

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

MUNICIPIO DE RINCON
AUDITORIA 2005-2006
30 DE JUNIO DE 2006

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

FISCAL YEAR ENDED JUNE 30, 2006



*Mr. Carlos López-Bonilla
Mayor*

*Mr. Francisco Mercado, CPA
Municipal Administrator*

*Mrs. Nilsa Boto
Finance Director*

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

TABLE OF CONTENTS

| | <u>Page</u> |
|---|-------------|
| <u>FINANCIAL SECTION</u> | |
| Independent Auditor's Report | 1-2 |
| Management Discussion and Analysis | 3-14 |
| Basic Financial Statements: | |
| Government-wide Financial Statements: | |
| Statement of Net Assets | 15 |
| Statement of Activities | 16 |
| Fund Financial Statements: | |
| Balance Sheet Governmental Funds | 17-18 |
| Statement of Revenues, Expenditures and Changes in Funds | |
| Balances - Governmental Funds | 19-20 |
| Notes to the Basic Financial Statements | 21-48 |
| Required Supplementary Information: | |
| Budgetary Comparison Schedule - General Fund | 49 |
| Notes to Budgetary Comparison Schedule | 50-51 |
| Supplementary Information: | |
| Financial Data Schedule | 52-53 |
| Notes to Supplementary Information – Financial Data Schedule | 54 |
| <u>SINGLE AUDIT SECTION</u> | |
| Supplemental Information: | |
| Schedule of Expenditures of Federal Awards | 55 |
| Notes to Schedule of Expenditures of Federal Awards | 56 |
| Report on Internal control Over financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards | 57-58 |
| Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 | 59-60 |
| Schedule of Findings and Questioned Costs | 61-64 |
| Summary Schedule of Prior Audit Findings | 65-73 |
| Findings and Corrective Actions | 74 |

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INDEPENDENT AUDITORS' REPORT

*Mayor and Municipal Legislature
Municipality of Rincon
Rincon, Puerto Rico*

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Rincon, Puerto Rico, (the Municipality) as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Rincon, Puerto Rico as of June 30, 2006, 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.

In addition, in our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the General Fund, Commonwealth Legislative Resolutions Fund, Debt Service Fund, Community Development Grant Fund, Rural Development Corporation-Marine Facilities Fund and the aggregate remaining fund information of the Municipality of Rincon Puerto Rico as of June 30, 2006, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2006 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management Discussion and Analysis on pages 3 through 14 and the Budgetary Comparison Schedule – General Fund on page 49 are not required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Valdes, Garcia, Main & Montenegro CP

San Juan, Puerto Rico
December 21, 2006

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to the original.

MANAGEMENT DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

We will provide an overview of the Municipality's financial activities for the fiscal year ended June 30, 2006 through our discussion and analysis of the financial performance of the Municipality of Rincón. Please read it in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

The government-wide financial statements report information about the Municipality as a whole using the economic resources measurement focus and accrual basis of accounting:

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2006 by \$22,260,924 (net assets).
- Revenues decreased by 19% and expenses decreased 1% when compared with year 2005.
- Net change in net assets amounted to \$1,044,130, a decrease of 72% with respect to prior year net change.

Highlights for Fund Financial Statements

Detailed information about the Municipality's most significant funds is found in the fund financial statements, which use the current financial resources measurement focus and modified accrual basis of accounting:

- At the June 30, 2006, a negative net change in the fund balances of the Municipality's governmental funds for the amount of \$726,248 resulted in a reported combined ending fund balances of \$3,991,283. Approximately a negative 22% of the total combined fund balances is unreserved.
- The General Fund reported a deficiency of revenues and other financing sources over expenditures and other financing uses of \$184,457 and a negative unreserved fund balance (deficit) of \$853,237. Unreserved fund deficit increased 30% from prior year.

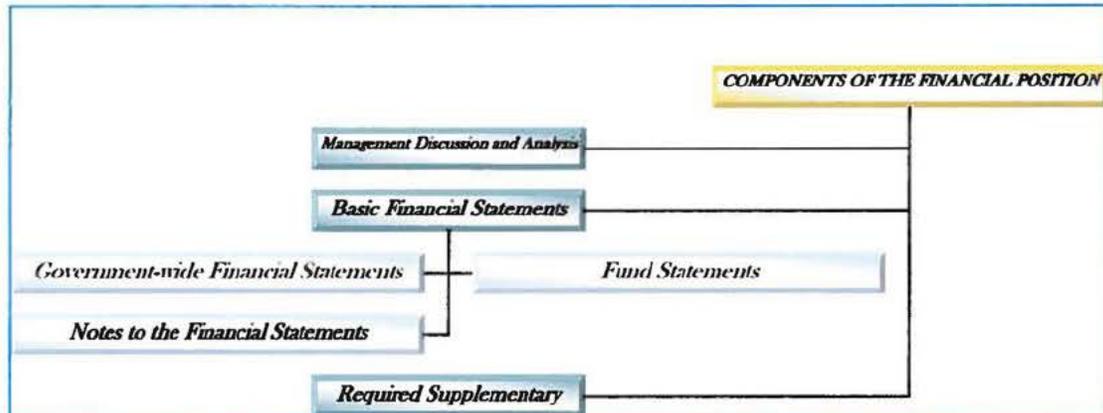
General Financial Highlights

- The investment in capital assets as of June 30, 2006 was \$23,747,984 (net of depreciation).
- Long term debt increased to \$7,192,993, approximately 9% with respect to prior year.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$64,560.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise three components: (1) management discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information.



The Municipality's basic financial statements consist of two kinds of statements, each with a different view of the Municipality's finances. The government-wide financial statements provide both long-term and short-term information about the Municipality's overall financial status. The fund financial statements focus on major aspects of the Municipality's operations, reporting those operations in more detail than the government-wide statements:

Basic Financial Statements

- **Government-Wide Financial Statements**

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the statement of net assets – presents information on all of the Municipality's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the Municipality's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's capital assets may need to be considered to assess the overall health of the Municipality. The second statement – the statement of activities – presents information showing how the net assets changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

The government-wide statements reports as governmental activities the municipality's basic services such as public works and sanitation; public safety, culture and recreation, housing, welfare, and community development; education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

- ***Fund Financial Statements***

The fund financial statements provide more detailed information about the Municipality's most significant funds. Funds are accounting devices that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well by bond covenants.

The Municipality's basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach the financial statements focus on near-term inflows and outflows of external resources, as well on balances of expendable resources available at year end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

The governmental fund statements focus on major funds. The Municipality's major funds are the general fund (which accounts for the main operating activities of the Municipality) and funds that complies with a minimum criterion (percentage of the assets, liabilities, revenues or expenditures). Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

- ***Notes to the financial statements***

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required supplementary information

The statements and notes are followed by the required supplementary information that contains the budgetary comparison schedule for the General Fund.

Supplementary information

The supplementary information also includes a financial data schedule containing financial information of the Section 8 Housing Choice Voucher Program administered by the Municipality.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

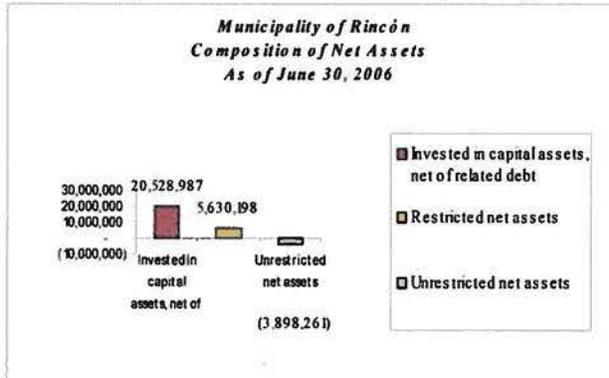
Net Assets

The following table presents a summary of the Statements of Net Assets as of June 30, 2006 and 2005:

TABLE 1

| <i>Summary Statement of Net Assets As of June 30,</i> | | |
|---|--------------------------------|---------------------------|
| | Governmental Activities | |
| | 2006 | 2005 (as restated) |
| Assets | | |
| Current and other assets | \$ 8,223,152 | \$ 8,876,927 |
| Capital assets | 23,747,984 | 21,829,898 |
| Total assets | \$ 31,971,136 | \$ 30,706,825 |
| Liabilities | | |
| Current and other liabilities | \$ 2,517,219 | \$ 2,844,087 |
| Long term liabilities | 7,192,993 | 6,645,944 |
| Total liabilities | 9,710,212 | 9,490,031 |
| Net assets | | |
| Invested in capital assets, net of related debt | 20,528,987 | 19,306,574 |
| Restricted | 5,630,198 | 5,794,524 |
| Unrestricted (deficit) | (3,898,261) | (3,884,304) |
| Total net assets | \$ 22,260,924 | \$ 21,216,794 |

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. At the close of the fiscal year, the assets of the Municipality exceeded its liabilities by \$22,260,924 representing an increase of 6% with respect to year 2005.



The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure); less accumulated depreciation and less any related outstanding debt used to acquire those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

Restricted net assets represent resources that are subject to external restrictions on how they may be used. Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements. As of June 30 2006, the Municipality presented an unrestricted net assets deficit. This deficit primarily arise from long term obligations such as compensated absences and debts to CRIM for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as invested in capital assets, net of related debt section of net assets. Therefore, are reported as part of the unrestricted net assets section.

Changes in net assets

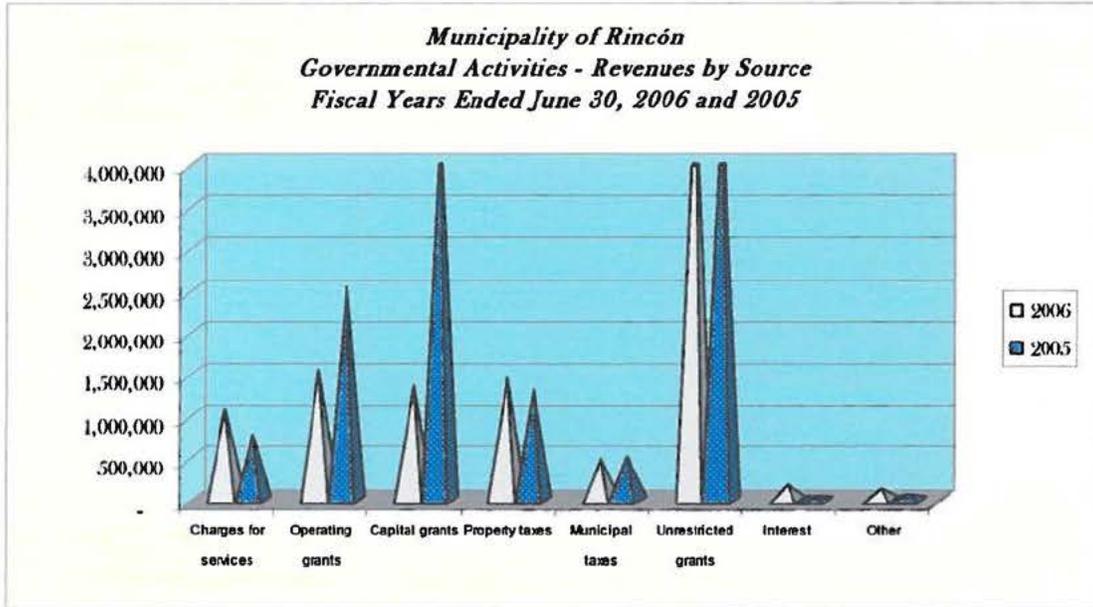
The following table summarizes the changes in net assets for the fiscal years ended 2006 and 2005:

TABLE 2

| <i>Summary of Changes in Net Assets As of June 30,</i> | | |
|--|--------------------------------|---------------------------|
| | Governmental Activities | |
| | 2006 | 2005 (as restated) |
| Program revenues: | | |
| Fees, fines and charges for services | \$ 1,069,448 | \$ 767,728 |
| Operating grants and contributions | 1,542,281 | 2,538,971 |
| Capital grants and contributions | 1,360,459 | 4,313,384 |
| General revenues: | | |
| Property taxes | 1,460,116 | 1,306,671 |
| Municipal license taxes | 481,405 | 512,507 |
| Grants and contributions not restricted to specific programs | 5,176,112 | 4,677,753 |
| Interest | 184,445 | 23,063 |
| Other | 130,744 | 62,278 |
| Total revenues | 11,405,010 | 14,202,355 |
| Expenses: | | |
| General government | 4,582,042 | 4,548,749 |
| Public works and sanitation | 2,664,145 | 2,634,919 |
| Public safety | 878,631 | 944,774 |
| Culture and recreation | 527,958 | 528,720 |
| Health | 320,367 | 320,367 |
| Housing, welfare and community development | 1,139,053 | 1,266,840 |
| Education | 17,589 | 3,881 |
| Interest on long term debt | 231,095 | 212,059 |
| Total expenses | 10,360,880 | 10,460,309 |
| Special items: | | |
| | - | 71,562 |
| Change in net assets | 1,044,130 | 3,813,608 |
| Net assets-beginning of year | 21,216,794 | 17,403,186 |
| Net assets-end of year | \$ 22,260,924 | \$ 21,216,794 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

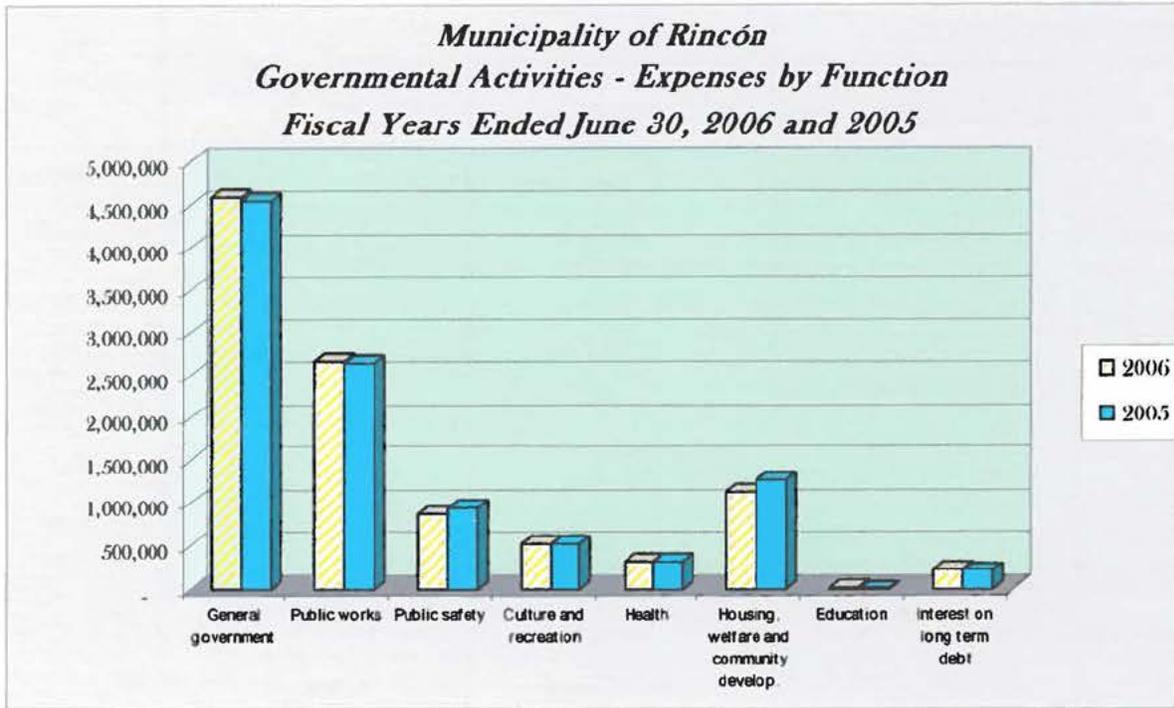
FIGURE 1



Approximately 25% of Municipality's revenues came from operating and capital grants, 45% of came from grants and contributions not restricted to specific programs and 12% from property taxes. Revenues decreased by 19% in comparison with year 2005. The most significant change is a 68% decrease in capital grants, due to assignments by the Commonwealth and Federal governments in previous year and a 40% decrease in operating grants, due to assignments by the Federal government also in prior year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

FIGURE 2



The Municipality's expenses cover a range of services. The largest expenses are general government representing approximately 45%, public works and sanitation with 26% and welfare with 11%. Program revenues of the Municipality covered 40% of total expenses.

Total expenses decreased 1% in comparison with previous year. This includes a decrease in welfare and community development of 10%, due to prior year additional welfare expenses related to donations and others financed with external grants such as FEMA and CDBG; and a 7% decrease in public works and sanitation, due to less salary expenses for non regular employees.

As noted previously the significant decrease in revenues combined with a decrease in expenses caused the net change in net assets to decrease approximately 70% compared with net change in net assets reported in 2005 statement of activities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

The following table focuses on the cost of each of the Municipality's largest programs as well as each program's net cost (total cost less fees generated by the programs and program –specific intergovernmental aid):

TABLE 3

| <i>Net Cost of Municipality's Governmental Activities Fiscal years ended June 30,</i> | | | | |
|---|-------------------------------|----------------------|-----------------------------|-----------------------|
| Functions/Programs | Total Cost of Services | | Net Cost of Services | |
| | 2006 | 2005 | 2006 | 2005 |
| General government | \$ 4,582,042 | \$ 4,548,754 | \$ (2,459,468) | \$ (2,520,686) |
| Public works and sanitation | 2,664,145 | 2,634,913 | (1,337,539) | 1,257,460 |
| Public safety | 878,631 | 944,773 | (744,421) | (816,555) |
| Culture and recreation | 527,958 | 528,720 | (495,458) | (427,614) |
| Housing, welfare and community development | 1,139,053 | 1,266,841 | (782,755) | 203,479 |
| Other | 569,051 | 536,305 | (569,051) | (536,305) |
| | <u>\$ 10,360,880</u> | <u>\$ 10,460,306</u> | <u>\$ (6,388,692)</u> | <u>\$ (2,840,222)</u> |

Some of the cost of governmental activities was paid by those who directly benefited from the programs (\$1,069,448) and other governments and organizations that subsidized certain programs with grants and contributions (\$2,902,740). The \$6,388,692 net cost of services was fully covered by other general revenues including property and municipal license taxes.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2006, the governmental funds reported combined ending fund balances of \$3,991,283, a net decrease of \$726,248 in comparison with the prior year. This decrease was caused primarily by a net reduction in the general fund of (\$184,457); (\$94,697) in the debt service fund; (\$256,847) in the Commonwealth Legislative Resolutions Fund and an increase of \$48,530 in the other governmental funds. Of total combined fund balances, \$(428,485) (-11%) constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents approximately -11% of total combined ending fund balances. For the year ended June 30, 2006, the fund balance of the general fund decreased by a net change of (\$184,457) when compared with the prior year. Of this net change an increase of \$45,471 pertains to other special funds (with self imposed restrictions) included as part of the general fund. Resources to finance these special funds were provided in current and previous years but funds were expended in current year.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2005-2006 presented an increase of 7% with respect to prior year budget. Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year budget revenues were increased by \$158,009 due to additional collections of construction permits and interests. Budget expenditures were increased by \$14,465. Actual revenues exceeded revised budgeted revenues by \$187,043 (net). The most significant variances were in intergovernmental revenues, \$149,806, and property taxes, \$24,291, due to additional collections of intergovernmental subsidies and property taxes respectively. The Municipality reported a net negative variance of \$122,483 between revised budgeted appropriations and actual expenditures due to excess electricity expenditures of \$188,854 (reported in general government function) but ended with a total net positive variance of \$64,560.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$23,747,984 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of approximately 8% over the prior year.

TABLE 4

| <i>Capital Assets, net As of June 30,</i> | | |
|---|--------------------------------|---------------------------|
| | Governmental Activities | |
| | 2006 | 2005 (as restated) |
| Non-depreciable assets: | | |
| Land | \$ 3,463,903 | \$ 3,103,903 |
| Construction in progress | 5,620,418 | 4,431,227 |
| Depreciable assets: | | |
| Land improvements | - | - |
| Buildings and buildings improvements | 8,972,234 | 9,045,909 |
| Infrastructure | 3,143,912 | 3,072,822 |
| Vehicles, machinery and equipment | 2,547,517 | 2,176,037 |
| Total | \$ 23,747,984 | \$ 21,829,898 |

The Municipality's major capital projects that were still in construction as of June 30, 2006 are as follows:

- Improvements to new City Hall - \$3,641,355
- Barrero Sanitary Sewer System - \$1,489,225
- Improvements to the Market Place - \$65,775
- Improvements to the Lighthouse - \$69,114
- Rio Grande Residential development - \$218,061

The Municipality acquired a total of \$816,149 on equipment during the fiscal year 2005-2006, including motor vehicles for a combined amount of \$389,363 and machinery and heavy equipment for \$379,073.

The Municipality's fiscal year 2006-2007 consolidated capital budget calls for a significant amount of projects including improvements to the market place "Ventana al Mar" (\$1,600,000); the construction of the "Ojo de Agua" Public Parking (\$452,514); the construction of "Plaza de la Amistad" (\$781,333); the improvements to the urban infrastructure of the Municipality (\$325,035); the improvements to the Lighthouse Recreational area" (Phase I \$900,000); and the acquisition for future development of Marine Facilities (\$1,800,000). These projects will be financed through Federal and Commonwealth grants, funds from the Commonwealth Legislature, general obligation bonds and Municipal funds. More detailed information about the Municipality's capital assets is presented in Note E to the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

Long term debt

At year-end, the Municipality had \$ 4,814,000 in general and special bonds and notes, an increase of 7% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2006 and 2005:

TABLE 5

| <i>Outstanding Long-term Debt Fiscal years ended June 30,</i> | | |
|---|--------------------------------|---------------------|
| | Governmental Activities | |
| | 2006 | 2005 |
| General and special obligation bonds and notes | \$ 4,814,000 | \$ 4,521,000 |
| Note payable to CRIM – Law No. 42 | 451,214 | 458,096 |
| Note payable to CRIM – LIMS | 107,278 | 123,332 |
| Note payable to CRIM – financing of delinquent accounts | 76,714 | 82,153 |
| Line of credit – GDB | 400,121 | 179,682 |
| Payable to CRIM – final settlements of 2003-2004 and 2005-2005 fiscal years | 28,574 | 117,094 |
| PR Department of Treasury - prior years property taxes | 31,719 | 41,734 |
| Compensated absences | 1,001,768 | 913,978 |
| Christmas bonus payable | 183,667 | 181,764 |
| Judgments and claims | 97,939 | 27,111 |
| Total | \$ 7,192,994 | \$ 6,645,944 |

The Municipality reported an increase in the other long term debts of \$254,048. This decrease was primarily due to the increase in the line of credit balance with the GDB. The other significant decrease in the other long term debts results from the net effect of the payment of the 2003-2004 final settlement debt with the CRIM, and an increase of the judgment and claims debt balance in current year. More detailed information about the Municipality's long term liabilities is presented in Note F of the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's officials considered certain factors when setting the fiscal year 2006-2007 budget. One of these factors is the economy. Among economic areas considered are the estimates for the growth in population, personal income, housing statistics and unemployment rates. Another important factor is the implementation of a sales tax effective October 15, 2006, which should provide additional funding to finance Municipal operations. The Municipality's unemployment rate now stands at 11.8%, which compares with the Commonwealth rate of 10.9%.

For year 2006-2007 the Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2007 are \$7,335,000 representing an increase of approximately 1.10% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase modestly by the close of 2007 fiscal year. In addition to the general fund estimated budget the Municipality plans to submit to the Federal and Commonwealth government fund proposals for welfare and community development as well as permanent capital improvements and public works. The construction industry has been one of the major sources of income generated by the Municipality, contributing with construction permits fees from housing projects.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability for the money it receives. If you have any questions about this report or need any additional information contact the Finance Department at the Municipality of Rincon, PO Box 97, Rincón, P.R. 00677.

BASIC FINANCIAL STATEMENTS

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

| ASSETS | <u>Governmental Activities</u> |
|---|---|
| Cash and cash equivalents | \$ 396,727 |
| Receivables, net | |
| Municipal license taxes | 305 |
| Others | 2,888 |
| Due from (note C): | |
| Commonwealth Government | 1,194,834 |
| Federal Government | 639,226 |
| Restricted assets: | |
| Cash and cash equivalents | 4,851,721 |
| Cash with fiscal agent | 830,359 |
| Deferred bond issuance costs | 24,009 |
| Other Assets | 283,083 |
| Capital Assets (note E): | |
| Land and construction in progress | 9,084,321 |
| Other capital assets, net | 14,663,663 |
| Total capital assets, net | <u>23,747,984</u> |
| Total assets | <u><u>\$ 31,971,136</u></u> |
| LIABILITIES | |
| Accounts payable and accrued liabilities | \$ 983,561 |
| Interest payable | 107,833 |
| Due to: | |
| Commonwealth Government (note C) | 86,076 |
| Federal Government | 7,247 |
| Deferred revenues: | |
| Municipal License taxes | 450,640 |
| Intergovernmental-Commonwealth agencies | 640,500 |
| Federal grants | 241,362 |
| Long term liabilities (note F): | |
| Due within one year | 1,236,845 |
| Due in more than one year | 5,956,148 |
| Total liabilities | <u>9,710,212</u> |
| NET ASSETS | |
| Invested in capital assets, net of related debt | 20,528,987 |
| Restricted for: | |
| Debt service | 641,031 |
| Capital Projects | 4,103,996 |
| Other specified purposes | 885,171 |
| Unrestricted (deficit) | (3,898,261) |
| Total net assets | <u><u>\$ 22,260,924</u></u> |

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2006**

| <u>Functions</u> | <u>Program Revenues</u> | | | <u>Net (expense) revenue and changes in net assets</u> | |
|-----------------------------------|-------------------------|---|---|--|---|
| | <u>Expenses</u> | <u>Fees, Fines and Charges for Services</u> | <u>Operating Grants and Contributions</u> | | <u>Capital Grants and Contributions</u> |
| Governmental Activities: | | | | | |
| General government | \$ 4,582,042 | \$ 1,036,948 | \$ 708,812 | \$ 376,814 | \$ (2,459,468) |
| Public works and sanitation | 2,664,145 | - | 369,054 | 957,552 | (1,337,539) |
| Public safety | 878,631 | - | 134,210 | - | (744,421) |
| Culture and recreation | 527,958 | 32,500 | - | - | (495,458) |
| Health | 320,367 | - | - | - | (320,367) |
| Welfare and community development | 1,139,053 | - | 330,205 | 26,093 | (782,755) |
| Education | 17,589 | - | - | - | (17,589) |
| Interest on long term debt | 231,095 | - | - | - | (231,095) |
| Total | <u>\$ 10,360,880</u> | <u>\$ 1,069,448</u> | <u>\$ 1,542,281</u> | <u>\$ 1,360,459</u> | <u>(6,388,692)</u> |

General revenues :

| | |
|--|------------------|
| Taxes | |
| Property taxes | 1,460,116 |
| Municipal license taxes | 481,405 |
| Grants contributions not restricted to specific programs | 5,176,112 |
| Interest | 184,445 |
| Other | 130,744 |
| Total general revenues: | <u>7,432,822</u> |

| | |
|---|----------------------|
| Change in net assets | 1,044,130 |
| Net assets-beginning, as restated (note K) | 21,216,794 |
| Net assets-ending | <u>\$ 22,260,924</u> |

The accompanying notes are an integral part of this statement.

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

| | General Fund | Commonwealth Legislative Resolutions | Debt Service | Community Development Block Grant Program | Rural Development Corporation-Marine Facilities | Other Governmental Funds | Total Governmental Funds |
|--|---------------------|--|-------------------|--|---|--------------------------------|--------------------------------|
| Assets | | | | | | | |
| Cash and cash equivalents | \$ 396,727 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 396,727 |
| Receivables, net | | | | | | | |
| License taxes | 305 | - | - | - | - | - | 305 |
| Other | 1,350 | - | 1,538 | - | - | - | 2,888 |
| Due from: | | | | | | | |
| Commonwealth Government | 234,712 | - | 102,954 | - | - | 857,168 | 1,194,834 |
| Federal Government | - | - | - | 372,705 | - | 266,521 | 639,226 |
| Other funds | 677,671 | - | - | - | - | - | 677,671 |
| Advances to other funds | - | 694,758 | - | - | - | 5,010 | 699,768 |
| Restricted assets: | | | | | | | |
| Cash and cash equivalents | 18,118 | 3,334,775 | - | - | 640,000 | 858,828 | 4,851,721 |
| Cash with fiscal agent | 8,999 | - | 648,250 | - | - | 173,110 | 830,359 |
| Total assets | \$ 1,337,882 | \$ 4,029,533 | \$ 752,742 | \$ 372,705 | \$ 640,000 | \$ 2,160,637 | \$ 9,293,499 |
| Liabilities and Fund Balances | | | | | | | |
| Liabilities | | | | | | | |
| Accounts payable and accrued liabilities | \$ 315,671 | \$ 46,317 | \$ - | \$ 148,665 | \$ - | \$ 472,908 | \$ 983,561 |
| Matured bonds and interest payable | - | - | 486,398 | - | - | - | 486,398 |
| Due to: | | | | | | | |
| Commonwealth Government | 86,076 | - | - | - | - | - | 86,076 |
| Federal Government | - | - | - | - | - | 7,247 | 7,247 |
| Other funds | - | - | 4,410 | 224,040 | - | 449,221 | 677,671 |
| Advances from other funds | 699,768 | - | - | - | - | - | 699,768 |
| Deferred revenues (note G): | | | | | | | |
| Municipal License taxes | 450,640 | - | - | - | - | - | 450,640 |
| Intergovernmental-Commonwealth Government | 214,212 | - | 86,040 | - | 640,000 | 306,421 | 1,246,673 |
| Federal grants | - | - | - | 238,777 | - | 425,405 | 664,182 |
| Total liabilities | 1,766,367 | 46,317 | 576,848 | 611,482 | 640,000 | 1,661,202 | 5,302,216 |
| Fund Balances | | | | | | | |
| Reserved for: | | | | | | | |
| Encumbrances | 32,266 | - | - | - | - | - | 32,266 |
| Debt Service | - | - | 175,894 | - | - | - | 175,894 |
| Capital projects (note P) | - | 3,288,458 | - | (238,777) | - | 484,646 | 3,534,327 |
| Other specified purposes (note P) | 392,486 | - | - | - | - | 14,789 | 407,275 |
| Advances | - | 694,758 | - | - | - | - | 694,758 |
| Unreserved | (853,237) | - | - | - | - | - | (853,237) |
| Total fund balances | (428,485) | 3,983,216 | 175,894 | (238,777) | - | 499,435 | 3,991,283 |
| Total liabilities and fund balances | \$ 1,337,882 | \$ 4,029,533 | \$ 752,742 | \$ 372,705 | \$ 640,000 | \$ 2,160,637 | \$ 9,293,499 |

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2006**

| | | |
|---|-----------|--------------------------|
| Total fund balances- governmental funds | \$ | 3,991,283 |
| <p>Amounts reported for governmental activities in the statement of net assets are different because:</p> | | |
| <p>Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet:</p> | | 23,747,984 |
| <p>Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:</p> | | |
| Deferred charges - bond issuance costs | | 24,009 |
| Other assets | | 283,083 |
| <p>Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:</p> | | |
| Receivable - Christmas bonus reimbursement | | 91,833 |
| Receivable - CDBG | | 238,777 |
| Receivable - Rural Development | | 154,152 |
| Receivable- Rural Development Corporation | | 77,730 |
| Receivable- Commonwealth's capital improvement fund | | 51,300 |
| Receivable - Child Care | | 18,449 |
| Receivable - Commonwealth's capital improvement fund | | 51,154 |
| Receivable - Special Communities | | 8,624 |
| Receivable - Property taxes- General Fund | | 102,383 |
| Receivable - Property taxes- Debt Service Fund | | 86,040 |
| Receivable - Public Order Code | | 61,193 |
| Receivable - other Commonwealth Government grants | | 87,358 |
| <p>Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds:</p> | | (22,435) |
| <p>Long term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:</p> | | (6,791,993) |
| Net assets of governmental activities: | \$ | <u>22,260,924</u> |

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2006**

| | General Fund | Commonwealth Legislative Resolutions | Debt Service | Community Development Block Grant Program | Rural Development Corporation- Marine Facilities | Other Governmental Funds | Total Governmental Funds |
|--|---------------------|--|-------------------|--|--|--------------------------------|--------------------------------|
| Revenues: | | | | | | | |
| Taxes | | | | | | | |
| Property taxes (note H) | \$ 868,066 | \$ - | \$ 403,627 | \$ - | \$ - | \$ - | \$ 1,271,693 |
| Municipal license taxes (note I) | 481,405 | - | - | - | - | - | 481,405 |
| Intergovernmental: | | | | | | | |
| Commonwealth Government (note J) | 5,579,835 | 81,154 | - | - | 360,000 | 981,199 | 7,002,188 |
| Federal Government | - | - | - | 417,401 | - | 504,911 | 922,312 |
| Fees, fines and charges for services | 1,105,787 | - | - | - | - | - | 1,105,787 |
| Interest | 69,253 | 79,932 | 13,253 | 594 | - | 21,413 | 184,445 |
| Other | 57,237 | 976 | - | - | - | 72,531 | 130,744 |
| Total revenues | 8,161,583 | 162,062 | 416,880 | 417,995 | 360,000 | 1,580,054 | 11,098,574 |
| Expenditures: | | | | | | | |
| Current: | | | | | | | |
| General government | 4,355,267 | - | 4,410 | 159,773 | - | 72,866 | 4,592,316 |
| Public works and sanitation | 1,912,560 | 56,732 | - | 29,049 | - | 119,490 | 2,117,831 |
| Public Safety | 646,594 | - | - | - | - | 137,843 | 784,437 |
| Culture and recreation | 290,722 | - | - | - | - | 29,079 | 319,801 |
| Health | 320,367 | - | - | - | - | - | 320,367 |
| Welfare and community development | 288,591 | 69,430 | - | 201,652 | - | 540,151 | 1,099,824 |
| Education | 13,445 | - | - | - | - | - | 13,445 |
| Capital outlays | 163,610 | 292,747 | - | 266,298 | 360,000 | 1,693,173 | 2,775,828 |
| Debt Service | | | | | | | |
| Principal | - | - | 443,000 | - | - | - | 443,000 |
| Interest | - | - | 225,176 | - | - | - | 225,176 |
| Bond issuance costs | - | - | - | - | - | 4,238 | 4,238 |
| Total expenditures | 7,991,156 | 418,909 | 672,586 | 656,772 | 360,000 | 2,596,840 | 12,696,263 |
| Excess (deficiency) of revenues over expenditures | 170,427 | (256,847) | (255,706) | (238,777) | - | (1,016,786) | (1,597,689) |
| Other financing sources (uses): | | | | | | | |
| Proceeds from credit line | - | - | - | - | - | 483,175 | 483,175 |
| Proceeds from general obligation bonds | - | - | - | - | - | 645,000 | 645,000 |
| Payment of credit line | - | - | - | - | - | (256,734) | (256,734) |
| Transfers in | 61,118 | - | 169,852 | - | - | 247,410 | 478,380 |
| Transfers out | (416,002) | - | (8,843) | - | - | (53,535) | (478,380) |
| Total other financing resources (uses) | (354,884) | - | 161,009 | - | - | 1,065,316 | 871,441 |
| Net change in fund balance | (184,457) | (256,847) | (94,697) | (238,777) | - | 48,530 | (726,248) |
| Fund balance at beginning of year | (244,028) | 4,240,063 | 270,591 | - | - | 450,905 | 4,717,531 |
| Fund balance at end of year | \$ (428,485) | \$ 3,983,216 | \$ 175,894 | \$ (238,777) | \$ - | \$ 499,435 | \$ 3,991,283 |

244,028
137,427
106,601

The accompanying notes are an integral part of this statement.

Original 12/05/2007
19

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

Net change in fund balances - total governmental funds: \$ (726,248)

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

Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:

| | | |
|---------------------------------|------------------|-----------|
| Expenditures for capital assets | \$ 2,775,828 | |
| Less: current year depreciation | <u>(841,109)</u> | 1,934,719 |

Governmental funds report the effect of bond issuance costs as expenditure when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This amount is the net effect of these differences:

| | | |
|-------------------------------------|-------------------|-----|
| Bond issuance costs | 4,238.00 | |
| Amortization of bond issuance costs | <u>(3,418.00)</u> | 820 |

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset:

(16,634)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

| | | |
|---|---------------|---------|
| Christmas bonus reimbursement | \$ 91,833 | |
| Rural Development | 77,730 | |
| Child Care | 18,449 | |
| Property Taxes-General Fund | 102,383 | |
| Property Taxes-Debt Service Fund | 86,040 | |
| Commonwealth's Capital Improvement Fund | 51,154 | |
| CDBG | 238,777 | |
| Public Order Code | 61,193 | |
| Special Communities | 8,624 | |
| Mitigation Plan (FEMA) | 11,442 | |
| Territorial Plan | 42,716 | |
| Others | <u>42,112</u> | 832,453 |

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

| | | |
|--|-----------------|-----------|
| Public Order Code | \$ (80,257) | |
| EDA | (94,720) | |
| Special Communities | (190,094) | |
| Mitigation Plan (FEMA) | (11,858) | |
| TANF | (58,205) | |
| Christmas bonus reimbursement-prior year | <u>(90,882)</u> | (526,016) |

Proceeds from notes payable and general obligation bonds are an other financing sources in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:

(1,128,175)

Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

| | | |
|---|--|--------|
| Matured bonds principal payments (net change) | | 91,000 |
|---|--|--------|

Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:

| | | |
|------------------------------------|----------------|---------|
| General obligation bonds and notes | \$ 352,000 | |
| Other long term liabilities | <u>640,269</u> | 992,269 |

Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:

| | | |
|-------------------------------|------------------|-----------|
| Compensated absences | \$ (129,538) | |
| Judgment and Claims | (97,939) | |
| Accrued interest (net change) | 1,085 | |
| Christmas bonus | <u>(183,666)</u> | (410,058) |

Change in net assets of governmental activities:

\$ 1,044,130

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Rincon was founded in 1770. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of twelve (12) members of the Municipal Legislature. The Municipality engages in comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

The financial statements of Municipality have been prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

1. Financial reporting entity

The financial reporting entity included in this report consists of the financial statements of the Municipality of Rincon (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. There are two methods of presentation of the component unit in the financial statements: (a) blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and (b) discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

The basic criteria for deciding financial accountability are any one of the following:

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit's governing body and,
 - 1) The primary government can impose its will on the potential component unit and/or,
 - 2) A financial benefit/ burden exist between the primary government and the potential component unit.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

In addition, a legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if all of the following criteria are met:

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

Other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Professional judgment is applied in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

Basis of presentation, measurement focus and basis of accounting

The financial report of the Municipality consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

Management Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Government-wide statements

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long lived) assets and receivables as well as long term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes are recognized as revenues in the year for which they are levied and municipal license taxes when the underlying exchange has occurred and time requirements are met. Revenues on both operating and capital grants are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues or expenditures or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users (for Debt Service and Community Development Block Grant Program Funds).

The Municipality reports the following major governmental funds:

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

Commonwealth Legislature Grants Fund: This fund accounts for revenue sources from grants provided by the Commonwealth's Legislature for specific purposes which include, among others, acquisition, development and improvements of capital assets.

Debt Service Fund: This fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Community Development Block Grant Program Fund (CDBG): CDBG fund is used to account for revenues sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

Rural Development Corporation- Marine Facilities Fund: This fund is used for acquisition of marine facilities to be used by Municipality's citizens.

Governmental funds are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method of accounting, revenues are recognized when they are susceptible to accrual (i.e. 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 Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period except for reimbursement-based (expenditure-driven) grants for which the availability period is 90 days.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Revenues susceptible to accrual include property taxes, recognized as revenues in the year for which they are levied, municipal license taxes, recognized when the underlying exchange has occurred and time requirements are met and interest. In applying the susceptible to accrual concept to intergovernmental revenues, revenues are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met and revenue becomes available. There are, however, essentially two types of these revenues. In the first case, on expenditure-driven grants, monies must be expended on the specific project or purpose (eligibility requirement), before any amounts are paid to the Municipality. Revenue is, therefore, recognized as expenditures are incurred to the extent available. In the other cases, monies are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. In these cases revenues are recognized as the time of receipt or earlier if the susceptible to accrual criteria is met. Licenses and permits, charges for services, rent, fines and miscellaneous revenues are generally recorded as revenues when received or are recognized earlier if the susceptible to accrual criteria is met.

The Municipality reports deferred revenues in the governmental funds statements which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met. (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred. Certain exceptions to this fundamental concept include the following: 1) payments of principal and interest on general long term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) 2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

Notes to Financial Statements

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Required Supplementary Information

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

2. Cash, cash equivalents (unrestricted and restricted) and restricted cash with fiscal agents

Cash and cash equivalents consists of cash on hand, demand deposits and short term investments with original maturities of three months or less from the date of acquisition. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. Cash and cash equivalents related to Commonwealth Legislature Resolutions is restricted since their use is limited as required by law.

Restricted cash with fiscal agent in the debt service fund consist of the undisbursed balance of property tax collections retained by the Commonwealth of Puerto Rico, which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash and cash equivalents of other governmental funds represent the undisbursed balance of bond anticipation notes held in custody of Rural Development.

3. Receivables and due from governmental entities

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property tax revenue of current fiscal year collected by the CRIM on the first month (July) of subsequent fiscal year.

4. Interfund receivables and payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due from/to 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 from/to other funds".

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

5. Inventories

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

6. Capital assets

Capital assets of the primary government, with include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items) are reported in the governmental activities in the Statements of Net Assets. Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The Municipality maintains a threshold level of \$1 or more for capitalizing vehicles, machinery and equipment. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

All capital assets, other than land, are depreciated using the straight-line method over the following useful lives:

| <u>Description</u> | <u>Years</u> |
|-------------------------------------|--------------|
| Land improvements | 20 |
| Buildings and building improvements | 20-50 |
| Infrastructure | 20-40 |
| Vehicles, machinery and equipment | 5-15 |

7. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities.

8. Deferred bond issuance costs

Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

9. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness).

The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

Pursuant to Law No. 152 of August 20, 1996 effective July 1, 1997 the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

10. Fund balances and Net Assets

In the fund financial statements, governmental funds report reserved and unreserved fund balances. Reservations of fund balance represent portions of the fund balance that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

- Encumbrances: Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.
- Debt Service: Represents net assets available to finance future debt service payments.
- Capital Projects: Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed.
- Other specified purposes: Represent amounts to be used for future expenditures of Federal and Commonwealth's grants as well as funds reserved through enabling legislation passed by the government itself, to be used to finance activities other than construction or capital improvement commitments
- Advances: Represent the non current portion of interfund loans.

In the government-wide statements net assets are segregated into three categories:

- Invested in capital assets, net of related debt: Consists of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.
- Restricted net assets: Represents net assets (restricted assets net of related debt) that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).
- Unrestricted net assets: Represent net assets that do not meet the definition of net assets Invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

11. Interfund transactions

The Municipality reports certain transactions as operating transfers, which are legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

12. Risk financing

The Puerto Rico Treasury Department (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of Rincon consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

13. Use of estimates

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

14. Future adoption of accounting pronouncements

The GASB has issued the following statements, which the Municipality has not yet adopted:

| Statement | To be Adopted in Fiscal year ended, |
|---|--|
| 43 Financial Reporting for Post employment Benefits Plans Other Than Pension Plans | June 30, 2008 |
| 45 Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions | June 30, 2009 |
| 48 Sales and Pledges of Receivables and Future Revenues and Intra-entity Transfers of Assets and Future Revenues | June 30, 2008 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

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

NOTE B- CUSTODIAL CREDIT RISK - DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Municipality maintains cash deposits in commercial and governmental banks located in Puerto Rico.

Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. At year end the Municipality's bank balance in commercial banks amounts to \$5,382,567.

Deposits in governmental banks, all of which are uninsured and uncollateralized, are exposed to custodial credit risk. At year end the Municipality's bank balance in governmental banks amounts to \$817,596.

NOTE C- DUE FROM (TO) GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2006 follows:

| | Commonwealth Government | Federal Government |
|--|----------------------------|-----------------------|
| Puerto Rico Department of Education | \$ 20,500 | \$ - |
| Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund) | 102,954 | - |
| Municipal Revenue Collection Center (CRIM)- current year liquidation (general fund) | 102,383 | - |
| Puerto Rico Department of Treasury – Christmas Bonus Reimbursement | 91,833 | - |
| Public Order Code | 61,193 | - |
| Puerto Rico Department of Labor – Law No.52 | 19,996 | - |
| Office of Elderly Affairs | 30,655 | - |
| Commonwealth of Puerto Rico's public improvements fund | 558,637 | - |
| Puerto Rico Department of Housing – Special Communities | 86,237 | - |
| Office of Commissioner of Municipal Affairs – Territorial Plan Elaboration | 42,716 | - |
| Rural Development Corporation | 77,730 | - |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE C- DUE FROM (TO) GOVERNMENTAL ENTITIES-Continued

| | Commonwealth Government | Federal Government |
|---|----------------------------|-----------------------|
| Rural Development | - | 154,152 |
| Office of Commissioner of Municipal Affairs - CDBG | - | 372,705 |
| Puerto Rico Department of Family – Temporary Assistance for Needy Families (TANF) | - | 21,171 |
| Puerto Rico Department of Family – Child Care | - | 46,441 |
| U.S. Department of Labor – WIA Youth Activities | - | 27,205 |
| U.S. Department of Homeland Security – Homeland Security Grant Program | - | 6,110 |
| Federal Emergency Management Agency – Hazard Mitigation Grant Program | - | 11,442 |
| | \$ 1,194,834 | \$ 639,226 |

2. Amounts due to governmental entities as of June 30, 2006 follows:

| | Commonwealth Government |
|--|----------------------------|
| Puerto Rico Retirement Plan Administration | \$ 32,929 |
| Puerto Rico General Services Administration | 8,022 |
| Puerto Rico Aqueduct and Sewer Authority (PRASA) | 45,125 |
| | \$ 86,076 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE D- INTERFUND TRANSACTIONS

1. Due from/to other funds

Amounts due from to other funds represent advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

| <u>Receivable Fund</u> | <u>Payable Funds</u> | <u>Amount</u> |
|------------------------|--|-------------------|
| General Fund | Major Fund - CDBG | \$ 224,040 |
| | Major Fund - CAE | 4,410 |
| | Other governmental funds – Special Communities | 77,614 |
| | Other governmental funds – Public Order Code | 89,333 |
| | Other governmental funds – Child Care | 41,945 |
| | Other governmental funds-TANF | 21,637 |
| | Other governmental funds- Housekeeping Assistance | 23,255 |
| | Other governmental funds-FEMA | 39,941 |
| | Other governmental funds-CDR | 72,965 |
| | Other governmental funds-Territorial Plan | 42,716 |
| | Other governmental funds-others | 39,815 |
| Total: | | <u>\$ 677,671</u> |

2. Advances to other funds

Advances to other funds includes \$694,758 advances by the Commonwealth Legislative Grants Fund and other governmental funds to the general fund for payment of payrolls, payroll taxes and other operational expenditures in previous periods not reimbursed as of fiscal year-end.

3. Operating transfers

Transfers between individual funds were made for operational purposes. Transfers includes interest earned on restricted cash with fiscal agents in the debt service fund and operating and capital improvement loans in other governmental funds which is transferred to the general fund; and principal and interest payments of general long term debt transferred from the general fund to the debt service fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE E- CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2006 is as follows:

| | Balance July 1, 2005, as restated | Increases | Decreases | Balance June 30, 2006 |
|--|---|---------------------|------------------|--------------------------|
| Governmental activities: | | | | |
| Capital assets, not being depreciated: | | | | |
| Land | \$ 3,103,903 | \$ 360,000 | \$ - | \$ 3,463,903 |
| Construction in progress | 4,432,993 | 1,187,425 | | 5,620,418 |
| Total capital assets not being depreciated: | 7,536,896 | 1,547,425 | - | 9,084,321 |
| Capital assets, being depreciated: | | | | |
| Buildings and building improvements | 11,754,678 | 146,150 | - | 11,900,828 |
| Infrastructure | 5,734,116 | 266,104 | - | 6,000,220 |
| Vehicles, machinery and equipment | 5,207,937 | 816,149 | 166,343 | 5,857,743 |
| Total capital assets being depreciated | 22,696,731 | 1,228,403 | 166,343 | 23,758,791 |
| Less accumulated depreciation for: | | | | |
| Buildings and building improvements | 2,708,769 | 219,825 | - | 2,928,594 |
| Infrastructure | 2,661,266 | 195,042 | - | 2,856,308 |
| Vehicles, machinery and equipment | 3,033,695 | 426,240 | 149,709 | 3,310,226 |
| Total accumulated depreciation | 8,403,730 | 841,107 | 149,709 | 9,095,128 |
| Total capital assets being depreciated, net | 14,293,001 | 387,296 | 16,634 | 14,663,663 |
| Governmental activities capital assets, net | \$ 21,829,897 | \$ 1,934,721 | \$ 16,634 | \$ 23,747,984 |

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

| | |
|--|-------------------|
| Governmental activities: | |
| General government | \$ 26,340 |
| Public works and sanitation | 507,487 |
| Public safety | 66,732 |
| Culture and recreation | 207,976 |
| Welfare and community development | 30,799 |
| Education | 1,773 |
| Total depreciation expense, governmental activities | \$ 841,107 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE E- CAPITAL ASSETS-Continued

On September 25, 2001 the US Department of Commerce, Economic Development Administration (EDA) approved a \$1,000,000 grant to the Municipality for the construction of a Waterfront Tourism Business Center Sunset Village in the Municipality. The receipt of such grant is conditioned upon compliance with terms and conditions of a grant agreement. As required by the grant agreement, for projects involving acquisition, construction, or improvement of a building, the Municipality should agree to declare and furnish to EDA, prior to initial award disbursement, a lien, covenant, or other statement, satisfactory to EDA in form and substance of EDA's interest in the property acquired or improved in whole or in part with funds made available under this award. On December 20, 2002 the Municipality signed a deed of a voluntary mortgage in the amount of \$1,000,000 in favor of EDA over a parcel of land on which the project is located. During a 20 year term, the Municipality shall not sell, lease, mortgage or otherwise use or alienate any right to, or interest in the grant property as prohibited by the grant agreement, or use that property for any other purposes than the purposes for which the project was financed by EDA unless prior approval of the Assistant Secretary of the Department is obtained. Upon violation of applicable restrictions, the total amount will become due and payable by the Municipality to EDA.

NOTE F- LONG TERM DEBT

1. Summary of long- term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2006:

| | Balance at July 1, 2005 | Increases | Decreases | Balance at June 30, 2006 | Due within one year |
|---|----------------------------|---------------------|-------------------|-----------------------------|------------------------|
| General, Special Obligation Bonds and Notes | \$ 4,521,000 | \$ 645,000 | \$ 352,000 | \$ 4,814,000 | \$ 445,000 |
| Note payable to CRIM-Law No. 42 | 458,096 | - | 6,882 | 451,214 | 7,314 |
| Note payable to CRIM-LIMS | 123,332 | - | 16,054 | 107,278 | 17,023 |
| Note payable to CRIM-financing of delinquent accounts | 82,153 | - | 5,439 | 76,714 | |
| Line of credit - GDB | 179,682 | 483,175 | 262,736 | 400,121 | 400,121 |
| Payable to CRIM- final settlements 03-04 and 04-05 | 117,094 | - | 88,520 | 28,574 | 28,574 |
| Payable to Puerto Rico Treasury Department - prior years property taxes | 41,734 | - | 10,015 | 31,719 | 10,015 |
| Compensated absences | 913,977 | 129,538 | 41,747 | 1,001,768 | 47,193 |
| Christmas Bonus | 181,764 | 183,666 | 181,764 | 183,666 | 183,666 |
| Judgments and legal claims | 27,111 | 97,939 | 27,111 | 97,939 | 97,939 |
| | <u>\$ 6,645,943</u> | <u>\$ 1,539,318</u> | <u>\$ 992,268</u> | <u>\$ 7,192,993</u> | <u>\$ 1,236,845</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE F- LONG TERM DEBT-Continued

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2006 amount to \$4,814,000. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to levy and collect property taxes for payment of principal and interest on bonds and notes. A debt service fund has been established for the bonds and notes at GDB with the proceeds of those property taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of long term debt issued for operational purposes are made through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).

A detail of the general and special obligation bonds and notes as of June 30, 2006 follows:

| | <u>Outstanding Amount</u> |
|---|-------------------------------|
| 2000 special obligation bonds of \$910,000 due in annual installments of \$75,000 to \$125,000 through July 1, 2010; bearing interest at rates ranging from 5.0% to 8.0% (6.00% at June 30, 2006) | \$ 535,000 |
| 2002 special obligation bonds of \$635,000 due in annual installments of \$10,000 to \$50,000 through January 1, 2027; bearing interest at 6.25% | 610,000 |
| 2001 general obligation notes of \$465,000 due in annual installments of \$95,000 to \$105,000 through July 1, 2006; bearing interest at rates ranging from 2.8% to 3.21% (3.21% at June 30, 2006) | 105,000 |
| 1994 public improvement bonds of \$721,000 due in annual installments of \$27,000 to \$52,000 through January 1, 2017; bearing interest at 5.0% | 446,000 |
| 2002 general obligation bonds of \$1,660,000 due in annual installments of \$30,000 to \$130,000 through July 1, 2026; bearing interest at rates ranging from 2.8% to 5.6% (3.21% at June 30, 2006) | 1,540,000 |
| 2005 general obligation bonds of \$192,000 due in annual installments of \$15,000 to \$24,000 through July 1, 2014; bearing interest at rates ranging from 4.37% to 5.00% (6.25% at June 30, 2006) | 177,000 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE F- LONG TERM DEBT-Continued

| | Outstanding Amount |
|---|-----------------------|
| 2004 general obligation notes of \$305,000 due in annual installments of \$55,000 to \$65,000 through July 1, 2009; bearing interest at rates ranging from 4.37% to 5.00% (4.23% at June 30, 2006) | 250,000 |
| 2003 general obligation bonds of \$530,000 due in annual installments of \$12,000 to \$35,000 through January 1, 2029; bearing interest at 4.25% | 506,000 |
| 2005 general obligation notes of \$645,000 due in annual installments of \$80,000 to \$115,000 through July 1, 2012; bearing interest at rates ranging from 4.23% to 4.73% (4.23% at June 30, 2006) | 645,000 |
| | \$ 4,814,000 |

The debt services requirement to amortize general and special obligation bonds and notes as of June 30, 2006 follows:

| June 30 | Principal | Interest |
|-----------|--------------|--------------|
| 2007 | \$ 445,000 | \$ 259,634 |
| 2008 | 359,000 | 238,259 |
| 2009 | 376,000 | 197,517 |
| 2010 | 400,000 | 175,158 |
| 2011 | 352,000 | 154,702 |
| 2012-2016 | 1,003,000 | 608,819 |
| 2017-2021 | 687,000 | 404,994 |
| 2022-2026 | 867,000 | 194,159 |
| 2027-2029 | 325,000 | 9,795 |
| Totals | \$ 4,814,000 | \$ 2,243,037 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE F- LONG TERM DEBT-Continued

3. Other long-term liabilities

Outstanding
Amount

Note payable to CRIM (Law No. 42) – Law No. 42 of January 26, 2000 (as amended by Law No. 146 of October 11, 2001 and Law No. 172 of August 11, 2002) was enacted to authorize the CRIM to obtain a special loan in the form of a line of credit from the Governmental Development Bank of Puerto Rico (GDB) to finance a debt the municipalities of Puerto Rico own to CRIM for excess property tax advances as of June 30, 2000. Principal and interest payments are financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Amounts are retained from advances of property tax and amounts of municipal equalization fund send to the Municipality by the CRIM. Law No.42 was amended by Law no. 146 to extend from 10 to 30 years the financing period and by Law No. 172 to extend the debt period to June 30, 2001. On November 26, 2002 the Municipality entered into the financing agreement with the CRIM for a total amount of \$476,395, bearing interest at 6.18% and due on July 1, 2032. Debt service requirements in future years are as follows:

\$ 451,214

| <u>June 30</u> | <u>Principal</u> | <u>Interest</u> |
|----------------|-------------------|-------------------|
| 2007 | \$ 7,314 | \$ 27,807 |
| 2008 | 7,774 | 27,548 |
| 2009 | 8,262 | 27,310 |
| 2010 | 8,781 | 26,340 |
| 2011 | 9,323 | 25,889 |
| 2012-2016 | 56,236 | 119,336 |
| 2017-2021 | 76,263 | 98,379 |
| 2022-2026 | 103,248 | 72,179 |
| 2027-2031 | 140,268 | 35,469 |
| 2032-2033 | 33,745 | 1,565 |
| Totals | <u>\$ 451,214</u> | <u>\$ 461,822</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE F- LONG TERM DEBT-Continued

Outstanding
Amount

Note payable to CRIM (LIMS) - On November 28, 2001 the Municipality entered into a financing agreement with the CRIM in the amount of \$172,655 for the payment of the Municipality's share of the cost of a management information system (**LIMS**) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$11,578, including interest of 5.95% and is due on November 28, 2011. Amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the CRIM. Debt service requirements in future years are as follows:

107,278

| <u>June 30</u> | <u>Principal</u> | <u>Interest</u> |
|----------------|-------------------|------------------|
| 2007 | \$ 17,025 | \$ 6,049 |
| 2008 | 18,051 | 5,016 |
| 2009 | 19,141 | 3,921 |
| 2010 | 20,297 | 2,759 |
| 2011 | 21,522 | 1,527 |
| 2012 | 11,242 | 279 |
| Totals | <u>\$ 107,278</u> | <u>\$ 19,551</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE F- LONG TERM DEBT-Continued

Outstanding
Amount

Note payable to CRIM (Financing of delinquent accounts)— On March 27, 2002 the Municipality entered into a financing agreement with the CRIM in the amount of \$165,479 to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a nonrevolving line of credit bearing interest of 6.5% for the first 5 years and variable for the next 25 years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first 5 years will be financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Also, during the first 5 years any collection from those delinquent accounts will be credited to the loan principal. After the 5 year period the loan outstanding balance will be restructured for a 25 years period. Debt service requirements in future years are as follows:

76,714

| <u>June 30</u> | <u>Principal</u> | <u>Interest</u> |
|----------------|------------------|------------------|
| 2007 | \$ - | \$ 4,986 |
| 2008 | - | 4,986 |
| 2009 | 1,319 | 4,948 |
| 2010 | 1,407 | 4,859 |
| 2011 | 1,502 | 4,765 |
| 2012-2016 | 9,158 | 22,174 |
| 2017-2021 | 12,664 | 18,669 |
| 2022-2026 | 17,512 | 13,821 |
| 2027-2031 | 24,216 | 7,117 |
| 2032-2033 | 8,936 | 464 |
| Totals | <u>\$ 76,714</u> | <u>\$ 86,789</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE F- LONG TERM DEBT-Continued

| | Outstanding Amount |
|---|-----------------------|
| <p>Line of credit, GDB – On February 25, 2004, the Municipality entered into a \$1,200,000 (including interest) line of credit agreement with GDB for the construction of a new city hall. Borrowings under this agreement bears interest at variable rates ((LIBOR + 1.25% ranging from 5% to 12% annually) and are payable upon maturity of the line of credit agreement in fiscal year 2006-2007. This line of credit will be repaid from Commonwealth's public improvements fund. (RC del S. 1474 of November 9, 2003)</p> | 400,121 |
| <p>Payable to CRIM, final settlement 2004-2005 - represents the balance owed to CRIM at June 30, 2006 for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal year ended June 30, 2005 (see note H). This amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the CRIM.</p> | 28,574 |
| <p>Payable to Puerto Rico Treasury Department, prior years property taxes - represent advances of property taxes paid in prior years to the Municipality in excess of actual property tax revenues. This amount is currently being repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the CRIM.</p> | 31,719 |
| <p>Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds</p> | 1,001,768 |
| <p>Christmas Bonus - represent the accrued portion corresponding to fiscal year 2005-2006 of the Christmas bonus to be paid in December 2006</p> | 183,666 |
| <p>Claims and judgments - represent the final costs of a legal case paid subsequent to June 30, 2006. The awarded amount will be paid with unrestricted funds.</p> | 97,939 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE G - DEFERRED REVENUES

Deferred revenues for Commonwealth Government represent revenues not available as required by current standards and for Federal Grants represent resources received before allowable expenditures are incurred or not available as required by current standards. A detail of these balances as presented in fund statements follows:

| | Commonwealth Government | Federal Grants | Other |
|---|----------------------------|-------------------|-------------------|
| Municipal Revenue Collection Center (CRIM) – property taxes (general fund) | \$ 102,383 | \$ - | \$ - |
| P.R. Department of Treasury – Christmas bonus reimbursement | 91,833 | | |
| Public Order Code | 61,193 | - | - |
| Office of Elderly Affairs | 13,704 | - | - |
| P.R. Department of Labor | 19,996 | - | - |
| Commonwealth of Puerto Rico's Public Improvements Fund | 102,454 | - | |
| P.R. Department of Housing – Special Communities | 8,624 | - | - |
| Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund) | 86,040 | - | - |
| Rural Development Corporation | 717,730 | | |
| Office of Commissioner of Municipal Affairs – Territorial Plan | 42,716 | - | - |
| Office of Commissioner of Municipal Affairs – CDBG | - | 238,777 | - |
| P.R. Department of Family – Child Care | - | 18,449 | - |
| P.R. Department of Education – Food Program | - | 13,117 | - |
| FEMA | - | 111,237 | - |
| P.R. Emergency Management Agency- Hazard Mitigation Plan | - | 11,442 | - |
| Rural Development (RD) | - | 154,152 | - |
| P.R. Department of Justice – Local Law | - | 117,008 | - |
| Municipal License Taxes | - | | 450,640 |
| | <u>\$ 1,246,673</u> | <u>\$ 664,182</u> | <u>\$ 450,640</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE H – PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st.

The tax rates in force as of June 30, 2006 are 9.03% for real property (of which 8.83% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 7.03% for personal property (of which 6.83% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 8% and 6%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property (of which 5.8% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 4% on personal property (of which 3.8% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 2.00% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund.

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. 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. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net payable to the CRIM of \$28,574 resulting from the final settlement for fiscal year 2004-2005. The total amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources. A receivable from the CRIM of \$102,383 resulting from the final settlement for the fiscal year 2005-2006 is recorded as deferred revenue in the fund statements since is not available as required by current standards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE I – MUNICIPAL LICENSE TAXES

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15.

During the fiscal year ended June 30, 2006, the tax rates were as follows:

Financial business – 1.50% of gross revenues

Other organizations - .50% of gross revenues

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$ 450,640 is recorded as deferred revenues.

NOTE J – INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of the following:

| | <u>Amount</u> |
|---|---------------------|
| Amount of municipal equalization fund and subsidy send by CRIM | \$ 3,884,491 |
| Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA) | 1,021,903 |
| Reimbursement from Commonwealth Government - Christmas Bonus expenditures | 157,428 |
| Puerto Rico Department of Labor – Law No.52 | 506,959 |
| Other intergovernmental revenues | 9,054 |
| | <u>\$ 5,579,835</u> |

NOTE K – RESTATEMENTS

Net assets at beginning of year have been adjusted to reflect the following restatements:

| | <u>Amount</u> |
|---|----------------------|
| Net assets at beginning of year as previously reported: | \$ 21,504,987 |
| Restatements: | |
| Net correction of errors - capital assets | (288,193) |
| Net assets at beginning of year as restated: | <u>\$ 21,216,794</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE L – RETIREMENT PLAN

1. Plan description

Regular employees of the Municipality contribute to a cost sharing multiple employer defined benefit retirement plan, administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems. The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and non-occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation.

Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

Law No. 305 of September 24, 1999 amended the Act. No. 447 of 1951 and was enacted with the purpose of establishing a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will subject to the total accumulate balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary 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 System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions have not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE L – RETIREMENT PLAN-Continued

2. Funding policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.275% of gross salary.

The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

| Fiscal year ended: | Law No. 447 | System 2000 |
|--------------------|-------------|-------------|
| 2006 | \$ 103,093 | \$ 82,876 |
| 2005 | \$ 109,917 | \$ 76,393 |
| 2004 | \$ 114,374 | \$ 57,077 |

NOTE M – POSTEMPLOYMENT BENEFITS

Pursuant to Law No. 157 of June 27, 2003, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees. For the fiscal year ended the post employment benefits paid to retired employees under this requirement amounted to \$3,719.

NOTE N – COMMITMENTS

1. Operating leases

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted approximately \$31,396. Management believes that the summary of the future minimum rental commitments under noncancelable operating leases with terms exceeding one year is not significant.

2. Construction

The Municipality has commitments at June 30, 2006 of approximately \$991,862 for design, construction, improvements or renovation of certain municipal facilities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE O- CONTINGENCIES

1. Federal and State Grants

Projects financed by the Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that would not be covered by insurance. As a result of one settled case as of June 30, 2006 and not to be covered by insurance, the Municipality accrued \$97,939 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsel that based on their experience, such actions and the potential liabilities will not impair the Municipality's financial position.

NOTE P- FUND BALANCE DEFICITS

Community Development Grant Program fund and certain special funds included as part of the general fund and other governmental funds in the fund statements disclosed fund balance deficits as follows:

| <u>Fund Description</u> | <u>Community Development Block Grant Fund</u> | <u>General Fund</u> | <u>Other Governmental Funds</u> |
|--|---|---------------------|---|
| CDBG | \$ 238,777 | \$ - | \$ - |
| Law No. 52 | | 19,996 | - |
| Other funds | | 14,879 | - |
| Rural Development | - | - | 154,150 |
| Public Order Code | - | - | 61,087 |
| OCAM-Territorial Plan | - | - | 42,716 |
| Rural Development Corporation | - | - | 24,399 |
| Federal Emergency Management Agency- Mitigation Plan | - | - | 11,441 |
| Special Communities Federal Emergency Management Agency- | - | - | 8,298 |
| Tropical Storm Jeanne | - | - | 6,523 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2006**

NOTE P– FUND BALANCE DEFICITS-Continued

The deficits results from the accrual of expenditures without accruing intergovernmental revenues for reimbursement of expenditures. As required by current standards, the Municipality recorded intergovernmental revenues for reimbursement-based (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available.

NOTE Q– SUBSEQUENT EVENTS

1. Sales Tax Implementation

Effective on October 15, 2006 the Municipality imposed a sales tax of 1.50% to be applicable over all direct sales to consumers, including certain services as approved by the Municipal Legislature. Subsequently on November 15, 2006 the stipulations for the imposition and collection of the tax were amended by the Municipal Legislature to be in conformity with Commonwealth Government Sales Tax Law (Act No. 117 of July 4, 2006)

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

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2006**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts (Budgetary Basis)</u> | <u>Variance with Final Budget Positive (Negative)</u> |
|---|-------------------------|------------------|---|---|
| | <u>Original</u> | <u>Final</u> | | |
| REVENUES: | | | | |
| Property taxes | \$ 1,381,291 | \$ 1,381,291 | \$ 1,405,582 | \$ 24,291 |
| Municipal license tax | 470,000 | 474,094 | 481,100 | 7,006 |
| Intergovernmental | 4,539,443 | 4,376,500 | 4,526,306 | 149,806 |
| Fees, fines and charges for services | 815,494 | 1,053,836 | 1,073,166 | 19,330 |
| Interest | 25,000 | 103,516 | 85,964 | (17,552) |
| Other | 24,500 | 24,500 | 28,662 | 4,162 |
| Total revenues | <u>7,255,728</u> | <u>7,413,737</u> | <u>7,600,780</u> | <u>187,043</u> |
| EXPENDITURES: | | | | |
| General government | 3,388,806 | 3,621,200 | 3,759,970 | (138,770) |
| Public works and sanitation | 1,969,950 | 1,901,525 | 1,893,373 | 8,152 |
| Public safety | 737,133 | 665,236 | 661,486 | 3,750 |
| Culture and recreation | 316,316 | 278,227 | 277,054 | 1,173 |
| Health | 339,565 | 320,368 | 320,367 | 1 |
| Welfare and community development | 316,508 | 296,187 | 292,976 | 3,211 |
| Total expenditures | <u>7,068,278</u> | <u>7,082,743</u> | <u>7,205,226</u> | <u>(122,483)</u> |
| Excess (deficiency) of revenues over (under) expenditures | 187,450 | 330,994 | 395,554 | 64,560 |
| Other financing sources (uses) | | | | |
| Transfers out | (187,450) | (330,994) | (330,994) | - |
| Total other financing sources (uses) | <u>(187,450)</u> | <u>(330,994)</u> | <u>(330,994)</u> | <u>-</u> |
| Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 64,560</u> | <u>\$ 64,560</u> |

The accompanying notes are an integral part of this required supplementary information.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

JUNE 30, 2006

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1981, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared.

Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The budget comparison schedule provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - BUDGET TO GAAP RECONCILIATION

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
June 30,2006**

NOTE C - BUDGET TO GAAP RECONCILIATION - Continued

| | |
|---|----------------------------------|
| Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis): | \$ 64,560 |
| Budget to GAAP differences: | |
| Entity differences: | |
| Non budgeted funds recorded as revenues for financial reporting purposes: | 582,644 |
| Non budgeted funds recorded as expenditures for financial reporting: | (690,499) |
| Non budgeted transfers in: | 162,960 |
| Non Budgeted Transfer out: | (9,634) |
| Non budgeted other financing sources (uses): | - |
| Basis of accounting differences: | |
| Revenues recorded for financial reporting purposes but not in budgetary basis: | 68,610 |
| Revenues recorded in budgetary basis purposes but not in financial reporting: | (28,058) |
| Expenditures recorded in budgetary basis but not for financial reporting purposes: | 14,331 |
| Expenditures recorded for financial reporting purposes but not in budgetary basis: | (358,433) |
| Timing differences: | |
| Current year encumbrances recorded as expenditures for budgetary reporting purposes: | 32,266 |
| Prior year encumbrances recorded as expenditures for financial reporting purposes: | (23,204) |
| Net change in fund balance (GAAP basis): | <u><u>\$(184,457)</u></u> |

SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
FINANCIAL DATA SCHEDULE
BALANCE SHEET INFORMATION
JUNE 30, 2006

| <u>Line Item Number</u> | ASSETS | <u>Section 8 Housing Choice Vouchers CFDA No.14.871</u> |
|-------------------------|---|---|
| | Current Assets | |
| | Cash: | |
| 111 | Cash - unrestricted | \$ 18,789 |
| 100 | Total cash | 18,789 |
| 150 | Total Current Assets | 18,789 |
| | Noncurrent Assets | |
| | Fixed assets | |
| 164 | Furniture, equipment & machinery - administration | 2,009 |
| 166 | Accumulated depreciation | (1,467) |
| 160 | Total fixed assets, net of accumulated depreciation | 542 |
| 180 | Total Noncurrent Assets | 542 |
| 190 | TOTAL ASSETS | \$ 19,331 |
| | LIABILITIES AND EQUITY | |
| | LIABILITIES | |
| | Current Liabilities | |
| 331 | Accounts payable - HUD PHA programs | 7,247 |
| 345 | Other current liabilities | 542 |
| 347 | Inter-program - due to | 6,503 |
| 310 | Total Current Liabilities | 14,292 |
| 300 | TOTAL LIABILITIES | 14,292 |
| | EQUITY | |
| 508.1 | Invested in Capital Assets, Net of Related Debt | 542 |
| 512.1 | Unrestricted Net Assets | 4,497 |
| 513 | TOTAL EQUITY/NET ASSETS | 5,039 |
| 600 | TOTAL LIABILITIES and EQUITY/NET ASSETS | \$ 19,331 |

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
FINANCIAL DATA SCHEDULE
STATEMENT OF REVENUES AND EXPENSES INFORMATION
FISCAL YEAR ENDED JUNE 30, 2006

| <u>Line Item Number</u> | | | <u>Section 8 Housing Choice Vouchers CFDA No. 14.871</u> |
|---------------------------------|---|-----------|--|
| 703 | | | |
| | REVENUES: | | |
| 706 | HUD PHA operating grants | \$ | 118,962 |
| 711 | Investment income - unrestricted | | 54 |
| 715 | Other revenue | | 698 |
| 700 | TOTAL REVENUES | | 119,714 |
| | EXPENSES: | | |
| | Administrative | | |
| 911 | Administrative salaries | | 14,236 |
| 915 | Employee benefit contributions- administrative | | 4,622 |
| 916 | Other operating- administrative | | 600 |
| | Subtotal | | 19,458 |
| 969 | TOTAL OPERATING EXPENSES | | 19,458 |
| 970 | EXCESS OPERATING REVENUE OVER OPERATING EXPENSES | | 100,256 |
| 973 | Housing assistance payments | | 101,346 |
| 974 | Depreciation expense | | 109 |
| 900 | TOTAL EXPENSES | | 120,913 |
| 1000 | EXCESS (DEFICIENCY) OF TOTAL REVENUE OVER (UNDER) TOTAL EXPENSES | \$ | (1,199) |
| (EMO account information | | | |
| 1103 | Beginning equity | | 3,601 |
| 1104 | Prior period adjustments, equity transfers and correction of errors | | 2,637 |
| 1113 | Maximum annual contributions commitment (per ACC) | | 118,962 |
| 1115 | Contingency reserve, ACC program reserve | | 32,598 |
| 1116 | Total annual contributions available | | 151,560 |
| 1120 | Unit months available | | 408 |
| 1121 | Number of unit months leased | | 408 |

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE**

June 30, 2006

NOTE A – BASIS OF PRESENTATION

The accompanying financial data schedule (FDS) is a trial balance of the Section 8 Housing Choice Voucher Program, administered by the Municipality. The FDS was created in order to standardize the financial information reported by Public Housing Authorities (PHA) to the Real Estate Assessment Center (REAC), as required by the Uniform Financial Reporting Standards (UFRS). REAC is the US Department of Housing and Urban Development (HUD) national management center created to assess the condition of HUD owned and assisted properties. The UFRS are rules to implement requirements of 24 CFR, Part 5, Subpart H, for the electronic filing of financial information to HUD.

In accordance with the guidelines for reporting and attestation requirements of UFRS, the accompanying FDS is included as information supplementary to the financial statements. It was prepared using the accrual basis of accounting, as required by REAC regulations.

SINGLE AUDIT SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2006**

| Federal Grantor/Pass-Through Grantor/Program Title | Federal CFDA Number (note B) | Pass-Through Entity Identifying Number (note C) | Federal Expenditures (note A) |
|--|---------------------------------------|--|-------------------------------------|
| <u>U.S. Department of Agriculture</u> | | | |
| Passed through the P.R. Department of Education: Child and Adult Care Food Program | 10.558 | N/AV | \$ 8,082 |
| Water and Waste Disposal Systems for Rural Communities | 10.760 | N/A | 111,525 |
| Subtotal U.S. Department of Agriculture | | | <u>119,607</u> |
| <u>U.S. Department of Housing and Urban Development</u> | | | |
| Passed through the Office of Commissioner of Municipal Affairs (OCAM): Community Development Block Grant - State's Program | 14.228 | AB - 53 FD - 53 | 656,772 |
| Section 8 Housing Choice Vouchers | 14.871 | N/A | 120,804 |
| Subtotal U.S. Department of Housing and Urban Development | | | <u>777,576</u> |
| <u>U.S. Department of Justice</u> | | | |
| Passed through the P.R. Department of Justice: Local Law Enforcement Block Grant | 16.592 | 2003-LBVX-1619 | 9,992 |
| <u>U.S. Department of Labor</u> | | | |
| Passed through the Northwestern Consortium: WIA Adult Program | 17.258 | N/A | 27,205 |
| <u>U.S. Department of Health and Human Services</u> | | | |
| Passed through the P.R. Department of Family - Social Economic Development Development Administration: Temporary Assistance for Needy Families | 93.558 | N/AV | 39,636 |
| Passed through the P.R. Department of Family - Families and Children Administration: Child Care and Development Block Grant | 93.575 | 2004-2005-049 2006-035 | 96,274 |
| Subtotal U.S. Department of Health and Human Services | | | <u>135,910</u> |
| <u>U.S. Department of Homeland Security-Federal Emergency Management Agency (FEMA)</u> | | | |
| Passed through the Puerto Rico Governor's Office - (Governor's Authorized Representative-GAR): Disaster Grants - Public Assistance | 97.036 | N/AV | 59,527 |
| Passed through the P.R. State Emergency Management Agency: Pre-Disaster Mitigation | 97.047 | PDMC-PL-02-PR-2003-041 | 16,147 |
| Passed through the P.R. Department of Justice: Homeland Security Grant Program | 97.067 | 2004-GE-MR-01 | 6,110 |
| Subtotal U.S. Department of Homeland Security | | | <u>81,784</u> |
| Total Expenditures of Federal Awards | | | <u>\$ 1,152,074</u> |

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

June 30, 2006

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments and Nonprofit Organizations". Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - FEDERAL CFDA NUMBER

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

NOTE C – PASS-THROUGH ENTITY IDENTIFYING NUMBER

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

NOTE D – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

| Description | Community Development Block Grant Program | Other Governmental Funds |
|--|---|--------------------------------|
| 10.558 | \$ - | \$ 8,082 |
| 10.760 | - | 111,525 |
| 14.228 | 656,772 | - |
| 14.871 | - | 120,804 |
| 16.592 | - | 9,992 |
| 17.258 | - | 27,205 |
| 93.558 | - | 39,636 |
| 93.575 | - | 96,274 |
| 97.036 | - | 59,527 |
| 97.047 | - | 16,147 |
| 97.067 | - | 6,110 |
| Total federal awards expenditures: | 656,772 | 495,302 |
| Total non-federal awards expenditures: | - | 2,101,538 |
| Total expenditures, fund statements: | \$ 656,772 | \$ 2,596,840 |

VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

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

*Mayor and Municipal Legislature
Municipality of Rincon
Rincon, Puerto Rico*

We have audited the financial statements of the Municipality of Rincon as of and for the year ended June 30, 2006, and have issued our report thereon dated December 21, 2006, in which we have expressed an unqualified opinion. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Rincon's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statements 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 that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item **2006 II-1**.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving control over financial reporting and its operations that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to

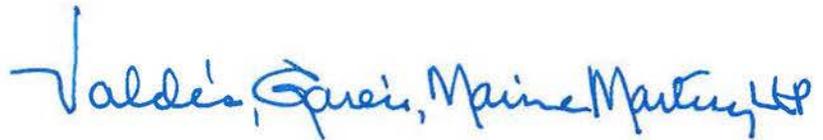
significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Municipality's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as item **2006 II-1**.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items **2006 II-1** in the accompanying schedule of findings and questioned costs to be material weaknesses.

We also noted certain additional matters that we reported to management of the Municipality in a separate letter dated December 21, 2006.

This report is intended for the information of the Municipality's management, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

San Juan, Puerto Rico
December 21, 2006



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VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

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

*Mayor and Municipal Legislature
Municipality of Rincon
Rincon, Puerto Rico*

Compliance

We have audited the compliance of the Municipality of Rincon, Puerto Rico (the Municipality) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

In our opinion, the Municipality of Rincon complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2006.

Internal Control Over Compliance

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

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

This report is intended for the information of the management of the Municipality, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

San Juan, Puerto Rico
December 21, 2006



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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Auditor's Results

For the year ended June 30, 2006

I. Summary of audit results:

Part I - Financial Statements

1. Type of audit report: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
2. Material weakness(es) identified? Yes No
3. Reportable condition(s) identified that are not considered to be material weakness? Yes No
4. Noncompliance material to financial statements noted? Yes No

Part II - Federal Awards

Internal control over major programs:

1. Material weakness(es) identified? Yes No
2. Reportable condition(s) identified that are not considered to be material weakness(es)? Yes No
3. Type of auditor' report issued on compliance for major programs: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
4. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? Yes No

5. Identification of major programs:

| | |
|-----------------------|---|
| <u>CFDA Number(s)</u> | <u>Name of Federal Pr or Cluster</u> |
| 14.228 | Community Development Bloc State's Program |

6. Dollar threshold used to distinguish Type A and Type B programs: \$300,000
7. Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO
MUNICIPALITY OF RINCÓN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2006

**Section II – Financial Statements Findings Reported in Accordance with
Government Auditing Standards:**

Reference Number: 2005 II-1

Area: Accounting records and reports

Type: Material Weakness

Criteria: The Municipality should establish internal control policies and procedures to maintain adequate, complete and reconciled accounting records and reports. Accounting principles generally accepted in the United States of America require financial transactions to be recorded in accounting records properly reconciled with subsidiaries or supporting records and reports.

Condition: Our tests of the Municipality's accounting records disclosed the following:

(1). The Municipality has not maintained a general ledger to post and register its financial transactions. In addition, has not established a complete set of manual accounting records properly balanced and has not established procedures for reconciliation with the computerized accounting system. Certain records (such as "libro de caja") are not being properly maintained. The financial statements have been prepared from other alternative sources, including manual subsidiary records and reports.

(2). There are significant transactions and amounts included as reconciling items in bank reconciliations of General Fund, Resolución Conjunta, Fema Tormenta Jeanne and Payroll Account

**COMMONWEALTH OF PUERTO
MUNICIPALITY OF RINCÓN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2006

**Section II – Financial Statements Findings Reported in Accordance with
Government Auditing Standards:**

Reference Number: 2005 II-1 - continued

Cause: The Municipality has not established procedures to maintain a complete and reconciled set of accounting records. The Finance Department does not have trained personnel in accounting controls and personnel lacks adequate supervision and monitoring of financial reporting process. Significant amounts included as reconciling items in bank conciliations arise primarily from amounts adjusted by banks but not in the accounting records, amounts deposited into erroneous bank accounts and accounting errors.

Effect: As a result of the inadequacy of accounting records in this area, the financial statements have been prepared from other alternative sources, including manual subsidiary records and reports.

Recommendation: The Municipality should start immediately an implementation process of a complete set of accounting records and reports properly reconciled. The process should include hiring or transfers of employees with knowledge of accounting principles related to governmental financial reporting. This personnel should be properly trained, monitored and supervised to assure achievement of financial reporting objectives.

Views of responsible officials and planned corrective actions: See accompanying correction action plan submitted by management as part of this audit report.

**COMMONWEALTH OF PUERTO
MUNICIPALITY OF RINCÓN**

FOR THE YEAR ENDED JUNE 30, 2006

**Section III – Federal Awards Findings and Questioned Costs Reported in
Accordance with *OMB Circular A-133***

| | |
|---------|----------------------|
| Finding | No matters reported. |
|---------|----------------------|

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCÓN**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

Financial Statements Findings Reported in Accordance with *Government Auditing Standards*:

| Fiscal Year Ended <u>June 30,</u> | Finding <u>No.</u> | <u>Condition</u> | <u>Status</u> | |
|---|-----------------------|--|--|---------|
| 2005 | 2005 II-1 | The Municipality has not properly implemented and established internal controls and procedures to maintain adequate, complete and reconciled Set of accounting records and reports. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). See current year finding number 2006 II-1 in the Accompanying schedule of findings and questioned Costs. | 2 ND |
| 2005 | 2005 II-2 | The Municipality received from the Commonwealth's Legislature certain grants funds which are restricted for specific purposes. Certain general fund expenditures have been financed with these restricted grant funds, which is not in accordance with grantor's established purposes. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). | |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

Federal Awards Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

| Fiscal Year Ended <u>June 30,</u> | <u>Program</u> | <u>Number</u> | <u>Condition</u> | <u>Status</u> |
|---|---|---------------|--|---|
| 2005 | US D of A – Rural Development: Water and Waste Disposal System for Rural Communities –CFDA No. 10.760 | 2005 III-1 | The Municipality has not performed the contractor’s payroll review. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Municipal Affairs (OCAM). |
| 2004 | 2004 II-1 | | The Municipality has not properly implemented and established internal controls and procedures to maintain adequate, complete and reconciled set of accounting records and reports. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |
| 2004 | 2004 II-2 | | The Municipality received from the Commonwealth’s Legislature certain grants funds which are restricted for specific purposes. Certain general fund expenditures have been financed with these restricted grant funds, which is not in accordance with grantor’s established purposes. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |

1/1/07
3 no

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

| <u>Fiscal Year ended June 30,</u> | <u>Finding No.</u> | <u>Condition</u> | <u>Status</u> |
|---|---|--|---|
| 1998 1999, 2000 2001, 2002 | 98 II-1, 99 II-2, 2000 II-1, 2001 II-1, 2002 II-1 | The Municipality has not established adequate controls and procedures to assure the completeness, existence and valuation of fixed assets inventories. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |
| 1998, 1999, and 2000 | 98 II-2, 99 II-2, 2000 II-2 | a. Several instances of excess of expenditures over appropriations in the general fund. b. Operational budgetary deficit and cumulative fund balance deficit (GAAP) | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |
| 1997 | 97 II-2 | During our examination of internal controls and procedures over the bid process we noted that there was an awarded bid for a construction project of \$3,082,000 where the appropriated budget was \$2,500,000 to cover the awarded bid costs. As stated on the bid board minutes, the bid was awarded on the recommendation of the Recreational Development Company of Puerto Rico (a state governmental agency). | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |

y
no

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

| <u>Fiscal Year</u> <u>ended</u> <u>June 30,</u> | <u>Finding</u> <u>No.</u> | <u>Condition</u> | <u>Status</u> |
|---|------------------------------|--|---------------|
| | | <p>This recommendation authorized the Municipality to award the bid for the budget amount the Municipality had available with an agreement to obtain the total additional funds within six months. The Municipality decided to contract the construction project in three stages based on availability of funds. The total amounts of the three stages was \$2,715,000, which represents \$318,000 above the original estimated construction costs. As stated in communications between the contractor and the Municipality, the excess costs are based on changes in costs for the additional time incurred and extended overhead cost.</p> | |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

Federal Awards Findings and Questioned Costs Reported in Accordance with OMB Circular A-133

| | | | | |
|------|--|------------|--|--|
| 2004 | US D of A - Rural Development: Water and Waste Disposal System for Rural Communities-CFDA No. 10.760 | 2004 III-1 | The Municipality has not performed the contractor's payroll review. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Municipal Affairs (OCAM). See current year finding number 2005 III-1 in the accompanying schedule of findings and questioned costs. |
| 2004 | US Department of Commerce: Grants for Public Works and Economic Development Facilities – CFDA No. 11.300 | 2004 III-3 | In 2 cases the Municipality has excess cash in bank for an unreasonable period of time after transfer of funds by the Federal Government. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Municipal Affairs (OCAM). |
| 2004 | US Department of Commerce: Grants for Public Works and Economic Development Facilities – CFDA No. 11.300 | 2004 III-4 | The required certified payrolls were not submitted weekly. There is no adequate evidence to support the contractor's payrolls review at the federal programs office. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Municipal Affairs (OCAM). |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

| <u>Fiscal year ended June 30,</u> | <u>Program</u> | <u>Number</u> | <u>Condition</u> | <u>Status</u> |
|-----------------------------------|--|---------------|---|---|
| 2004 | US Department of Commerce: Grants for Public Works and Economic Development Facilities – CFDA No. 11.300 | 2004 III-5 | The Municipality did not prepare the financial Reports. | Finding was corrected. |
| 2003 | US Department of HUD: Community Development Block Grant State’s Program- CFDA No. 14.228 | 2003 III-1 | Our tests to a sample of 7 participant’s files (from a population of 16 files) of the materials donation program disclosed that certain documents were missing form files. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Municipal Affairs (OCAM). |
| 2003 | US Department of Commerce: Grants for Public Works and Economic Development Facilities – CFDA No. 11.300 | 2003 III-3 | As stated in the grant agreement between the Municipality and the federal grantor the Municipality is required to submit to the federal agency a financial report that provides information on the amount of allowable project expenses that has been incurred but not claimed for reimbursement as of the end of the period. The report would be as of September 30 of each year and | Finding was corrected. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

must be submitted annually until the final grant payment is made by EDA. The report should be submitted to EDA not later than October 30 of each year. The report have not been prepared and submitted by the Municipality.

| | | | | |
|------|--|------------|--|----------------------|
| 2003 | US Department of Commerce: Grants for Public Works and Economic Development Facilities – CDFA No. 11.300 | 2003 III-4 | The Municipality is required to establish and place in operation adequate internal controls to provide reasonable assurance that contractors paid the prevailing wages rates for projects covered by the Davis-Bacon Act. Our tests disclosed that there is no evidence that the Municipality is performing on site visits to monitor classification and wage rates. | Finding not cleared. |
| 2003 | US Department of Commerce: Grants for Public Works and Economic Development Facilities – CDFA No. 11.300 | 2003 III-5 | The Municipality is required to establish and place in operation adequate internal controls to require each of its contractors employed in the completion of the project to comply with procurement, suspension and debarment policies. There is no evidence of project contractor’s certification of compliance with referred requirements. | Finding not cleared. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

| <u>Fiscal year Ended June 30,</u> | <u>Program</u> | <u>No.</u> | <u>Condition</u> | <u>Status</u> |
|---|--|------------|---|---|
| 2003 | US Department of Commerce: Grants for Public Works and Economic Development Facilities – CDFA No. 11.300 | 2003 III-6 | The project contractor was obligated to make a documented good faith effort on this project to employ the unemployed/underemployed residents of the Municipality of Rincon. Records should be provided to the Municipality. There is no evidence of compliance with this requirement. | Finding not cleared. |
| 2002 | US Department of HUD: Community Development Block Grant State’s Program-CDFA No. 14.228 | 2002 III-1 | Our tests to a sample of six participant’s files of materials donations program financed with SBGP funds disclosed that certain documents were missing from files. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |
| 2001 | US Department of HUD: Community Development Block Grant State’s Program-CDFA No. 14.228 | 2001 III-1 | In our tests related to procurement procedures we noted that in two bids for asphalt services and in one case related to the acquisition of a vehicle the Municipality could not provide evidence of proper evaluation and criteria for bidder selection. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2006

| <u>Fiscal year ended June 30</u> | <u>Program</u> | <u>No.</u> | <u>Condition</u> | <u>Status</u> |
|--|--|------------|--|---|
| 2001 | US Department of HUD: Community Development Block Grant State's Program-CDFA No. 14.228 | 2001 III-2 | Municipalities are required to request from contractors a certification stating that Entity's Principals are not suspended or debarred from doing business with State or Federal Government or this requirement may be included as a contract's clause. During our examination on three of the Municipality's contracts over \$100,000 we noted that in two cases such clauses were not included in contracts nor a certification was obtained from contractors. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |
| 2000 | US Department of HUD: Community Development Block Grant State's Program-CDFA No. 14.228 | 2000 III-1 | A service contract not provided for examination. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). Related questioned cost of \$548,751 remains unclear. |
| 1997 | US Department of HUD: Community Development Block Grant State's Program-CDFA No. 14.228 | 97 III-1 | During our internal controls tests over the federal funds we found that grantee has not established procedures to comply with suspension and debarment requirement. | Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). |

Municipality of Rincón
Findings and Corrective Actions
Year ended June 30, 2006

Reference number: 2006-II-I

Area : Accounting records and report

Type : Material weakness

Recommendation: The Municipality should start immediately an implementation process of a complete set of accounting records and reports properly reconciled. The process should include hiring or transfers of employees with knowledge of accounting principles related to governmental financial reporting. This personnel should be properly trained, monitored and supervised to assure achievement of financial reporting objectives.

Corrective Actions:

- 1) The Finance Department will give priority to properly implement and establish internal controls and procedures to maintain adequate,, complete and reconciled set of accounting records and reports.
- 2) Presently we are identifying the funds and adjustments between the bank accounts and Commonwealth's Legislature Funds.
- 3) The Finance Department will perform the implementation process of a complete set of accounting records and reports properly reconciled.