intervention, the auditors noted that Municipality did not maintained a set of manual accounting records for the fiscal year 2003-2004, to present properly the financial position and the results of operations of the Program. Such condition did not permit the Municipality to prepare and submit on time and accurate Voucher for Payment of Annual Contributions and Operating Statement, and not permit an audit trial of such report to the accounting records.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-03.</p>
04-04	14.871	<p><u>The housing assistance payments expenditures reported in the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2004 included the housing assistance payments issued during the fiscal year 2003-2004 on behalf of portability participants administered by the Municipality. Also, the administrative fee income related to portability participants administered by the Municipality was not reported in the operating receipts section of the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2004.</u></p> <p>No corrective action was taken. Finding pending for Federal Agency final resolution.</p>
04-05	14.871	<p><u>The auditors realized a Cash Management Test and after the procedures, they found that the Municipality maintained during the current fiscal year average cash balance in books of approximately \$274,973. At June 30, 2004, the cash balance in book was \$292,662; \$34,482 of these funds was from HUD overpayment during the fiscal year 2003-04 as determined in the year-end settlement; \$27,499 was from operating reserve at June 30, 2004, as determined in the year-end settlement; and the remaining \$230,681 was not identified by the auditors with respects to its origin.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-04.</p>
04-06	14.871	<p><u>The Municipality (PHA) did not perform an adequate number of quality control re-inspections during the fiscal year 2003-2004. The</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>Municipality maintained a universe of approximately one hundred sixty three (163) housing vouchers, but only two (2) quality control re-inspections were conducted by the program staff, instead of the minimum sample size required by the Program regulations.</u></p> <p>Full corrective action was taken.</p>
04-07	14.871	<p><u>The determination of reasonable rent (reasonable rent certification) was not duly documented. The auditors examined a sample of fifteen (15) participant's files and observed that in three (3) participants admitted to the program during the fiscal year 2003-2004, the certification of reasonable rent did not include the comparable rent with other similar units.</u></p> <p>No corrective action has been taken. Implementation of the corrective action plan is in process.</p>
04-08	14.871	<p><u>The Municipality did not maintain and up-to-date utility allowance schedule for the audit period ending June 30, 2004. There is no evidence of the last time that and Utility Allowance Schedule was actualized.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-06.</p>
04-09	14.228	<p><u>During the intervention, the auditors noted that for the fiscal year 2003-2004, the Municipality did not record in its manual accounting records the transactions related to Community Development Block Grant - State's Program. Such condition did not permit the Municipality to prepare and submit on time and accurate quarterly reports required by the pass-through grantor, and not permit an audit trial of such reports to the accounting records.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-07.</p>
04-10	14.228	<p><u>The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-09.
04-11	14.228	<u>During the examination of the program's Financial Quarterly Reports, the auditors noted the following situations: (a) The Municipality did not maintain evidence to demonstrate if the Financial Quarterly Reports were submitted on a timely basis to the Pass-through Grantor (OCAM); (b) the Financial Quarterly Reports for the period ended 6/30/04 was not available for the examination; (c) the Financial Quarterly Reports for the periods ended 09/30/03, 12/31/03 and 3/31/04 could not be traced to the general ledgers because the Municipality did not maintain an actualized and accurate set of manual accounting records.</u>
		No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-07.
04-12	93.600	<u>During the fiscal year 2003-2004, the program made a lease contract with the Puerto Rico Industrial Development Company (PRIDCO) to rent a local that will be the new administrative office of Head Start Program. The lease amount is of \$4,236.00 by month, for the first five (5) years. As of June 30 2004, the program had paid the amount \$50,835.00 and still has not yet moved to the new facilities.</u>
		No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-11.
04-13	93.600	<u>During the Cash Management test, the auditors noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$293,254.39 was maintained during the fiscal year ended June 30, 2004.</u>
		No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-12.
04-14	93.600	<u>The Accounting System maintained by the Head Start Program financial activities did not provide for the classification of financial transactions between administration and programmatic costs. Alternate procedures were used by the Program staff at the end of the program fiscal year to compute compliance with the fifteen (15%) administrative costs limit.</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		Full corrective action was taken.
04-15	93.600	<u>During the contract provisions test, the auditors identified the following conditions: (a) Four (4) contracts did not include provisions for contractual legal remedies when contract violates contract term, and did not provide such sanctions and penalties; (b) four (4) contracts did not include provisions for termination grantee for default.</u> Full corrective action was taken.
03-06	14.871	<u>The Municipality maintained during the current fiscal year average cash balance in books of approximately \$262,060. At June 30, 2003, the cash balance in book was \$258,168, \$25,855 of these funds were from operating reserve at June 30, 2003, as determined in the year-end settlement; and the remaining \$232,313 was not identified by the auditors with respects to its origin. Also, an underpayment of \$16,736 was determined by HUD during the fiscal year 2002-03 year-end settlement.</u> No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-04.
03-09	14.871	<u>On five (5) new participant files the certification of reasonable rent did not include the comparable rent with other similar units. On four (4) participant files the determination of reasonable rent did not include comparable unassisted units in an increase of the rent to owner during fiscal year 2002-2003.</u> No corrective action has been taken. Implementation of the corrective action plan is in process.
03-10	14.871	<u>The Municipality did not maintain and up-to-date utility allowance schedule for the audit period ending June 30, 2003. There is no evidence of the last time that and Utility Allowance Schedule was actualized.</u> No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-06.
03-11	14.228	<u>During the intervention, the auditors noted that the Municipality did not maintain, for the Community Development Block Grant - State's</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>Program, a reliable set of accounting records that present the financial position of the program, the results of operations and changes in fund balance.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-07.</p>
03-14	14.228	<p><u>The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-09.</p>
03-15	14.228	<p><u>The Financial Quarterly Reports for the quarters ended during the fiscal year 2002-2003 were not available for the examination. Therefore, the auditors could not obtain evidence to assure that the Financial Quarterly Reports were submitted timely to OCAM and prepared in accordance with the required accounting basis.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-07.</p>
03-17	93.600	<p><u>The Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$241,414 was maintained during the fiscal year ended June 30, 2003.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-12.</p>
03-18	93.600	<p><u>Four (4) contracts did not include provisions for contractual legal remedies when contract violates contract term, and did not provide such sanctions and penalties. Three (3) contracts did not include provisions for termination grantee for default.</u></p> <p>Full corrective action was taken.</p>
02-05	14.871	<p><u>The Municipality should periodically compare actual program cash requirements to the funds advanced from U. S. Treasury Department</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>and prepare and submit a revised requisition to reduce monthly advances.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
02-10	14.871	<p><u>The Municipality should evaluate utility allowance rate each year as established in the federal regulations.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
02-13	14.871	<p><u>The Municipality should implement controls to assure appropriate documentation of the determination of reasonable rent is maintained in participants file.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
02-14	93.600	<p><u>The Municipality should strength it's procedures to minimize the time elapsed between the transfer of funds from the Administration for Children and Families and the disbursements made by the Municipality.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>