

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE PEÑUELAS

AUDITORIA 2006-2007

30 DE JUNIO DE 2007

OFICINA DEL COMISIONADO
DE ASUNTOS MUNICIPALES

200 100 -3 AM 11:30

RECIBIDO
UNIDAD DE CORREO

Calderon - 1133

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION
SINGLE AUDIT**

YEAR ENDED JUNE 30, 2007

*Según Matanzas
3/3/08
[Signature]*

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2007

CONTENTS

| | Page |
|---|-------|
| <u>BASIC FINANCIAL STATEMENTS</u> | |
| Independent Auditor's Report | 1-2 |
| Required Supplemental Information (Part 1) Management's Discussion and Analysis | 3-10 |
| Government-Wide Financial Statements: | |
| Statement of Net Assets | 11 |
| Statement of Activities | 12 |
| Fund Financial Statements: | |
| Governmental Funds: | |
| Balance Sheet | 13 |
| Statement of Revenues, Expenditures and Changes in Fund Balances | 14 |
| Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities | 15 |
| Notes to basic financial statements | 16-38 |
| <u>SUPPLEMENTARY INFORMATION</u> | |
| Required Supplemental Information (Part II): | |
| Budgetary Comparison Schedule-General Fund | 39 |
| Notes to Budgetary Comparison Schedule-General Fund | 40 |
| Schedule of expenditures of federal awards | 41-42 |
| Notes to the schedule of expenditures of federal awards | 43 |
| <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> | 44-45 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2007

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 | 46-48 |
| <u>FINDINGS AND QUESTIONED COSTS</u> | |
| Schedule of findings and questioned cost | 50-61 |
| Summary schedule of prior year audit findings | 62 |



MENDOZA & RAMOS
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

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

INDEPENDENT AUDITORS' REPORT

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, 2007, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As described in Note 12, 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, 2007, and the changes in financial position, thereof for the year then ended.

INDEPENDENT AUDITORS' REPORT
Municipality of Peñuelas
Page 2

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, 2007, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 10 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 a report dated November 27, 2007, on our consideration of the Municipality's internal control structure over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Mendoza & Ramos CPAs
Mendoza & Ramos, C.S.P.
Certified Public Accountant

Guayama, Puerto Rico
November 27, 2007

The stamp number 2283091
was affixed to the original
of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2007**

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, 2007. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 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 2007 deserve special mention:

1. Total assets of the Municipality amounted to \$41,351,833 (\$34,145,597 in 2006) which represents an increase of 21.1% (2.5% in 2006) compared to prior fiscal year.
2. At the end of fiscal year 2007, total liabilities amounted to \$31,986,696 (\$31,787,738 in 2006). Out of said amount, \$24,984,211 (\$25,591,910 in 2006) corresponded to long-term liabilities of which \$21,151,000 (\$21,726,000 in 2006) 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 of the Municipality amounted to \$9,365,137 (\$2,182,182 in 2006) which represents an increase of 336.2% (1,027% in 2006) compared to prior fiscal year.
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$27,725,440 (\$20,775,336 in prior fiscal year) derived from the following sources: \$47,873 (\$40,630 in prior fiscal year) charges for services;
5. \$9,807,340 (\$7,035,772 in prior fiscal year) from operating grants and contributions;

FINANCIAL HIGHLIGHTS (CONTINUED)

\$1,910,070 (\$1,030,386 in prior fiscal year) from capital grants and contributions obtained from other sources, and \$15,960,157 (\$12,668,548 in prior fiscal year from general revenues available.

- 6. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$20,542,485 (\$18,175,212 during fiscal year 05-06).**
- 7. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$7,182,955 (\$2,600,124 during fiscal year 05-06).**
- 8. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$15,817,741 (\$12,605,133 as of June 30, 2006).**
- 9. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$1,066,233, compared to a fund balance of \$877,433 in the prior fiscal year, as restated.**
- 10. The actual General Fund budgetary activities resulted in a favorable balance of \$2,713,409 (\$972,114 during the prior fiscal year), caused mainly due to unexpected variances in revenue collections from interest and miscellaneous sources and savings in general government and public safety expenses.**

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

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

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

FINANCIAL STATEMENTS COMPONENTS

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

The Statement of Net Assets reflects information of the Municipality as a whole 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

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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, 2007, shows total expenses incurred to afford the cost of all functions and programs amounted to \$20,542,485 (\$18,175,212 during prior year). Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$11,765,283 (\$8,106,788 during prior year) was derived from the following sources: \$47,873 (\$40,630 during prior year) charges for services; \$9,807,340 (\$7,035,772 during prior year) from operating grants and contributions; and \$1,910,070 (\$1,030,386 during prior year) from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$15,960,157 (\$12,678,548 during prior year). When such figure is added to the \$11,765,283 (\$8,106,788 during prior year) previously mentioned, total revenues available for the financing of activities amounted to \$27,725,440 (\$20,775,336 during prior year). There was an excess of revenues over expenses in the amount of \$7,182,955 (\$2,610,124 during prior year) which contributed with a 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.

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 reports 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.

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 \$9,519,732 at the end of 2007, compared to \$2,182,182 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

| Condensed Statement of Net Assets | 2007 | 2006 | Change | % |
|---|---------------------|---------------------|---------------------|---------------|
| Assets | | | | |
| Current assets | \$ 22,095,282 | \$ 18,246,414 | \$ 3,848,868 | 21.1% |
| Capital assets | 19,256,551 | 15,899,183 | 3,357,368 | 21.1% |
| Total assets | 41,351,833 | 34,145,597 | 7,206,236 | 21.1% |
| Liabilities | | | | |
| Current liabilities | 8,180,101 | 7,218,987 | 806,519 | 13.2% |
| Non-current liabilities: | 23,806,595 | 24,568,751 | (762,156) | -3.1% |
| Total liabilities | 31,986,696 | 31,787,738 | 44,363 | 0.6% |
| Net Assets | | | | |
| Invested in capital assets, net of related debt | 4,311,551 | 459,183 | 3,852,368 | 839.0% |
| Restricted | 14,070,074 | 11,069,535 | 3,000,539 | 27.1% |
| Unrestricted (deficit) | (9,016,488) | (9,346,536) | 484,643 | -3.5% |
| Total net assets | \$ 9,365,137 | \$ 2,182,182 | \$ 7,337,550 | 329.2% |

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2007, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$7,337,550 (\$2,610,124 during prior year) increase in the Municipality's net assets. Approximately 43 (40 in prior fiscal year) percent of the Municipality's total revenue came from taxes, while 53 (55 in prior fiscal year) percent resulted from grants and contributions, including federal aid. Charges for Services and other miscellaneous revenues provided 4 (5 in prior fiscal year) percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, health and welfare services and public works. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

| Condensed Statement of Activities | 2007 | 2006 | Change | % |
|--|---------------------|---------------------|---------------------|------------------|
| REVENUES | | | | |
| Program Revenues: | | | | |
| Charges for Services | \$ 47,873 | \$ 40,630 | \$ 7,243 | 17.8% |
| Operating Grants and Contributions | 9,807,340 | 7,035,772 | 2,771,568 | 39.4% |
| Capital Grants and Contributions | 1,910,070 | 1,030,386 | 879,684 | 85.4% |
| Total Program Revenues | 11,765,283 | 8,106,788 | 3,658,495 | 45.1% |
| General Revenues and Special Items: | | | | |
| Property taxes | 5,138,708 | 4,748,221 | 390,487 | 8.2% |
| Municipal license tax | 5,727,821 | 2,949,607 | 2,778,214 | 94.2% |
| Other local taxes | 999,331 | 652,471 | 346,860 | 53.2% |
| Grants and contributions not restricted to specific programs | 3,063,894 | 3,265,294 | (201,400) | -6.2% |
| Interest and investment earnings | 812,798 | 447,307 | 365,491 | 81.7% |
| Miscellaneous | 217,605 | 605,648 | (388,043) | -64.1% |
| Total General Revenues and Special Items | 15,960,157 | 12,668,548 | 3,291,609 | 26.0% |
| Total Revenues | 27,725,440 | 20,775,336 | 6,950,104 | 33.5% |
| EXPENSES | | | | |
| General government | 5,488,033 | 4,498,630 | 989,403 | 0.8% |
| Public safety | 1,019,044 | 1,418,401 | (399,357) | 74.7% |
| Public works | 4,256,599 | 3,318,264.00 | 938,335 | 34.3% |
| Health and welfare | 5,718,465 | 5,560,299.00 | 158,166 | 1.9% |
| Culture and recreation | 975,790 | 589,014.00 | 386,776 | -50.2% |
| Economic development | 440,837 | 522,934.00 | (82,097) | -9.4% |
| Community development | 155,397 | 447,530.00 | (292,133) | -60.0% |
| Education | 217,464 | 159,733.00 | 57,731 | -36.9% |
| Public lighting | 852,608 | 872,517.00 | (19,909) | 18.8% |
| Interest on long-term debt | 1,263,653 | 787,890.00 | 475,763 | 35.7% |
| Total Expenses | 20,387,890 | 18,175,212 | 2,212,678 | 3.0% |
| Change in net assets | 7,337,550 | 2,600,124 | 4,737,426 | -54.0% |
| Net assets (deficit) - beginning, as restated | 2,182,182 | (417,942) | 2,600,124 | -95.9% |
| Net assets (deficit) - ending | \$ 9,519,732 | \$ 2,182,182 | \$ 7,337,550 | -1,077.4% |

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 \$15,817,741 (\$12,605,133 in 2006) an increase of \$3,526,427 (\$1,180,003 in 2006) in comparison with the prior year. There are reservations of fund balance amounting to \$14,888,593 (\$11,485,939 in 2006). This is the fund balance that it is not available for new spending because it has already been committed 1) \$137,085 (\$72,058 in 2006) to liquidate contracts and purchase orders of the prior fiscal year, 2) \$3,001,203 (\$2,982,793 in 2006) to pay debt service, 3) \$5,891,617 (\$7,164,378 in 2006) to pay for capital projects and 4) \$5,858,688 (\$1,266,710 for 2006) for other purposes.

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2007, the general fund has an undesignated fund balance of \$929,148 (\$805,375, as restated in 2006).

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 a favorable balance of \$2,713,409 (\$972,114 during the prior fiscal year), caused mainly due to unexpected variances in revenue collections from interest and miscellaneous sources and savings in general government and public safety expenses.

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.

The Municipality's investment in capital assets as of June 30, 2007, amounts to \$30,087,837 (\$25,708,239 in 2006), net of accumulated depreciation of \$10,831,287 (\$9,809,056 in 2006), including depreciation charges for the year totaled 1,022,230 (\$903,927 in 2006), leaving a net book value of \$19,256,551 (\$15,899,183 in 2006). This investment in capital

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

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, 2007, the Municipality has \$3,674,434 (\$5,238,222 in 2006) 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.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

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

FINAL COMMENTS

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

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

FINANCIAL CONTACT

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

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

| | Governmental Activities |
|--|------------------------------------|
| Assets | |
| Cash and cash equivalents | \$ 13,750,923 |
| Cash with fiscal agent | 6,726,043 |
| Accounts receivable: | |
| Property tax | 74,505 |
| Intergovernmental | 214,952 |
| Federal | 1,146,663 |
| Other | 182,196 |
| Capital assets | |
| Land, improvements, and construction in progress | 3,958,946 |
| Other capital assets, net of depreciation | 15,297,605 |
| Total capital assets | 19,256,551 |
| Total assets | 41,351,833 |
| Liabilities | |
| Accounts payable and accrued liabilities | 1,062,049 |
| Due to other governmental entities | 67,159 |
| Claims and Judgments | |
| Deferred revenues: | |
| Municipal license tax | 3,954,932 |
| Federal grant revenues | 1,143,731 |
| Other | |
| Interest payable | 774,614 |
| Noncurrent liabilities: | |
| Due within one year | 1,177,616 |
| Due in more than one year | 23,806,595 |
| Total liabilities | 31,986,696 |
| Net Assets | |
| Invested in capital assets, net of related debt | 4,311,551 |
| Restricted for: | |
| Capital projects | 5,891,618 |
| Debt service | 2,226,589 |
| Other purposes | 5,951,867 |
| Unrestricted (deficit) | (9,016,488) |
| Total net assets | \$ 9,365,137 |

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

| Functions/Programs | Expenses | Program Revenues | | | Net (Expense) Revenue and Changes in Net Assets |
|--------------------------------------|----------------------|-------------------------|--|--|--|
| | | Charges for Services | Operating Grants and Contributions | Capital Grants and Contributions | Governmental Activities |
| General government | 5,642,628 | | | | \$ (5,642,628) |
| Public safety | 1,019,044 | 6,159 | | 28,700 | (984,185) |
| Public works | 4,256,599 | 6,120 | 3,837,071 | 749,172 | 335,764 |
| Health and welfare | 5,718,465 | | 4,654,102 | | (1,064,363) |
| Culture and recreation | 975,790 | 35,594 | | 57,998 | (441,361) |
| Economic development | 440,837 | | 440,837 | | (425,837) |
| Community development | 155,397 | | 7,722 | 1,074,200 | 1,779,133 |
| Education | 217,464 | | 15,000 | | (217,464) |
| Public lighting | 852,608 | | 852,608 | | (852,608) |
| Interest on long-term debt | 1,263,653 | | | | (1,263,653) |
| Total governmental activities | \$ 20,542,485 | \$ 47,873 | \$ 9,807,340 | \$ 1,910,070 | (8,777,202) |

General revenues and special items:

| | |
|--|-----------|
| Property taxes | 5,138,708 |
| Municipal license tax | 5,727,821 |
| Other local taxes | 999,331 |
| Grants and contributions not restricted to specific programs | 3,063,894 |
| Interest and investment earnings | 812,798 |
| Miscellaneous | 217,605 |

| | |
|---|---------------------|
| Total general revenues | 15,960,157 |
| Change in net assets | 7,182,955 |
| Net assets (deficit) - beginning, as restated | 2,182,182 |
| Net assets (deficit) - ending | \$ 9,365,137 |

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

| | General Fund | Special Revenue Fund Head Start | Capital Project Fund - Local, State & Federal Grants | Debt Service Fund | Tax Investigation Fund | Special Revenue Fund - Local & State Grants | Other Governmental Funds | Total Governmental Funds |
|---|---------------------|---------------------------------------|--|-------------------------|---------------------------|---|--------------------------------|--------------------------------|
| Assets | | | | | | | | |
| Cash and cash equivalents | \$ 3,556,760 | \$ 225,024 | \$ 2,754,100 | \$ - | \$ 2,991,492 | \$ 3,013,661 | \$ 1,209,886 | \$ 13,750,923 |
| Cash with fiscal agent | 52,362 | | 3,674,434 | 2,991,829 | - | 7,418 | - | 6,726,043 |
| Accounts receivable: | | | | | | | | - |
| Intergovernmental | - | 160,948 | - | 28,998 | - | 214,952 | 985,715.00 | 1,390,613 |
| Other | 166,867 | | | 11,166 | | | | 178,033 |
| Due from other funds | 1,770,537 | | | | | | | 1,770,537 |
| Total assets | \$ 5,546,526 | \$ 385,972 | \$ 6,428,534 | \$ 3,031,993 | \$ 2,991,492 | \$ 3,236,031 | \$ 2,195,601 | \$ 23,816,149 |
| Liabilities and Fund Balances | | | | | | | | |
| Liabilities : | | | | | | | | |
| Accounts payable and accrued liabilities | \$ 458,202 | \$ 134,921 | \$ 317,432 | \$ - | \$ - | \$ 16,103 | \$ 135,391 | \$ 1,062,049 |
| Due to other governmental entities | 67,159 | | | | | | | 67,159 |
| Due to other funds | | 244,047 | 186,124 | 30,790 | - | 352,732 | 956,844.00 | 1,770,537 |
| Claim and Judgment | | | | | | | | - |
| Deferred revenues: | | | | | | | | - |
| Municipal license tax | 3,954,932 | | | | | | | 3,954,932 |
| Federal grant revenues | | 7,004 | 33,361 | | | | 1,103,366.00 | 1,143,731 |
| Total liabilities | 4,480,293 | 385,972 | 536,917 | 30,790 | - | 368,835 | 2,195,601 | 7,998,408 |
| Fund balances: | | | | | | | | |
| Reserved for: | | | | | | | | |
| Encumbrances | 137,085 | | | | | | | 137,085 |
| Capital projects | | | 5,891,617 | | | | | 5,891,617 |
| Debt service fund | | | | 3,001,203 | | | | 3,001,203 |
| Other purposes | | | | | 2,991,492 | 2,867,196 | - | 5,858,688 |
| Reserved reported in nonmajor funds: | | | | | | | | |
| Other purposes | | | | | | | | - |
| Unreserved: | | | | | | | | |
| Undesigned (Deficit) | 929,148 | | | | | | | 929,148 |
| Total fund balances | 1,066,233 | - | 5,891,617 | 3,001,203 | 2,991,492 | 2,867,196 | - | 15,817,741 |
| Total liabilities and fund balances | \$ 5,546,526 | \$ 385,972 | \$ 6,428,534 | \$ 3,031,993 | \$ 2,991,492 | \$ 3,236,031 | \$ 2,195,601 | \$ 23,816,149 |

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

| | General Fund | Special Revenue Fund Head Start Program | Capital Project Fund - Local, State & Federal Grants | Debt Service Fund | Tax Investigation Fund | Special Revenue Fund - Local & State Grants | Other Governmental Funds | Total Governmental Funds |
|---|--------------------|--|--|-------------------|------------------------|---|--------------------------|--------------------------|
| Revenues | | | | | | | | |
| Property taxes | \$ 3,783,086 | | | \$ 1,335,632 | | | | \$ 5,118,718 |
| Municipal license taxes | 5,727,821 | | | | | | | 5,727,821 |
| Licenses, permits and other local taxes | 949,661 | | | | \$ 3,743,565 | | | 4,693,226 |
| Charges for services | 47,873 | | | | | | | 47,873 |
| Intergovernmental | 3,916,502 | | \$ 802,486 | | | \$ 557,065 | | 5,276,053 |
| Interest | 812,798 | | | | | | | 812,798 |
| Federal grants | | \$ 3,701,933 | | | | | \$ 2,063,978 | 5,765,911 |
| Miscellaneous | 213,380 | | | | | | | 213,380 |
| Total revenues | 15,451,121 | 3,701,933 | 802,486 | 1,335,632 | 3,743,565 | 557,065 | 2,063,978 | 27,655,780 |
| Expenditures | | | | | | | | |
| Current: | | | | | | | | |
| General government | 5,483,550 | | 135,482 | | 492,393 | 1,962 | - | 6,113,387 |
| Public safety | 926,060 | | | | 4,859 | - | 28,700 | 959,619 |
| Public works | 3,915,887 | | 798,687 | | 398,914 | 349,371 | 12,209 | 5,475,068 |
| Health and welfare | 970,912 | 3,701,933 | 30,776 | | 14,278 | 29,394 | 958,920 | 5,706,213 |
| Culture and recreation | 1,157,684 | | 1,110,302 | | 44,251 | 12,084 | - | 2,324,321 |
| Economic development | | | | | - | 440,837 | - | 440,837 |
| Community development | | | | | - | 7,567 | 1,064,149 | 1,071,716 |
| Education | 166,797 | | | | 28,200 | 4,542 | - | 199,539 |
| Public lighting | - | | | | - | - | - | - |
| Debt service: | | | | | | | | |
| Principal interest | | | | 575,000 | | | - | 575,000 |
| | | | | 1,263,653 | | | - | 1,263,653 |
| Total expenditures | 12,620,890 | 3,701,933 | 2,075,247 | 1,838,653 | 982,895 | 845,757 | 2,063,978 | 24,129,353 |
| Excess (deficiency) of revenues over (under) expenditures | 2,830,231 | - | (1,272,761) | (503,021) | 2,760,670 | (288,692) | - | 3,526,427 |
| Other financing sources (uses) | | | | | | | | |
| Transfers in | | | | 521,431 | - | 2,120,000 | - | 2,641,431 |
| Transfers out | (2,641,431) | | | | | | | (2,641,431) |
| Long-term debt issued | | | | | | | | - |
| Total other financing sources (uses) | (2,641,431) | - | - | 521,431 | - | 2,120,000 | - | - |
| Net change in fund balances | 188,800 | - | (1,272,761) | 18,410 | 2,760,670 | 1,831,308 | - | 3,526,427 |
| Fund balance beginning, as restated | 877,433 | | 7,164,378 | 2,982,793 | 230,822 | 1,035,888 | - | 12,291,314 |
| Fund balance, ending | \$ 1,066,233 | \$ - | \$ 5,891,617 | \$ 3,001,203 | \$ 2,991,492 | \$ 2,867,196 | \$ - | \$ 15,817,741 |

Handwritten signature and date:
03/09/08

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

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, 2007

Net Change In Fund Balances - Total Governmental Funds **\$ 3,526,427**

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. | 4,379,598 |
| 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. | (1,022,230) |
| 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. | (358,210) |
| Bonds and notes proceeds provides 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. | 575,000 |
| Repayment of long term Claims and Judgments debts is an expenditure in Governmental Funds, but the repayment reduces long -term Claims and Judgments debts in the Government-Wide Statement of Net Assets. This is the amount paid in the current period. | 354,027 |
| Accounts receivables not collected 60 days after the closing date are not recognize in Governmental Funds, but these receivables are reported n the Government-Wide Statements of Activities and Change in Net Assets. | 49,670 |
| Accounts receivables collected during fiscal year 2006-2007 are not recognize in Governmental Funds, but these receivables are reported n the Government-Wide Statements of Activities and Change in Net Assets. | 19,990 |
| Some expenditures reported in the Statement of Activities do not require the use of current financial resources, but are not reported as expenses in the Governmental Funds. | (154,595) |
| 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 represent the change in long-term debt with the Treasury Department from prior | 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 represent the change in long-term compensated absences from prior | <u>(277,879)</u> |
| Change in Net Assets of Governmental Activities | <u>\$ 7,182,955</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

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
YEAR ENDED JUNE 30, 2007**

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

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. 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
YEAR ENDED JUNE 30, 2007

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

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

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

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

Special Revenue Fund - 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 Project 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.

Tax Investigation Fund - is the accounting entity in which revenues derived from tax investigations related to municipal licenses and construction excise taxes is accounted for, principally to be used for capital projects. The uses and limitations of the fund are specified by Municipality ordinances and Executive resolutions.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007

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

Other Governmental Funds – is the accounting entity in which revenues derived from local funds, state grants, federal grants or other restricted revenue source, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or state and federal statutes.

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 if 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 – 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 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.

Other Funds– 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 are accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

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

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("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
YEAR ENDED JUNE 30, 2007**

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
YEAR ENDED JUNE 30, 2007**

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 represents mostly contributions from the Puerto Rico Electric Power Authority (PREPA), which, pays the municipalities as contributions in lieu of taxes greater of the following amounts: (a) twenty percent (20%) of its net revenues as defined in the Trust Indenture signed with the Trustee as representative of the bondholders, adjusted by subsidies granted by the PREPA; (b) an amount equal to the actual cost of electric power consumed by each Municipality in its common facilities during the current year; or (c) an average of the contribution in lieu of taxes paid by PREPA to each municipality during the past five fiscal years. The contribution in lieu of tax revenue and related receivable recorded in the General Fund for the current fiscal year was determined based on revenue estimates made by the PREPA and actual transactions during the current fiscal year, because the final contribution amount from the PREPA was not available at the date of release of the basic financial statements. 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
YEAR ENDED JUNE 30, 2007**

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

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

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

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

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

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

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

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.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

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

- b. committed amounts generally will become liabilities in future periods as the projects are completed.
 - c. *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.
 - d. *Other Purposes*- Represents net assets available for specific use and/or legally segregated for other specific future use.
 - e. *Debt Service Fund*- Represents net assets available to finance future debt service payments.
9. **Interfund and intra-entity transactions**- The Municipality has the following types of transactions among funds:
- a. **Operating Transfers**- Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. **Intra-Entity Transactions**- Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
10. **Risk financing**- The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2007 amounted to approximately \$189,938. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$321,358 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

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 | \$ 19,256,551 | \$ 19,256,551 |
| Deduct: | | |
| Bonds Payable | <u>(14,945,000)</u> | <u>(14,945,000)</u> |
| <u>Net assets restricted for capital projects</u> | | |
| Fund balance restricted for capital projects | | 5,891,618 |
| <u>Net assets restricted for debt service</u> | | |
| Debt service fund - fund balance | \$3,001,203 | |
| Deduct: | | |
| Interest payable | <u>(774,614)</u> | 2,226,589 |
| <u>Net assets restricted for other purposes</u> | | |
| Special revenue fund - local and state grants restricted | | 5,951,867 |
| <u>Net assets unrestricted (deficit)</u> | | |
| General fund - total fund balance: | \$973,054 | |
| Add: Accounts Receivables | 49,670 | |
| Deduct: | | |
| Retirement Administration Debt | (154,595) | |
| Bonds Payable | (6,206,000) | |
| Property Tax Debt | (1,951,298) | |
| Compensated Absences | (1,651,687) | |
| Claims and judgment debts | <u>(75,632)</u> | <u>(9,016,488)</u> |
| Total net assets - governmental activities | | <u>\$ 9,365,137</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

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 \$3,556,760 in the general fund, \$225,024 in the special revenue fund – head start, \$2,754,100 in the capital project fund – local, state and federal grants, \$2,991,492 in the tax investigation fund \$3,013,661 in the special revenue fund – local and state grants were fully collateralized at June 30, 2007. In the other governmental funds there were deposits with commercial banks of approximately \$1,209,886 that were fully collateralized.

The deposits at GDB of approximately \$52,362, that is restricted for other purposes in the general fund, the \$7,418 in the special revenue fund – local and state grants, the \$3,674,434 that is restricted principally for capital projects in the capital project fund – local, state and federal grants, and the \$2,991,829 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality 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, 2007, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.40% 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, 2007, 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
YEAR ENDED JUNE 30, 2007

3. RECEIVABLES (CONTINUED)

- B. *Intergovernmental Receivables*- On September 7, 2004, Act Num. 255 was enacted and a new formula as described in Note 1 (E) (2), was established for the calculation of the contribution in lieu of taxes to be paid to the municipalities by PREPA. Since the final liquidation following such formula was not available for fiscal year 2006-2007, an estimated amount was recognized, based on the estimate contributions in lieu of taxes determined by PREPA for the current fiscal year.

Intergovernmental receivable of \$214,952 in the special revenue fund – local and state grants represent expenditures incurred not yet reimbursed by Department of Labor – Law 52 and 82 Grants.

Intergovernmental receivable of \$160,948 in special revenue fund – head start represent expenditures incurred not yet reimbursed by the pass-through grantor.

Intergovernmental receivable in special revenue fund – other federal grants represent expenditures incurred not yet reimbursed by the Federal government or the pass-through grantor. Following is a detail of the intergovernmental receivable:

| <u>Program Description</u> | <u>Amount</u> |
|-----------------------------------|-------------------|
| Community Development Block Grant | \$ 939,752 |
| Public Assistance Grant | 15,267 |
| Edward Byrne Memorial | 552 |
| Homeland Security | 28,700 |
| Hazard Mitigation | <u>1,444</u> |
| Total | <u>\$ 985,715</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>\$ 28,998</u> |
| Total | <u>\$ 28,998</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2007, and interfund transfers during the fiscal year ended at June 30, 2007, are summarized as follows:

a. Due from/to other fund:

| <u>Receivable Fund</u> | <u>Payable Fund</u> | <u>Purpose</u> | <u>Amount</u> |
|------------------------|---|---|---------------------|
| General Fund | Special Revenue Fund - Local and State Grants | Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures | \$ 352,732 |
| General Fund | Special Revenue Fund - Head Start | Payroll and related accruals paid and not reimbursed. | 244,047 |
| General Fund | Special Revenue Fund - Other Federal Grants | Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures | 944,230 |
| General Fund | Capital Project Fund - Local, State and Federal Grants | Reimbursable expenditures | 186,124 |
| General Fund | Debt Service Fund | Interest Revenue | 30,790 |
| General Fund | Other Governmental Funds | Payroll and related accruals paid and not reimbursed | <u>12,614</u> |
| Total | | | <u>\$ 1,770,537</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 | \$ 521,431 |
| General Fund | Special Revenue Fund - Local and State Grants | Public works | <u>2,120,000</u> |
| Total | | | <u>\$ 2,641,431</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

5. CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2006, 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, 2006</u> | <u>Additions</u> | <u>Transfers</u> | <u>Balance</u> <u>June 30, 2007</u> |
|---|---------------------------------------|-----------------------|-----------------------|--|
| Capital asset, not being depreciated: | | | | |
| Land | \$ 659,123 | | | \$ 659,123 |
| Construction in progress | <u>3,294,236</u> | <u>\$ 3,299,823</u> | <u>\$ (3,294,236)</u> | <u>3,299,823</u> |
| Total capital assets not being depreciated | <u>\$ 3,953,359</u> | <u>\$ 3,299,823</u> | <u>\$ (3,294,236)</u> | <u>\$ 3,958,946</u> |
| Capital assets, being depreciated: | | | | |
| Buildings | \$ 8,664,541 | | \$ 2,118,970 | \$10,783,511 |
| Buildings improvements | | | | |
| Infrastructure | 7,556,885 | | 1,175,266 | 8,732,151 |
| Infrastructure improvements | 228,502 | | | 228,502 |
| Equipment | 1,352,127 | \$ 188,001 | | 1,540,128 |
| Furnishing | | | | |
| Computers | | | | |
| Vehicles | <u>3,952,826</u> | <u>891,774</u> | <u>-</u> | <u>4,844,600</u> |
| Total capital assets being depreciated | <u>\$ 21,754,880</u> | <u>\$ 1,079,775</u> | <u>\$ 3,294,236</u> | <u>\$ 26,128,892</u> |
| Less accumulated depreciation for: | | | | |
| Buildings | \$ (2,919,357) | \$ (327,905) | | \$ (3,247,262) |
| Buildings improvements | | | | |
| Infrastructure | (2,686,072) | (295,549) | | (2,981,621) |
| Infrastructure improvements | (116,944) | (10,268) | | (127,212) |
| Equipment | (1,109,828) | (104,078) | | (1,213,906) |
| Furnishing | | | | |
| Computers | | | | |
| Vehicles | <u>(2,976,855)</u> | <u>(286,430)</u> | <u>-</u> | <u>(3,261,285)</u> |
| Total accumulated depreciation | <u>\$ (9,809,056)</u> | <u>\$ (1,022,230)</u> | <u>\$ -</u> | <u>\$ (10,831,287)</u> |
| Total capital assets being depreciated, net | <u>\$ 11,945,824</u> | <u>\$ 57,545</u> | <u>\$ 3,294,236</u> | <u>\$ 15,297,605</u> |
| Governmental activities capital assets, net | <u>\$ 15,899,183</u> | <u>\$ 3,357,368</u> | <u>\$ -</u> | <u>\$ 19,256,551</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

| | |
|--|---------------------|
| General government | \$ 496,266 |
| Public safety | 34,682 |
| Public works | 295,066 |
| Culture and recreation | 159,189 |
| Education | 14,270 |
| Health and welfare | <u>22,757</u> |
| Total depreciation expense-governmental activities | <u>\$ 1,022,230</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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

6. PROPERTY TAXES (CONTINUED)

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 \$1,372,133 and \$579,165 related to Law 42 and Law 146, respectively at June 30, 2007.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007

6. PROPERTY TAXES (CONTINUED)

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

The annual tax rate is 8.33% 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> |
|--|------------------|
| Puerto Rico Aqueduct and Sewer Authority | \$ 47,876 |
| Internal Revenue Services | 13,965 |
| General Services Administration | <u>5,318</u> |
| Total | <u>\$ 67,159</u> |

8. DEFERRED REVENUES

A. Municipal License Tax- The deferred revenues of approximately \$3,954,932 in the general fund relates to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2007-08.

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 | \$ 7,004 |
| Total | <u>\$ 7,004</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

8. DEFERRED REVENUES (CONTINUED)

The deferred revenues presented in the capital project 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> |
|----------------------------|------------------|
| Rural Development | <u>\$ 33,361</u> |
| Total | <u>\$ 33,361</u> |

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> |
|---|---------------------|
| Emergency Management - State and Local Assistance | \$ 3,946 |
| Public Assistance Grant | 47,724 |
| Local Law Enforcement Block Grant | 2,661 |
| Others | 57,816 |
| Section 8 Housing Choice Voucher | 988,219 |
| Total | <u>\$ 1,100,366</u> |

9. LONG-TERM LIABILITIES

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

| <u>Description</u> | <u>Beginning Balance</u> | <u>Borrowings or Additions</u> | <u>Payments or Deductions</u> | <u>Ending Balance</u> | <u>Due Within One Year</u> |
|----------------------------|------------------------------|------------------------------------|-----------------------------------|---------------------------|--------------------------------|
| Bonds Payable | \$21,726,000 | | \$ (575,000) | \$21,151,000 | \$ 615,000 |
| Property Tax Debt | 2,380,880 | | (429,582) | 1,951,298 | 114,325 |
| Treasury Department-Claims | 111,223 | | (35,592) | 75,631 | 35,207 |
| Compensated Absences | 1,373,807 | 1,313,278 | (1,035,398) | 1,651,687 | 258,490 |
| Retirement Debt | | 154,595 | | 154,595 | 154,595 |
| Claims and judgments | - | - | - | - | - |
| Total | <u>\$25,591,910</u> | <u>\$1,467,873</u> | <u>\$(2,075,572)</u> | <u>\$24,984,211</u> | <u>\$1,177,616</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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

9. LONG-TERM LIABILITIES (CONTINUED)

the projected debt service requirement. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

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

| <u>Type of bonds</u> | <u>Maturity Date</u> | <u>Original Amount</u> | <u>Range of Interest Rates</u> | <u>Balance at June 30, 2007</u> |
|--------------------------------|----------------------|------------------------|--------------------------------|---------------------------------|
| 1999-Series | 7-1-2018 | \$ 2,630,000 | 5.00% to 7.81% | 2,055,000 |
| 2000-Series | 7-1-2026 | 1,760,000 | 5.00% to 7.00% | 1,350,000 |
| 2001-Series | 7-1-2010 | 1,300,000 | 5.00% to 8.00% | 1,110,000 |
| 2001-Series | 7-1-2017 | 1,070,000 | 5.00% to 8.00% | 845,000 |
| 2002-Series | 7-1-2026 | 135,000 | 5.00% to 7.00% | 110,000 |
| 2002-Series | 7-1-2021 | 475,000 | 5.00% to 7.00% | 410,000 |
| 2002-Series | 7-1-2026 | 1,965,000 | 5.00% to 7.00% | 1,785,000 |
| 2002-Series | 7-1-2026 | 2,085,000 | 5.00% to 7.00% | 1,845,000 |
| 2004-Series | 7-1-2027 | 1,115,000 | 5.00% to 6.50% | 1,035,000 |
| 2004-Series | 7-1-2014 | 1,195,000 | 5.00% | 1,000,000 |
| 2005-Series | 7-1-2030 | 1,730,000 | 5.00% | 1,695,000 |
| 2005-Series | 7-1-2030 | 3,021,000 | 5.00% | 3,011,000 |
| 2005-Series | 7-1-2030 | 3,685,000 | 5.00% | 3,535,000 |
| 2006-Series | 7-1-2030 | 1,390,000 | 6.25% to 7.25% | <u>1,365,000</u> |
| Total general obligation bonds | | | | <u>\$ 21,151,000</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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

9. LONG-TERM LIABILITIES (CONTINUED)

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

| <u>Year Ending June 30,</u> | <u>Principal</u> | <u>Interest</u> |
|---------------------------------|----------------------|----------------------|
| 2008 | \$ 620,000 | \$ 1,195,097 |
| 2009 | 655,000 | 1,194,945 |
| 2010 | 710,000 | 1,158,967 |
| 2011 | 750,000 | 1,115,165 |
| 2012 | 790,000 | 1,068,630 |
| 2013-2017 | 4,840,000 | 4,581,509 |
| 2018-2022 | 4,925,000 | 3,144,885 |
| 2023-2027 | 5,430,000 | 1,766,338 |
| 2028-2031 | <u>2,421,000</u> | <u>590,338</u> |
| Total | <u>\$ 21,151,000</u> | <u>\$ 15,815,874</u> |

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, 2007 as described in Note 6.
4. **Treasury Department Debt-** These amounts represent the balance owned to the Treasury Department at June 30, 2007, 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 \$1,055,202 of accrued sick leave benefits, and approximately \$596,485 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

10. PENSION PLAN (CONTINUED)

benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

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

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

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2007 amounted to approximately \$277,196 and \$310,694, 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),

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

10. PENSION PLAN (CONTINUED)

or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances.

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

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

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.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2007**

13. CONTINGENCIES (CONTINUED)

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, 2007**

| | <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 | \$ 3,432,078 | \$ 3,666,478 | \$ 3,914,830 | \$ 248,352 |
| Municipal license tax | 2,574,050 | 5,724,050 | 5,727,821 | 3,771 |
| Licenses, permits and other local taxes | 101,000 | 516,000 | 883,406 | 367,406 |
| Charges for service | 27,500 | 39,500 | 41,714 | 2,214 |
| Intergovernmental | 3,767,038 | 3,916,438 | 3,063,894 | (852,543) |
| Interest | 48,000 | 558,530 | 771,727 | 213,197 |
| Miscellaneous | 50,300 | 48,900 | 220,482 | 171,582 |
| Total revenues and other financing sources | 9,999,965 | 14,469,895 | 14,623,874 | 153,978 |
| EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES: | | | | |
| Current: | | | | |
| General government | 4,569,308 | 5,632,131 | 4,475,250 | 1,156,881 |
| Public safety | 2,772,111 | 3,993,540 | 3,733,845 | 259,695 |
| Public works | 730,686 | 947,055 | 924,909 | 22,146 |
| Health and welfare | 836,268 | 1,017,752 | 934,443 | 83,309 |
| Culture and recreation | 541,848 | 1,191,097 | 1,153,790 | 37,308 |
| Education | 85,894 | 166,880 | 166,797 | 83 |
| Operating transfer to other funds | 463,850 | 1,521,440 | 521,431 | 1,000,009 |
| Total expenditures, encumbrances and other financing uses | 9,999,965 | 14,469,895 | 11,910,465 | 2,559,430 |
| EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES) | - | - | \$ 2,713,409 | \$ 2,713,409 |
| Explanation of Differences: | | | | |
| Sources/Inflows of resources: | | | | |
| Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule | | | | \$ 14,623,874 |
| Differences-budget to GAAP: | | | | |
| No budgeted revenues | | | | 827,247 |
| Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances | | | | <u>\$15,451,121</u> |
| Uses/outflows of resources: | | | | |
| Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule | | | | \$11,910,465 |
| Differences-budget to GAAP: | | | | |
| GAAP adjustments to expenditures | | | | <u>3,351,856</u> |
| Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances | | | | <u>\$15,262,321</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
YEAR ENDED JUNE 30, 2007

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with 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, 2007 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2007.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2007

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u> |
|---|------------------------------------|---|-------------------------|
| U.S. DEPARTMENT OF AGRICULTURE: | | | |
| Pass-through the Commonwealth of Puerto Rico - Department of Education: | | | |
| Child and Adult Care Food Program | 10.558 | Not Available | \$ 381,434 |
| Total U.S. Department of Agriculture | | | <u>381,434</u> |
| U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT: | | | |
| Direct Program: | | | |
| Section 8 Housing Choice Vouchers | 14.871 | | 1,237,440 |
| Pass-through the Commonwealth of Puerto Rico - Office of the Commissioners of Municipal Affairs: | | | |
| Community Development Block Grant / Small Cities | 14.219 | 01-FD-51 02-AB-FC-51 03-AB-FC-51 04-AB-FC-51 05-AB-FC-51 | <u>1,064,149</u> |
| Total U.S. Department of Housing and Urban Development | | | <u>2,301,589</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2007

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u> |
|--|------------------------------------|---|----------------------------|
| U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES | | | |
| Pass-through the Commonwealth of Puerto Rico - Administration for Children and Families: | | | |
| Head Start Program | 93.600 | 02-CH-483-22 | <u>3,320,499</u> |
| Total U.S. Department of Health and Human Services | | | <u>3,320,499</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 | 2,935 |
| Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR): | | | |
| Public Assistance Grant | 83.544 | 1552-DRPR | 11,800 |
| National Incident Management System | 97.107 | Not Available | <u>28,700</u> |
| Total U.S. Department of Homeland Security | | | <u>43,435</u> |
| TOTAL EXPENDITURES OF FEDERAL AWARDS | | | <u>\$ 6,046,957</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, 2007

1. BASIS OF PRESENTATION:

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality of Peñuelas, Commonwealth of Puerto Rico (the Municipality) for the fiscal year ended June 30, 2007. The Municipality's reporting entity is disclosed in Note 1 to the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2007.

The accompanying schedule of expenditures of federal awards is presented on the modified accrual basis of accounting.

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality of Peñuelas, Commonwealth of Puerto Rico (the Municipality) for the fiscal year ended June 30, 2007. The Municipality's reporting entity is disclosed in Note 1 to the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2007.

The accompanying schedule of expenditures of federal awards is presented on the modified accrual basis of accounting.

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*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

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

To the Honorable Mayor and
Members of the Municipal Legislature
MUNICIPALITY OF PEÑUELAS, PUERTO RICO

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Peñuelas, Puerto Rico (the "Municipality") as of and for the fiscal year ended June 30, 2007, which collectively comprise Municipality of Peñuelas's basic financial statements and have issued our report thereon dated November 30, 2007. The report on governmental wide financial statement was adverse because 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. 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.

Internal Control Over Financial Reporting

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

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

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

deficiencies described in the accompanying schedule of finding and questioned costs to be significant deficiencies in internal control over report. See finding 07-01.

INDEPENDENT AUDITORS' REPORT

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider 07-01 to be material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial 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 instances of noncompliance or other matter that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 07-01.

We noted certain other matters that we reported to management of the Municipality in a separate letter dated December 30, 2007.

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

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

Mendoza & Ramos CPA's
MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
November 30, 2007

Stamp number 2283092 was
affixed to the original of this
report.



INDEPENDENT AUDITORS' 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
Members of the Municipal Legislature
MUNICIPALITY OF PEÑUELAS, PUERTO RICO

Compliance

We have audited the compliance of the Municipality of Peñuelas, Puerto Rico (the "Municipality") with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2007. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

As described item 07-03, 07-05 and 07-06 in the schedule of findings and questioned costs, the Municipality did not comply with requirements regarding Cash Management, Equipment and Real Property and Reporting that are applicable to its Community Development Block Grant Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

INDEPENDENT AUDITORS' REPORT

As described item 07-04 in the schedule of findings and questioned costs, the Municipality did not comply with requirements regarding Cash Management and Special Test that are applicable to its Section 8 Housing Choice Vouchers. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

As described item 07-02 in the schedule of findings and questioned costs, the Municipality did not comply with requirements regarding Allowance Costs that are applicable to its Head Start Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the Fiscal Year Ended June 30, 2007.

Internal Control Over Compliance

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

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

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of federal program that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of finding and questioned costs as items 07-03, 07-05 and 07-06 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by Municipality's internal control. We do not consider any of the deficiencies described in the accompanying schedule of finding and questioned costs to be material weaknesses.

INDEPENDENT AUDITORS' REPORT

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

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

Mendoza & Ramos CPAs
MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
January 18, 2008

Stamp number 2283093 was
affixed to the original of this
report.



FINDINGS AND QUESTIONED COST:

- **Schedule of Findings and Questioned Costs**
- **Summary Schedule of Prior Audit Findings**

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION I-FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Financial Statements

Type of auditors' report issued:

- Unqualified Opinion, except for adverse opinion for government-wide financial statement
 Qualified Opinion
 Adverse Opinion
 Disclaimer Opinion

Internal control over financial reporting:

- Material weakness (es) identified? Yes No
- Significant deficiencies identified that are not considered to be material weakness (es)? Yes None Reported
- Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

- Material weakness (es) identified? Yes No
- Significant deficiencies identified that are not considered to be material weakness (es)? Yes None Reported

Type of auditors' report issued on compliance for Major Programs:

- Unqualified Opinion
 Qualified Opinion
 Adverse Opinion
 Disclaimer

Any audit findings disclosed that are required to be reported in accordance with 510(a) OMB Circular A-133?

- Yes No

The Municipality's major programs were:

| CFDA Number | Name of Federal Program |
|-------------|-----------------------------------|
| 10.558 | Child and Adult Care Food Program |
| 14.219 | Community Development Block Grant |
| 14.871 | Section 8 Housing Choice Vouchers |
| 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

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION II – FINANCIAL STATEMENT FINDINGS

| | |
|---------------------|---|
| FINDING | 07-01 |
| CATEGORY | INTERNAL CONTROL |
| NONCOMPLIANCE | CAPITAL ASSETS |
| TOPIC SENTENCE | Fixed \ Capital Assets and Expenditures – Subsidiary Ledger. |
| 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 Statements No. 34 requires that all capital assets, including infrastructure, must be presented in the Statements of Net Assets and that these assets must be depreciated during its useful life. |
| CAUSE | Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets. |
| EFFECT | 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 | The Municipality's Finance Department staff in charge of the capital assets subsidiary ledger will update the capital assets records 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, 2008. |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|------------------|---|
| FINDING | 07-02 |
| FEDERAL PROGRAM | HEAD START (CFDA NO. 93.600) DEPARTMENT OF HEALTH AND HUMAN SERVICES |
| CATEGORY | COMPLIANCE |
| NONCOMPLIANCE | Allowable cost / Cost principles |
| TOPIC SENTENCE | Allowable costs / Cost principles requirements |
| 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, 2007, the program had paid the amount of \$203,340 (\$50,835 paid during the fiscal year 2006-2007) 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 | 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 of 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 | 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 |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING

07-02 (continuation)

MANAGEMENT RESPONSE 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.

On October 2006 we receive a public improvement funds approval of approximately \$490,000 for rehabilitation of leased building, but in a sealed bid (formal advertising) conducted by our Bid Board on January 2007, the lesser bidder offer was for approximately \$1,800,000.

Due to the fact that the approved funds were less than lesser bidder offer, the sealed bid was not awarded.

But actually, we are considering the alternative to purchase and rehabilitate the leased building with non-federal funds.

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|-----------------|--|
| FINDING | 07-03 |
| FEDERAL PROGRAM | COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.219) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS |
| CATEGORY | COMPLIANCE AND INTERNAL CONTROL |
| NONCOMPLIANCE | CASH MANAGEMENT |
| TOPIC SENTENCE | Non-compliance with the cash management requirement |
| CONDITION | <p>During the fiscal year 2006-2007, the Municipality received \$954,666.87 from the pass-through entity ("Municipality Affairs Commissioner Office - OCAM") regarding the State Community Development Block Grant Program ("CDBG").</p> <p>In order to determine compliance with the cash management requirement, we selected for testing three remittances of funds received from "OCAM" amounting \$622,433.39 (65%). In two cases, the time elapsed between the receipt and the disbursement of such funds was for more than nine days up to three months.</p> |
| CRITERIA | As stated in 24 CFR 85.21 and 31 CFR 205.33, Subpart B, grantees must minimize the time elapsing between the drawdown of Federal funds from the Federal government, or pass-through entity, and their disbursements for Federal program purposes. |
| CAUSE | Municipality's Finance Department and CDBG accounting department, divisions responsible for the disbursement of funds, do not count with the resources or a plan, to attain and process within a reasonable period of time, all monthly disbursements which are requested for the different Municipality's divisions or other federal programs. |
| EFFECT | If the recipient fails to expend those Federal assistance funds within a reasonable period, or fails to establish procedures to minimize the time elapsing between cash advances and the disbursements, the Municipality could be adversely affected in the benefits they are entitled to receive in the future. |
| RECOMMENDATION | According to priorities and monthly responsibilities, the Municipality's Finance Department and CDBG accounting department should implement a plan or a schedule to process and comply with all monthly disbursements within a reasonable period of time. |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 07-03 (continuation)

QUESTIONED COSTS None

MANAGEMENT RESPONSE To correct the condition reported by the external auditors, our Program accountant will plan with the Municipality's Finance Director to start the disbursement process when the requisitions of funds were submitted to the Office of the Commissioner of Municipal Affairs (OCAM) in order to assure that when the funds were transferred by the Pass-through Grantor we will disburse it in a reasonable lap of time.

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|-----------------|---|
| FINDING | 07-04 |
| FEDERAL PROGRAM | SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT |
| CATEGORY | COMPLIANCE |
| NONCOMPLIANCE | CASH MANAGEMENT |
| TOPIC SENTENCE | Non-compliance with the cash management requirement |
| | <p>CONDITION Section 8 Housing Choice Voucher Program does not have adequate controls over the timing of disbursements once the federal funds are received.</p> <p>During the fiscal year 2006-2007, the Municipality received \$1,226,870 from Section 8 Housing Choice Vouchers grant funds. In order to determine compliance with the applicable cash management requirements, we selected for testing four out of 12 remittances received during the fiscal year amounting \$357,207 (30%). The time elapsed between the receipt and the disbursement of such funds was from 15 days to over a month.</p> <p>We also noted that during the fiscal year 2006-2007, the Program maintained an average monthly bank account balance of approximately \$855,000. As of June 30, 2007, such balance amounted to \$963,441.</p> |
| CRITERIA | As stated in 24 CFR 85.21 and 31 CFR 205.33, Subpart B, grantees must minimize the time elapsing between the drawdown of Federal funds from the Federal government, or pass-through entity, and their disbursements for Federal program purposes. |
| CAUSE | Monthly deposits transferred by HUD are supported by an annual contribution contract based on an estimated number of occupied units and annual payments to owners. Due to the non identification of participants, the Program counts with a number of vouchers much higher than number of participants, the Program counts with a number of vouchers much higher than the number of participants which are benefited by Program. Such situation cause that, even when the Program counts with the necessary funds to provide housing assistance, these funds could not be expended due lack of units to be rented. |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|---------------------|--|
| FINDING | 07-04 (continuation) |
| EFFECT | If the recipient fails to expend those Federal assistance funds within a reasonable period, or fails to establish procedures to minimize the time elapsing between cash advances and the disbursements, the Municipality could be adversely affected in the benefits they are entitled to receive in the future. |
| RECOMMENDATION | The program should implement adequate internal control procedures which allow the promptly use of federal funds received. This could be attained through the identification of participants and dwelling units ready for occupancy once the vouchers are granted. |
| QUESTIONED COSTS | None |
| MANAGEMENT RESPONSE | To correct the condition reported by the external auditors, our Program accountant will plan with the Municipality's Finance Director in order to assure that when the funds were transferred by the US Treasury we will disburse its in a reasonable lap of time. Actually, we increased our occupancy level, and we are maintaining a continuous effort to maintain a high percentage of occupancy level. Also, the excessive HAP fund balance has been recaptured by HUD. |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|-----------------|--|
| FINDING | 07-05 |
| FEDERAL PROGRAM | COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.219) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS |
| CATEGORY | COMPLIANCE AND INTERNAL CONTROL |
| NONCOMPLIANCE | EQUIPMENT AND REAL PROPERTY MANAGEMENT |
| TOPIC SENTENCE | Non-compliance with the equipment and real property management requirement. |
| CONDITION | Federal Program Department does not have a property register that includes all the required information for purposes of accounting record, description and evaluation. |
| CRITERIA | <p>As stated in 24 CFR 85.32(d)(1), Subpart C, property records must be maintained and it shall include:</p> <ul style="list-style-type: none">• description of the property,• serial number or other identification number,• the source of property, percentage of Federal participation in the property,• the location,• use and condition of the property,• any ultimate disposition data including the date of disposal,• sale price of property, <p>Also, a physical inventory of the property must be taken and the result reconciled with the property records at least on every two years, respectively.</p> |
| CAUSE | The Municipality does not maintain the appropriate information on the real property records to assure that it is in accordance with the federal regulation. |
| EFFECT | Municipality is not in compliance with Subpart C, 24 CFR 85.32 (d)(1). |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|----------------------------|--|
| FINDING | 07-05 (continuation) |
| RECOMMENDATION | Municipality should revise and updated its property records according to the federal regulation. |
| QUESTIONED COSTS | None |
| MANAGEMENT RESPONSE | The Municipality's Finance Department staff in charge of the capital assets subsidiary ledger will update the capital assets records 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, 2008. |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|-----------------|---|
| FINDING | 07-06 |
| FEDERAL PROGRAM | COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.219) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS |
| CATEGORY | COMPLIANCE AND INTERNAL CONTROL |
| NONCOMPLIANCE | REPORTING |
| TOPIC SENTENCE | Financial Administration – Standard for Management System Reporting |
| CONDITION | During our audit, we noted that for the fiscal year ended on June 30, 2007, the Municipality did not record in its manual accounting records the transactions related to Community Development Block Grant ("CDBG"). Such condition did not permit us to trace the amounts included in the Financial Quarterly Reports. |
| CRITERIA | Code of Federal Regulation 24, Subpart I, Sec. 570489 (d)(1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirements 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 others 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 | 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. |
| EFFECT | The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d)(1) and with the Grant Agreement. |

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|---------------------|---|
| FINDING | 07-06 (continuation) |
| 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 | The Program accountant will be instructed to actualize the manual accounting records. Also, we are planning to use lower cost accounting software (Peachtree) exclusively for the Program transactions. |

END OF SCHEDULE

MUNICIPALITY OF PEÑUELAS, PUERTO RICO

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

(1) Audit Findings that have been Fully Corrected:

| Finding Number | CFDA | Questioned Cost | Comments |
|---|-------------|------------------------|-----------------|
| 06-05 Eligibility | 14.871 | None | Fully Corrected |
| 06-08 Reporting | 14.871 | None | Fully Corrected |
| 06-09 Special Test- Waitlist | 14.871 | None | Fully Corrected |
| 06-10 Special Test- Determination of HAP Amount | 14.871 | None | Fully Corrected |
| 06-11 Special Test- Utilities Allowances | 14.871 | None | Fully Corrected |
| 06-12 Special Test | 14.871 | None | Fully Corrected |
| 05-III-03 Reporting | 14.871 | None | Fully Corrected |
| 05-III-05 Reporting | 14.871 | None | Fully Corrected |
| 05-III-06 Special Test | 14.871 | None | Fully Corrected |

(2) Audit Findings not corrected or Partially Corrected:

| Finding Number | CFDA | Questioned Cost | Comments |
|--------------------------------|-------------|------------------------|--------------------------|
| 05-III-04 Cash Management | 14.871 | None | Situation still prevails |
| 05-III-07 Reporting | 14.228 | None | Situation still prevails |
| 05-III-08 Davis Bacon Act | 14.228 | None | Situation still prevails |
| 05-III-09 Property & Equipment | 14.228 | None | Situation still prevails |
| 05-III-11 Real Property | 93.600 | \$50,835 | Situation still prevails |

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

NONE

END OF SCHEDULE

Municipality of Peñuelas

Corrective Action Plan Single Audit 2006-2007

| Finding Reference Number | Responsible Employee | Corrective Action Planned | Expected Implementation Date |
|--------------------------|--|---|---|
| 07-01 | Mr. Arnaldo Rivera Aguirre Finance Department Director | The Municipality's Finance Department staff in charge of the capital assets subsidiary ledger will update the capital assets records 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, 2008. | 06/30/08 |
| 07-02 | Mrs. Wanda B. Jaime Head Start Program Director | <p>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.</p> <p>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.</p> <p>On October 2006 we receive a public improvement funds approval of approximately \$490,000 for rehabilitation of leased building, but in a sealed bid (formal advertising) conducted by our Bid Board on January 2007, the lesser bidder offer was for approximately \$1,800,000.</p> | Pending to more Public Improvement funds approval or identification of another source of funds. |

OFICINA DEL COMISIONADO
 DE ASUNTOS MUNICIPALES
 2007 APR -3 AM 11:30
 RECIBIDO
 UNIDAD DE CORREO

Municipality of Peñuelas

Corrective Action Plan Single Audit 2006-2007

| Finding Reference Number | Responsible Employee | Corrective Action Planned | Expected Implementation Date |
|--------------------------|---|--|------------------------------|
| | | <p>Due to the fact that the approved funds were less than lesser bidder offer, the sealed bid was not awarded.</p> <p>But actually, we are considering the alternative to purchase and rehabilitate the leased building with non-federal funds.</p> | |
| 07-03 | Mrs. Nancy E. Rivera Federal Programs Department Director | To correct the condition reported by the external auditors, our Program accountant will plan with the Municipality's Finance Director to start the disbursement process when the requisitions of funds were submitted to the Office of the Commissioner of Municipal Affairs (OCAM) in order to assure that when the funds were transferred by the Pass-through Grantor we will disburse it in a reasonable lap of time. | 04/30/08 |
| 07-04 | Mrs. Nancy E. Rivera Federal Programs Department Director | To correct the condition reported by the external auditors, our Program accountant will plan with the Municipality's Finance Director in order to assure that when the funds were transferred by the US Treasury we will disburse its in a reasonable lap of time. Actually, we increased our occupancy level, and we are maintaining a continuous effort to maintain a high percentage of occupancy level. Also, the excessive HAP fund balance has been recaptured by HUD. | 04/30/08 |
| 07-05 | Mrs. Nancy E. Rivera Federal Programs Department Director | The Municipality's Finance Department staff in charge of the capital assets subsidiary ledger will update the capital assets records 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 | 06/30/08 |

Municipality of Peñuelas

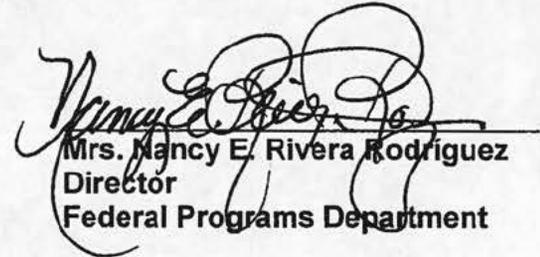
Corrective Action Plan
Single Audit 2006-2007

| Finding Reference Number | Responsible Employee | Corrective Action Planned | Expected Implementation Date |
|--------------------------|---|---|------------------------------|
| | | 30, 2008. | |
| 07-06 | Mrs. Nancy E. Rivera Federal Programs Department Director | The Program accountant will be instructed to actualize the manual accounting records. Also, we are planning to use lower cost accounting software (Peachtree) exclusively for the Program transactions. | 06/30/08 |

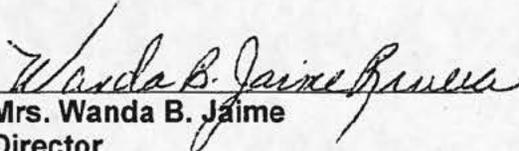
In compliance with the OMB Circular A-133, Subpart C—"Auditees", 300 "Auditee responsibilities", we prepared the corrective action plan described above on March 28, 2008 in accordance with 315(c).



Mr. Arnaldo Rivera Aguirre
Director
Finance Department



Mrs. Nancy E. Rivera Rodriguez
Director
Federal Programs Department



Mrs. Wanda B. Jaime
Director
Head Start Program



Hon. Walter Torres
Mayor
Municipality of Peñuelas