

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

**MUNICIPIO DE SAN GERMAN**  
**AUDITORIA 2005-2006**  
**30 DE JUNIO DE 2006**

OFICINA DEL COMISIONADO  
DE ASUNTOS MUNICIPALES

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SAN GERMAN**

*FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT*

FISCAL YEAR ENDED JUNE 30, 2006

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SAN GERMAN**

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**FINANCIAL SECTION**

## Independent Auditor's Report

*Mayor and Municipal Legislature  
Municipality of San Germán  
San Germán, 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 San Germán, Puerto Rico, 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 opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of San German, 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.

The Management's Discussion and Analysis on pages 2 through 13 and the Budgetary Comparison Schedule – General Fund on page 44 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



*Rodríguez, Rivera & Toro LLP*

**MANAGEMENT DISCUSSION AND ANALYSIS**

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

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The following discussion will provide an overview of the Municipality's financial activities for the fiscal year ended June 30, 2006 through an analysis of the financial performance of the Municipality of San German. 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 \$31,594,623 (net assets).
- Revenues (not including special items) decreased by 12% and expenses increased 4% in comparison with year 2005.
- Net change in net assets amounted to \$1,272,651, a decrease of 38% with respect to prior year's net change.

**Highlights for Fund Financial Statements**

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

- At June 30, 2006, a net change of \$(1,531,707) in the fund balances of the Municipality's governmental funds resulted in a reported combined ending fund balances of \$5,550,840. Approximately 10% of the total combined fund balances is unreserved.
- The General Fund reported a deficit of revenues and other financing sources under expenditures and other financing uses of \$(1,208,164) and an unreserved fund balance of \$597,428. Unreserved fund balance decreased 65% from prior year.

**General Financial Highlights**

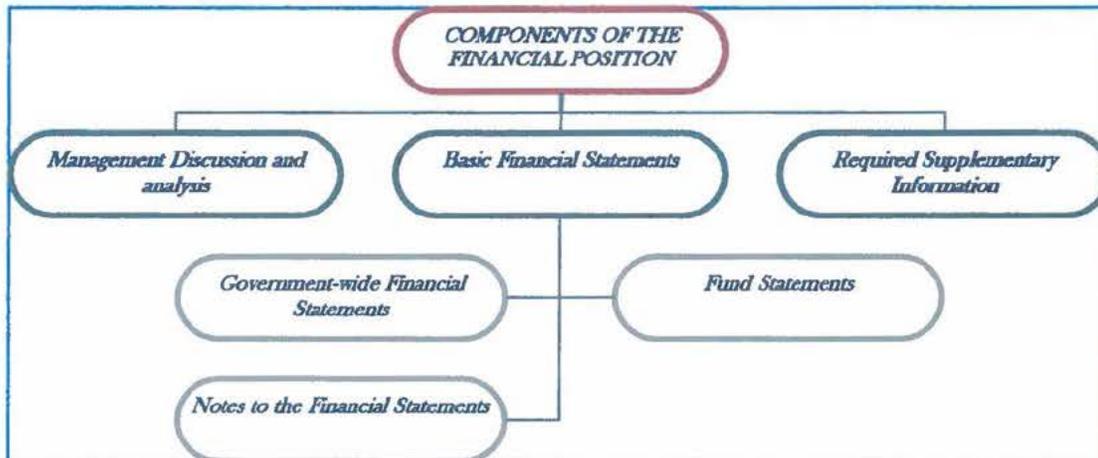
- The investment in capital assets as of June 30, 2006 was \$39,980,502 (net of depreciation).
- Long term debt increased to \$15,803,902.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$1,200,325.

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

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**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.

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

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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.

- ***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.

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the 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>		
	<b>Governmental Activities</b>	
	<b>2006</b>	<b>2005, as restated</b>
<b>Assets</b>		
Current and other assets	\$ 12,144,106	\$ 13,587,541
Capital assets	39,980,502	36,840,031
<b>Total assets</b>	<b>\$ 52,124,608</b>	<b>\$ 50,427,572</b>
<b>Liabilities</b>		
Current and other liabilities	\$ 6,895,650	\$ 6,841,393
Long term liabilities	13,634,335	13,264,207
<b>Total liabilities</b>	<b>20,529,985</b>	<b>20,105,600</b>
<b>Net assets</b>		
Invested in capital assets, net of related debt	30,515,207	27,377,005
Restricted	4,053,686	4,827,890
Unrestricted (deficit)	(2,974,270)	(1,882,923)
<b>Total net assets</b>	<b>\$ 31,594,623</b>	<b>\$ 30,321,972</b>

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased 4% with respect to prior year. 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.

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 arises 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.

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Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

**Changes in net assets**

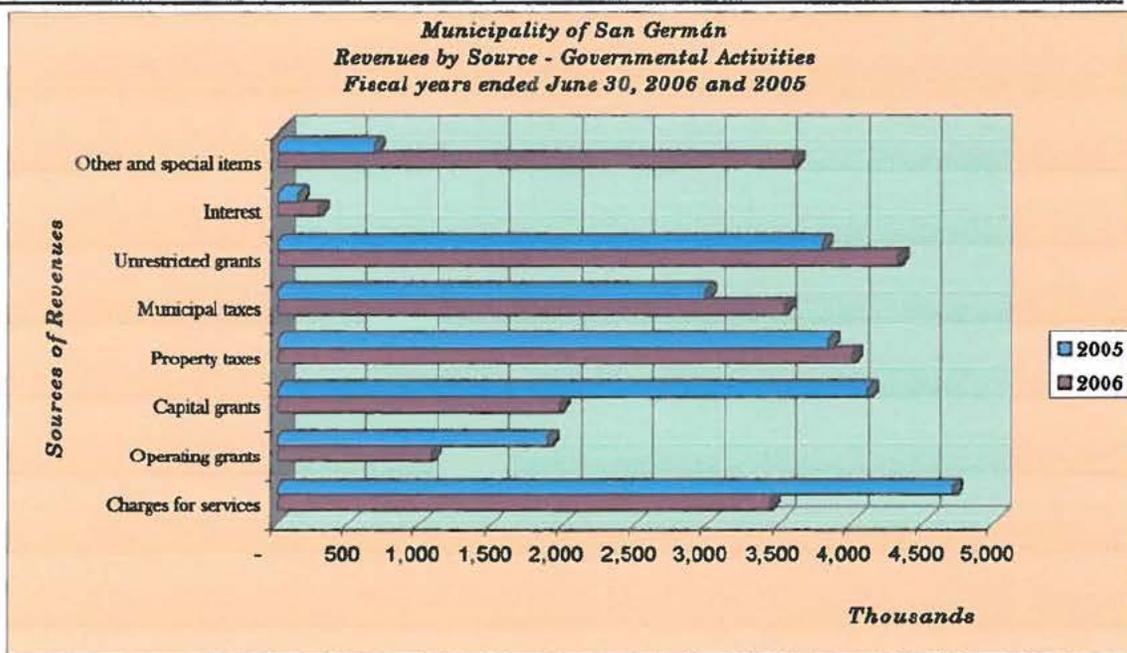
The following table summarizes the changes in net assets for the years ended June 30, 2006 and 2005:

**TABLE 2**

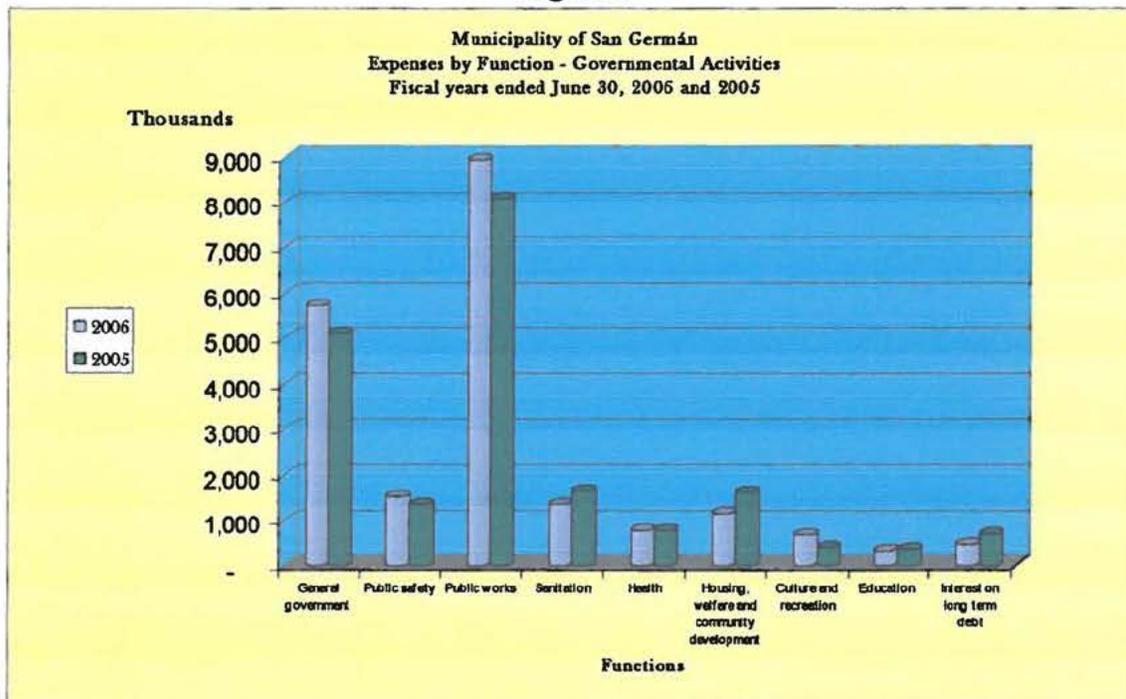
<i>Summary of Changes in Net Assets As of June 30,</i>		
	<b>Governmental Activities</b>	
	<b>2006</b>	<b>2005, as restated</b>
<b>Program revenues:</b>		
Fees, fines and charges for services	\$ 3,434,865	\$ 4,708,508
Operating grants and contributions	1,076,642	1,884,424
Capital grants and contributions	1,970,107	4,111,612
<b>General revenues:</b>		
Property taxes	4,007,234	3,842,907
Municipal license taxes	3,540,471	2,985,306
Grants and contributions not restricted to specific programs	4,323,349	3,801,184
Interest	285,721	146,431
Other	443,271	311,916
<b>Total revenues</b>	<b>19,081,660</b>	<b>21,792,288</b>
<b>Expenses:</b>		
General government	5,703,017	5,100,054
Public safety	1,511,702	1,344,520
Public works	8,938,940	8,093,279
Sanitation	1,360,311	1,661,808
Health	786,763	786,763
Housing, welfare and community development	1,164,797	1,611,196
Culture and recreation	678,945	411,241
Education	344,853	367,751
Interest on long term debt	471,614	714,839
<b>Total expenses</b>	<b>20,960,942</b>	<b>20,091,451</b>
<b>Special items</b>	<b>3,151,253</b>	<b>359,965</b>
<b>Change in net assets</b>	<b>1,272,651</b>	<b>2,060,802</b>
<b>Net assets-beginning of year, as restated</b>	<b>30,321,972</b>	<b>28,261,170</b>
<b>Net assets-end of year</b>	<b>\$ 31,594,623</b>	<b>\$ 30,321,972</b>

**Figure 1**

**Commonwealth of Puerto Rico  
Municipality of San Germán  
Management Discussion and Analysis  
For the year ended June 30, 2006**



**Figure 2**



**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Management Discussion and Analysis**  
**For the year ended June 30, 2006**

Approximately 15% of the Municipality's revenues came from fees and charges for services, 18% from property taxes, 19% from unrestricted grants and 16% from municipal license tax. The Municipality's expenses cover a range of services. The largest expenses are public works and sanitation representing approximately 49%, and general government with 27%.

With respect to prior year, revenues reported a net decrease of approximately 12%. This net decrease is primarily the result of: (1) a 14 % increase in unrestricted grants and contributions mostly due to an increase in the municipal subsidies and equalization fund sent by CRIM; (2) a 95% increase in interest on investments due to an increase of almost 2 points in the interest rate earned on the certificates of deposits held by the Municipality; (3) a 19% increase in municipal license taxes; (4) a 52 % decrease in capital grants revenues due to a significant decrease in grants received from the Commonwealth Legislature for the future acquisition and construction of capital assets; (5) a 43% decrease in operating grants due to a significant decrease in the grants received for general government and housing, welfare and community development expenditures; and (6) a 27% decrease in fees and charges for services mainly due to the loss of construction permits caused by the fact that various major construction projects were halted due to the partial shut down of the central government. In addition, the special items caption increased by \$2,791,968 (776%) due to the transfer to the Municipality by the PR Department of Transportation and Public Works of a public parking building with a construction cost of \$3,151,933.

Expenses increased 4% in comparison with 2005 year. The most significant increases occurred in general government with 12%, public safety with 12%, and public works with 10%, which were offset by a 28% decrease in housing, welfare and community development. As noted previously the significant decrease in revenues caused a decrease of 38% in the net change in net assets with respect to prior year net change.

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</i>				
<i>Fiscal years ended June 30,</i>				
<b>Functions/Programs</b>	<b>Total Cost of Services</b>		<b>Net Cost of Services</b>	
	<b>2006</b>	<b>2005, as restated</b>	<b>2006</b>	<b>2005</b>
General government	\$ 5,703,017	\$ 5,100,054	\$ (3,964,945)	\$ (1,555,217)
Public safety	1,511,702	1,344,520	(1,372,710)	(1,257,829)
Public works	8,938,940	8,093,279	(5,023,722)	(2,319,149)
Sanitation	1,360,311	1,661,808	(1,360,311)	(1,661,808)
Health	786,763	786,763	(786,763)	(786,763)
Housing, welfare and community development	1,164,797	1,611,196	(539,480)	(353,649)
Culture and Recreation	678,945	411,241	(622,372)	(377,315)
Education	344,853	367,751	(337,411)	(360,338)
Other	471,614	714,839	(471,614)	(714,839)
	<u>\$ 20,960,942</u>	<u>\$ 20,091,451</u>	<u>\$ (14,479,328)</u>	<u>\$ (9,386,907)</u>

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

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The net cost of services was fully covered by other general revenues such as property and municipal license taxes among others.

**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 \$5,550,840, a net decrease of \$1,531,707 in comparison with the prior year. This decrease was caused primarily by a net change in the general fund of (\$1,208,164); (\$442,936) in the debt service fund; (\$773,875) in the Commonwealth Legislative Resolutions and (\$123,044) in the other governmental funds. Of the total combined fund balances, \$597,428 (10%) 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. For the year ended June 30, 2006, the fund balance of the general fund decreased by \$1,208,164 when compared with the prior year. The principal components of the net decrease of \$681,905 in revenues are a decrease of \$425,048 in property taxes; a decrease of \$1,402,273 in fees, fines and charges for services (mainly due to construction permits), a \$542,031 increase in intergovernmental revenues and \$555,165 increase in Municipal license taxes. The net increase in expenditures of \$896,303 is mainly due to an increase of \$643,543 in public works and \$185,192 in public safety expenditures.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The general fund original budget for the fiscal period 2005-2006 presented an increase of 5% with respect to prior year budget. Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year the original budget was readjusted by \$1,226,840 from previous year excess fund balance. Actual revenues were less than the revised budgeted revenues by \$19,858 (net). The most significant variance (\$307,858) was in rental income and charges for services due mainly to a negative variance of \$645,771 in construction permits fees.

Even though a positive variance of 32,871 is reported between revised budget and actual expenditures, public works shows a negative variance due utility charges in excess of budget. Actual expenditures exceeded actual revenues by \$1,200,325.

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

**CAPITAL ASSET AND DEBT ADMINISTRATION**

**Capital assets**

At the end of the fiscal year, the Municipality has invested \$39,980,502 (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>		
	<b>Governmental Activities</b>	
	<b>2006</b>	<b>2005</b>
<b>Non-depreciable assets:</b>		
Land	\$ 5,943,873	\$ 5,803,873
Construction in progress	5,353,042	4,607,306
<b>Depreciable assets:</b>		
Buildings and Buildings Improvements	14,056,487	11,098,129
Equipment	3,673,708	3,662,128
Roads	5,556,058	6,278,966
Bridges	5,397,334	5,389,615
<b>Total</b>	<b>\$ 39,980,502</b>	<b>\$ 36,840,031</b>

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

- Construction of "Teatro Parque"
- Construction of a Gymnasium
- Construction of a Recreational Center for the Elderly
- Construction of a Sewer System
- Construction of an Agriculture Service Complex

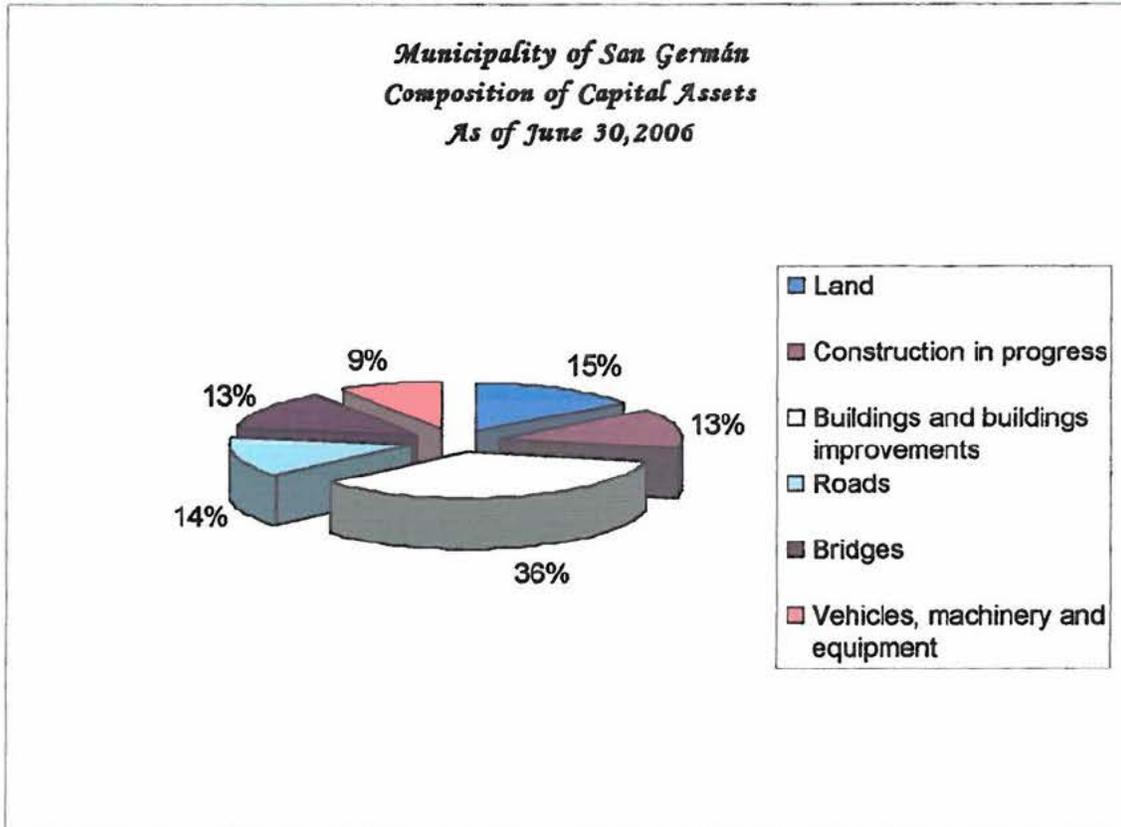
These projects will be financed through Federal and Commonwealth grants, funds from the Commonwealth Legislature, general obligation bonds and Municipal funds.

During the current year the Department of Transportation and Public Works of Puerto Rico transferred to the Municipality a parking building constructed in Municipality's land with a total cost of \$3,151,933.

In addition, the Municipality acquired equipment amounting to \$824,765, mainly vehicles and heavy equipment.

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

Capital assets composition as of June 30, 2006 follows:



More detailed information about the Municipality's capital assets is presented in Note E to the financial statements.

**Long term debt**

At year-end, the Municipality maintains an outstanding balance of \$11,294,272 in general and special bonds and notes, an increase of 52% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2006 and 2005:

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

**TABLE 5**

<i>Outstanding Long-term Debt As of June 30,</i>			
	<b>Governmental Activities</b>		
	<b>2006</b>	<b>2005</b>	
General and special obligation bonds and notes	\$ 11,294,272	\$ 7,449,772	
Note payable to CRIM – LIMS	335,306	385,483	
Note Payable to CRIM – prior years delinquent accounts	178,083	224,775	
Bond Anticipation Note	-	3,000,000	
Compensated absences	3,185,801	2,999,229	
Christmas Bonus	322,414	309,437	
Claims and judgments	58,327	56,000	
Payable to CRIM – property tax advances	429,699	364,297	
<b>Total</b>	<b>\$ 15,803,902</b>	<b>\$ 14,788,993</b>	

The general and special obligation bonds and notes increased by \$4,695,000 as a result of the issuance of a \$3,000,000 general obligation bond for the payment of the \$3,000,000 Bond Anticipation Note and of a \$1,695,000 general obligation note for the purchase of equipment. More detailed information about the Municipality's long term liabilities is presented in Note H to the financial statements.

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2006-2007 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 9.3%, which compares with the Commonwealth rate of 10.9%. Another important factor that may affect the 2006-2007 budget is the implementation of a Municipal sales tax effective July 1, 2006, which should provide additional unrestricted funds to finance Municipal operations.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2006-2007 are \$15,321,436, an increase of approximately 4% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. In addition to the estimated budget for the general fund, the Municipality has submitted Federal and Commonwealth funds proposals for welfare and community development as well as for capital improvements and public works funds.

**Commonwealth of Puerto Rico  
Municipality of San German  
Management Discussion and Analysis  
For the year ended June 30, 2006**

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**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 questions about this report or need additional information, contact the Municipality's Director of Finance at P.O. Box 85, San German, Puerto Rico 00683.

**BASIC FINANCIAL STATEMENTS**

Commonwealth of Puerto Rico  
Municipality of San German  
Statement of Net Assets  
June 30, 2006

	Governmental Activities
<u>Assets</u>	
<b><u>Current Assets:</u></b>	
Cash and cash equivalents	\$ 3,334,000
Receivables (net where applicable of allowance for uncollectibles) (note C)	
Commonwealth governmental agencies	703,764
Municipal license taxes	375,543
Federal government	181,196
Other	197,278
<b>Total Current Assets:</b>	<b>4,791,781</b>
<b><u>Non-Current Assets:</u></b>	
Restricted Assets:	
Cash and cash equivalents	2,116,779
Cash with fiscal agents	5,173,645
Deferred charges	50,508
Capital assets: (note E)	
Land and construction in progress	11,296,915
Other capital assets, net	28,683,587
Total capital assets	39,980,502
Other assets	11,393
<b>Total Noncurrent Assets:</b>	<b>47,332,827</b>
<b>Total Assets</b>	<b>\$ 52,124,608</b>
<u>Liabilities</u>	
<b><u>Current Liabilities:</u></b>	
Accounts payable and accrued liabilities	\$ 1,094,574
Interest payable	515,716
Due to Commonwealth governmental agencies (note F)	125,593
Due to Federal Government (note F)	58,903
Deposits payable	41,575
Deferred revenues	2,889,722
Current portion of long-term obligations (note H)	2,169,567
<b>Total Current Liabilities:</b>	<b>6,895,650</b>
<b><u>Noncurrent Liabilities:</u></b>	
Non current portion of long-term obligations (note H)	13,634,335
<b>Total Liabilities</b>	<b>20,529,985</b>
<b><u>Net Assets</u></b>	
Invested in capital assets, net of related debt	30,515,207
Restricted for:	
Capital projects	160,460
Debt service	2,396,502
Other specified purposes	1,496,724
Unrestricted (deficit)	(2,974,270)
<b>Total Net Assets</b>	<b>\$ 31,594,623</b>

The accompanying notes are an integral part of these financial statements.

Commonwealth of Puerto Rico  
Municipality of San German  
Statement of Activities  
For the year ended June 30, 2006

		Program Revenues			
Expenses	Fees, Fines and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Net (Expenses) Revenues and Changes in Net Assets	
<b>Functions</b>					
<b>Governmental activities:</b>					
General government	\$ 5,703,017	\$ 1,489,754	\$ 248,318	\$ -	\$ (3,964,945)
Public safety	1,511,702	-	138,992	-	(1,372,710)
Public works	8,938,940	1,945,111	-	1,970,107	(5,023,722)
Sanitation	1,360,311	-	-	-	(1,360,311)
Health	786,763	-	-	-	(786,763)
Welfare	1,164,797	-	625,317	-	(539,480)
Culture and recreation	678,945	-	56,573	-	(622,372)
Education	344,853	-	7,442	-	(337,411)
Interest on long-term debt	471,614	-	-	-	(471,614)
Total government activities	<u>\$ 20,960,942</u>	<u>\$ 3,434,865</u>	<u>\$ 1,076,642</u>	<u>\$ 1,970,107</u>	<u>(14,479,328)</u>
<b>General Revenues:</b>					
					4,007,234
					3,540,471
					4,323,349
					285,721
					443,271
<b>Special Item (note Q)</b>					
					3,151,933
					<u>15,751,979</u>
Change in net assets					1,272,651
Net assets at beginning of year, as restated (note O)					30,321,972
Net assets at end of year					<u>\$ 31,594,623</u>

The accompanying notes are an integral part of these financial statements.

Commonwealth of Puerto Rico  
Municipality of San German  
Balance Sheet  
Governmental Funds  
June 30, 2006

<u>Assets</u>	<u>Major Funds</u>				<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
	<u>General</u>	<u>Debt Service</u>	<u>Commonwealth Legislative Resolutions</u>	<u>\$1,695,000 Bond Issuance</u>		
Cash and cash equivalents	\$ 3,334,000	\$ -	\$ -	\$ -	\$ -	\$ 3,334,000
Receivables (net where applicable of allowance for uncollectibles)						
Commonwealth governmental agencies	297,530	273,047	-	-	133,187	703,764
Municipal license taxes	375,543	-	-	-	-	375,543
Federal government	-	-	-	-	181,196	181,196
Other	197,278	-	-	-	-	197,278
Due from other funds (note D)	398,941	-	-	-	-	398,941
Advances to other funds (note D)	165,252	-	-	-	-	165,252
Restricted Assets						
Cash and cash equivalents	-	-	1,816,923	-	299,856	2,116,779
Cash with fiscal agents	-	2,637,507	9,451	1,395,141	1,131,546	5,173,645
<b>Total assets</b>	<b>\$ 4,768,544</b>	<b>\$ 2,910,554</b>	<b>\$ 1,826,374</b>	<b>\$ 1,395,141</b>	<b>\$ 1,745,785</b>	<b>\$ 12,646,398</b>
<b><u>Liabilities and Fund balances</u></b>						
<b><u>Liabilities</u></b>						
Accounts payable and accrued liabilities	\$ 263,984	\$ -	\$ 14,957	\$ 347,113	\$ 468,520	\$ 1,094,574
Matured bonds and notes payable	-	982,500	-	-	-	982,500
Matured interest payable	-	493,589	-	-	-	493,589
Due to Commonwealth governmental agencies (note F)	125,082	-	511	-	-	125,593
Due to Federal Government (note F)	-	-	-	-	58,903	58,903
Due to other funds	-	-	20,210	31,716	347,015	398,941
Advances from other funds	-	-	-	-	165,252	165,252
Deposits payable	39,899	-	-	-	1,676	41,575
Deferred revenues (note G)	3,177,212	222,063	-	-	335,356	3,734,631
<b>Total liabilities</b>	<b>3,606,177</b>	<b>1,698,152</b>	<b>35,678</b>	<b>378,829</b>	<b>1,376,722</b>	<b>7,095,558</b>
<b><u>Fund balances</u></b>						
Reserved for:						
Encumbrances	399,687	-	-	-	-	399,687
Debt service	-	1,212,402	-	-	-	1,212,402
Capital projects	-	-	626,975	-	92,040	719,015
Other specified purposes	-	-	1,163,721	1,016,312	277,023	2,457,056
Advances	165,252	-	-	-	-	165,252
Unreserved	597,428	-	-	-	-	597,428
<b>Total fund balances</b>	<b>1,162,367</b>	<b>1,212,402</b>	<b>1,790,696</b>	<b>1,016,312</b>	<b>369,063</b>	<b>5,550,840</b>
<b>Total liabilities and Fund balances</b>	<b>\$ 4,768,544</b>	<b>\$ 2,910,554</b>	<b>\$ 1,826,374</b>	<b>\$ 1,395,141</b>	<b>\$ 1,745,785</b>	<b>\$ 12,646,398</b>

The accompanying notes are an integral part of these financial statements.

**Commonwealth of Puerto Rico  
Municipality of San German  
Reconciliation of the Balance Sheet of Governmental Funds  
to the Statement of Net Assets  
June 30, 2006**

**Fund Balance - total governmental funds** \$ 5,550,840

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

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds: 39,980,502

Other assets used in governmental activities are not financial resources and therefore are not reported in the funds:

Deferred charges-bond issue costs	\$ 50,508	
Other assets	<u>11,393</u>	61,901

Other assets are not available to pay for current period expenditures and therefore are deferred in the funds:

Receivables:

Rent	24,669	
Construction permits	45,773	
Other	13,676	
P.R. Department of Treasury - Christmas bonus reimbursement	161,207	
CRIM - Property taxes (Debt Service Fund)	222,063	
OCAM - Public Order Code	178,858	
Federal Grants - CDBG	9,220	
Federal Grants - EDA	99,694	
P.R. Department of Treasury - Law No. 52	<u>89,748</u>	844,908

Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds: (22,126)

Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds:

General obligation bonds and notes	10,311,772	
Compensated absences	3,185,801	
Claims and judgments	58,327	
CRIM - delinquent accounts	178,083	
CRIM - LIMS	335,306	
CRIM- Property taxes advances	429,699	
Christmas bonus	<u>322,414</u>	<u>(14,821,402)</u>

**Net assets of governmental activities** \$ 31,594,623

The accompanying notes are an integral part of these financial statements.

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Statement of Revenues, Expenditures, and Changes in Fund Balance -**  
**Governmental Funds**  
**For the year ended June 30, 2006**

	Major Funds				Other Governmental Funds	Total Governmental Funds
	General	Debt Service	Commonwealth Legislative Resolutions	\$1,695,000 Bond Issuance		
<b>Revenues:</b>						
Taxes						
Property taxes (note I)	\$ 2,773,110	\$ 1,077,463	\$ -	\$ -	\$ -	\$ 3,850,573
Municipal license taxes	3,540,471	-	-	-	-	3,540,471
Intergovernmental (note J)	4,316,860	-	4,910	-	1,569,703	5,891,473
Federal Grants	-	-	-	-	1,524,476	1,524,476
Rental income and charges for services	3,332,620	-	-	-	-	3,332,620
Fines and forfeitures	9,585	-	-	-	-	9,585
Interest	208,667	76,302	477	-	275	285,721
Other	229,611	-	-	-	84,581	314,192
<b>Total Revenues</b>	<b>14,410,924</b>	<b>1,153,765</b>	<b>5,387</b>	<b>-</b>	<b>3,179,035</b>	<b>18,749,111</b>
<b>Expenditures:</b>						
Current						
General government	4,917,242	-	11,912	18,029	298,736	5,245,919
Public safety	1,350,592	-	-	-	40,830	1,391,422
Public works	5,853,075	-	426,282	-	854,215	7,133,572
Sanitation	1,329,192	-	-	-	450	1,329,642
Health	786,763	-	-	-	-	786,763
Welfare	459,056	-	11,792	31,253	653,390	1,155,491
Culture and recreation	612,101	-	-	-	57,376	669,477
Education	325,066	-	2,607	-	17,180	344,853
Capital outlays	52,618	-	326,669	620,516	1,356,522	2,356,325
Debt service						
Principal	-	1,105,500	-	-	-	1,105,500
Interest	-	435,357	-	-	-	435,357
Bond issuance costs	-	-	-	8,890	12,607	21,497
<b>Total expenditures</b>	<b>15,685,705</b>	<b>1,540,857</b>	<b>779,262</b>	<b>678,688</b>	<b>3,291,306</b>	<b>21,975,818</b>
<b>(Deficiency) of revenues over expenditures</b>	<b>(1,274,781)</b>	<b>(387,092)</b>	<b>(773,875)</b>	<b>(678,688)</b>	<b>(112,271)</b>	<b>(3,226,707)</b>
<b>Other financing sources (uses):</b>						
Proceeds from general obligation bonds	-	-	-	1,695,000	3,000,000	4,695,000
Payment of bond anticipation note	-	-	-	-	(3,000,000)	(3,000,000)
Transfers - in	175,225	60,608	-	-	48,000	283,833
Transfers - (out)	(108,608)	(116,452)	-	-	(58,773)	(283,833)
<b>Total Other Financing sources (uses)</b>	<b>66,617</b>	<b>(55,844)</b>	<b>-</b>	<b>1,695,000</b>	<b>(10,773)</b>	<b>1,695,000</b>
<b>Net change in fund balance</b>	<b>(1,208,164)</b>	<b>(442,936)</b>	<b>(773,875)</b>	<b>1,016,312</b>	<b>(123,044)</b>	<b>(1,531,707)</b>
<b>Fund balance at beginning of year, as restated (note O)</b>	<b>2,370,531</b>	<b>1,655,338</b>	<b>2,564,571</b>	<b>-</b>	<b>492,107</b>	<b>7,082,547</b>
<b>Fund balance at end of year</b>	<b>\$ 1,162,367</b>	<b>\$ 1,212,402</b>	<b>\$ 1,790,696</b>	<b>\$ 1,016,312</b>	<b>\$ 369,063</b>	<b>\$ 5,550,840</b>

*Ortiz*  
1/5/07

The accompanying notes are an integral part of these financial statements.

Commonwealth of Puerto Rico  
Municipality of San German  
Reconciliation of the Statement of Revenues, Expenditures, and  
Changes in Fund Balances of Governmental Funds to the Statement of Activities  
For the year ended June 30, 2006

<b>Net change in fund balances - total governmental funds</b>		<b>\$ (1,531,707)</b>
 Amounts reported for governmental activities in the Statement of Activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays (\$2,356,325) exceeds depreciation (\$2,086,003) in the current year:		270,321
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:		(283,670)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds:		
Rent	\$ 24,669	
Construction permits	45,773	
Others	13,676	
P.R. Department of Treasury - Law No. 52	89,748	
P.R. Department of Treasury - Christmas bonus reimbursement	161,207	
CRIM - Property taxes (Debt Service Fund)	222,063	
OCAM - Public Order Code	178,857	
Federal Grants - CDBG	9,220	
Donated capital assets	<u>3,153,833</u>	3,899,046
Revenues reported in funds which are not reported as revenues in the Statement of Activities:		
CRIM - Property taxes (General Fund)	(65,402)	
Rent	(7,889)	
Other	(5,361)	
P.R. Department of Treasury - Law No. 52	(147,865)	
Federal Grants - CDBG	(33,330)	
P.R. Department of Treasury - Christmas bonus reimbursement (prior year)	<u>(154,718)</u>	(414,565)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		255,000
Proceeds from general obligation bonds is an other financing source in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:		(4,695,000)
Repayment of long-term debt consumes the current financial resources of governmental funds, but has no effect on net assets of governmental activities:		
General obligation bonds and notes	850,500	
Other long term liabilities	<u>3,693,513</u>	4,544,013
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	21,497	
Amortization of bond issuance costs	<u>(5,699)</u>	15,798
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:		
Other assets		11,393
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:		
Claims and judgments	(58,327)	
Accrued interest (net change)	542	
Compensated absences	(417,779)	
Christmas bonus	<u>(322,414)</u>	(797,978)
<b>Change in net assets of governmental activities</b>		<b><u>\$ 1,272,651</u></b>

The accompanying notes are an integral part of these financial statements.

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Municipality of San German was founded in the year 1573. The Municipality is comprised by the Executive and the Legislative branches 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 fourteen (14) members of the Municipality Legislature. The Municipality provides benefits to the community such as: health, public works, environmental control, human resources, education, public security, housing and community development, culture and recreation, and other general and administrative services.

The Municipality's financial statements are prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The significant accounting policies established in GAAP and used by the Municipality are discussed below.

**1. FINANCIAL REPORTING ENTITY**

The financial reporting entity included in this report consists of the financial statements of the Municipality of San German (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.

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:

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued**

- 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.

**2. BASIS OF PRESENTATION**

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. Both the government-wide and fund financial statements categorize primary activities as governmental. The Municipality's police, parks, library and recreation, public works, sports arena, and general administrative services are classified as governmental activities.

**Management Discussion and Analysis**

The Management Discussion Analysis consists of a narrative introduction and analytical overview of the municipality's financial activity. The analysis is similar to analysis the private sector provides in their annual report.

**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 San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued**

**Government-wide statements**

In the government-wide Statement of Net Assets, the governmental activities are presented on a consolidated basis and are reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The Municipality's net assets are reported in three parts—invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The Municipality first utilizes restricted resources to finance qualifying activities.

The government-wide Statement of Activities reports both the gross and net cost of each of the Municipality's functions (police, public works, etc.). The functions are also supported by general government revenues (property and municipal taxes, certain intergovernmental revenues, fines, permits and charges, etc.). The Statement of Activities reduces gross expenses (including depreciation) by related program revenues which includes fees, fines, and charges for services, as well as operating and capital grants. Program revenues must be directly associated with the function (police, public works, community and youth services, etc.). Operating grants include operating-specific and discretionary (either operating or capital) grants while the capital grants column reflects capital-specific grants. 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 net costs by function are normally covered by general revenue (property taxes, intergovernmental revenues, interest income, etc).

This government-wide focus is more on the sustainability of the Municipality as an entity and the change in the Municipality's net assets resulting from the current year's activities. Fiduciary Funds are not included in government-wide financial statements. The effect of interfund activities is eliminated. Private sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government wide statements to the extent that those standards do not conflicts with or contradicts guidance of the Governmental Accounting Standard Board. The municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

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

**Invested in capital assets, net of depreciation:**

Consist of capital assets 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 assets acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.

**Restricted net assets:**

Represent net assets that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and requirements of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued**

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.

**Fund statements**

The financial transactions of the Municipality are reported in individual funds in the fund financial statements. Each fund is accounted for by providing a separate set of self-balancing accounts that comprises its assets, liabilities, reserves, fund equity, revenues and expenditure / expenses. An emphasis placed on major funds category. A fund is considered major if it is the primarily operating fund of the Municipality or if total assets, liabilities, revenues, or expenditures/expenses of that individual governmental fund are at least 10 percent of the corresponding total for all fund of that category or type.

The various funds are reported by generic classification within the financial statements. The following fund types are used by the Municipality:

**a. Governmental Funds**

Governmental Funds are those through which most governmental functions of the Municipality are financed. The acquisition, uses, and balances of the Municipality expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position rather than upon net income determination. The Municipality reports the following major governmental funds:

**General Fund** - The General Fund is the general operations fund of the Municipality. It is used to account for all financial resources except those required to be accounted for in another fund.

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

**Commonwealth Legislature Resolutions Fund** - The Commonwealth Legislative Resolutions Fund is used to account for grants from the Commonwealth's Legislature.

**\$1,695,000 Bond Issuance Fund**- The \$1,695,000 bond issuance fund is used to accounts for the acquisition of equipment.

**b. Reservations of Fund Balance**

Represent portions of the fund balance that are legally segregated for a specific future use or are not appropriable for expenditure. The Municipality has the following reservations of fund balance:

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

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**NOTE A - NATURE OF ORGANIZATION AND 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:	Represents 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:	Represents the non-current portion of interfund loans.

**Notes to Basic Financial Statements**

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

**Required Supplementary Information**

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

**4. 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.

**Government-wide statements**

Government-wide statements are prepared using the economic resources measurement focus, which concentrates on an entity'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.

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.

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT  
ACCOUNTING POLICIES - Continued**

**Fund statements**

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.

The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method of accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

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.

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

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.

**5. FINANCIAL STATEMENT AMOUNTS**

**a. 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 and Federal grants are restricted since their use is limited by applicable agreements or required by law.

Restricted cash with fiscal agent in the debt service fund consists 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 with fiscal agent of the general and other governmental funds represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB or a federal government agency.

**b. Receivables**

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.

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**c. 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".

**d. 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.

**e. 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.

**f. Capital Assets**

Capital assets of the primary government, which include property, plant, equipment, and infrastructure, (e.g., roads, bridges, sidewalks, and similar items) are reported in the governmental activities column in the Statement 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 \$50 or more for capitalizing machinery and equipment. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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

<u>Description</u>	<u>Years</u>
Buildings	40
Machinery and equipment	5-10
Improvements	10-20
Infrastructure	2-50

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**g. 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. In the fund financial statements, the face amount of the debt issued is reported as other financing sources. Governmental fund types recognize bond issuance costs during the current period.

**h. 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.

**i. Interfund transactions**

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

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**j. Risk Financing**

The Puerto Rico Department of Treasury acts as an agent, obtaining and determining the coverage for the cities and municipalities of Puerto Rico. The coverage for the Municipality of San German 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.

**k. Use of Estimates**

The preparation of the financial statements in accordance with U.S. GAAP 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 financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

**l. 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 Plan	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 of Future Revenues and Intra-Entity Transfer of Assets and Future Revenues	June 30, 2008

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

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**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 \$3,798,487.

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 \$7,225,898.

**NOTE C - RECEIVABLES**

The Municipality's receivables as of June 30, 2006 are the following:

Description	Commonwealth Governmental Agencies	Others	Federal Government
Municipal Revenues Collection Center (CRIM) – Property Taxes	\$ 273,047	\$ -	\$ 99,695
Puerto Rico Treasury Department – Christmas Bonus reimbursement	161,207	-	81,501
OCAM- Public Order Code	178,858	-	-
Puerto Rico Department of Labor – Law No. 52	89,748	-	-
Construction permits	-	121,433	-
Rent	-	94,188	-
Others	904	130,633	-
Less: allowance for uncollectibles	-	(148,976)	-
	\$ 703,764	\$ 197,278	\$ 181,196

**Commonwealth of Puerto Rico**  
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**NOTE C - RECEIVABLES- Continued**

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

Municipal license tax receivable as of June 30, 2006 follows:

<u>Description</u>	<u>Amount</u>
Total Municipal license tax receivable:	\$ 633,687
Less: allowance for uncollectible:	(258,144)
	<u>\$ 375,543</u>

As required by current standards, the Municipality recognizes assets related to municipal license taxes when cash is received or in the period when the exchange transaction on which the government imposes the tax occurs. Management understands that as of tax return filing date an enforceable legal claim arises against the provider of resources. Therefore, an asset (receivable) is recognized as of June 30 for the balance on tax returns filed but not paid at that date.

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Resources are intended to finance the operations of the applicable fiscal year. At this moment the Municipality recognizes revenues on municipal license taxes. A discount of 5% is allowed when full payment is made on or before April 15. Since this time requirement, cash collected and the receivable balance on tax returns filed but not collected, which totals \$2,795,564 are recorded as deferred revenues as of June 30.

**NOTE D - INTERFUND TRANSACTIONS**

The amount presented as due from (to) other funds in the governmental fund statements represents interfund transfers and /or borrowings between funds:

**Commonwealth of Puerto Rico**  
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**NOTE D - INTERFUND TRANSACTIONS- Continued**

**Due from/to other funds:**

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other governmental funds-DTOP	\$ 49,634
	Other governmental funds-Law No. 52	89,747
	Other governmental funds-FEMA	29,170
	Other governmental funds-OMEF	26,733
	Other governmental funds-CDBG	30,440
	Other governmental funds-Traffic Safety	20,675
	Other governmental funds-Law No.105	19,030
	Other governmental funds-Others	133,512
		<u>\$ 398,941</u>

**Advances to (from) other funds:**

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other governmental funds-EDA	\$ 74,000
	Other governmental funds-OMEF	36,787
	Other governmental funds-CME	25,060
	Other governmental funds-P.R. Housing Department.	13,490
	Other governmental funds	15,915
		<u>\$ 165,252</u>

**Transfers in (out):**

Transfers between individual funds were made for operational purposes. Transfers includes interest earned on 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; reimbursements for expenditures from other governmental funds to the general fund and principal and interest payments of long term debt transferred from the general fund to the debt service fund.

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**NOTE E - CAPITAL ASSETS**

Capital assets activity for the year ended June 30, 2006 was as follows:

	<u>Beginning Balance, July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance June 30, 2006</u>
Governmental activities:				
Capital assets not being depreciated:				
Land	\$ 5,803,887	\$ 139,986	\$ -	\$ 5,943,873
Construction in progress	4,607,306	1,106,926	361,190	5,353,042
Total capital assets not being depreciated	<u>10,411,193</u>	<u>1,246,912</u>	<u>361,190</u>	<u>11,296,915</u>
Other capital assets:				
Buildings and improvements	16,263,742	3,425,209	-	19,688,951
Equipment	9,364,516	824,765	1,391,521	8,797,760
Roads	11,312,730	201,294	114,396	11,399,628
Bridges	6,617,417	173,154	-	6,790,571
Total other capital assets	<u>43,558,405</u>	<u>4,624,422</u>	<u>1,505,917</u>	<u>46,676,910</u>
Less accumulated depreciation for:				
Buildings and improvements	5,165,613	466,851	-	5,632,464
Equipment	5,702,388	552,117	1,130,453	5,124,052
Roads	5,033,764	901,600	91,794	5,843,570
Bridges	1,227,802	165,435	-	1,393,237
Total accumulated depreciation	<u>17,129,567</u>	<u>2,086,003</u>	<u>1,222,247</u>	<u>17,993,323</u>
Other capital assets, net	<u>26,428,838</u>	<u>2,538,419</u>	<u>283,670</u>	<u>28,683,587</u>
Governmental activities capital assets, net	<u>\$ 36,840,031</u>	<u>\$ 3,785,331</u>	<u>\$ 644,860</u>	<u>\$ 39,980,502</u>

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**NOTE E - CAPITAL ASSETS- Continued**

Depreciation expense was charged to functions as follows:

	<u>Amount</u>
General government	\$ 110,912
Public safety	120,281
Public works	1,805,367
Culture and recreation	9,468
Sanitation	30,669
Welfare	<u>9,306</u>
Total depreciation expense, governmental activities	<u>\$ 2,086,003</u>

**NOTE F - DUE TO GOVERNMENTAL AGENCIES**

Due to governmental agencies as of June 30, 2006 follows:

<u>Description</u>	<u>Commonwealth governmental agencies</u>	<u>Federal Government</u>
Puerto Rico Department of Labor - (unemployment)	\$ 20,581	\$ -
PRIDCO	7,736	-
Puerto Rico Retirement System	96,765	-
Other	511	-
HUD (Section 8)	-	58,903
Total	<u>\$ 125,593</u>	<u>\$ 58,903</u>

**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 follows:

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**NOTE G - DEFERRED REVENUES- Continued**

Description	General Fund	Debt Service Fund	Other Governmental Funds
Municipal license taxes	\$ 2,795,564	\$ -	\$ -
Puerto Rico Treasury Department – Christmas Bonus reimbursement	161,207	-	-
OCAM- Public Order Code	136,323	-	-
Other	84,118	-	-
CRIM – property taxes	-	222,063	-
Federal grants - EDA	-	-	99,695
Federal grants - CDBG	-	-	9,220
Federal grants – FEMA, Hurricane Georges	-	-	44,158
Federal grants – Edward Byrne	-	-	50,000
OCAM- Public Order Code	-	-	42,525
Puerto Rico Department of Labor – Law No. 52	-	-	89,748
	<u>\$ 3,177,212</u>	<u>\$ 222,063</u>	<u>\$ 335,346</u>

**NOTE H - LONG TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2006 was as follows:

	Beginning Balance, July 1, 2005	Additions	Reductions	Ending Balance June 30, 2006	Amounts Due within One Year
<b>Governmental activities:</b>					
<b>Bonds and notes payable:</b>					
General obligation bonds	\$ 2,850,000	\$ 3,000,000	\$ 150,000	\$ 5,700,000	\$ 232,000
General obligation notes	1,100,000	1,695,000	365,000	2,430,000	595,000
Public improvement bonds	3,384,772	-	278,000	3,106,772	294,204
Special obligation bond	115,000	-	57,500	57,500	57,500
Total bonds and notes payable	<u>7,449,772</u>	<u>4,695,000</u>	<u>850,500</u>	<u>11,294,272</u>	<u>1,178,704</u>
<b>Other liabilities:</b>					
Note payable to CRIM - LIMS	385,483	-	50,177	335,306	53,207
Note payable to CRIM – financing of delinquent account	224,775	-	46,692	178,083	-
Bond anticipation note	3,000,000	-	3,000,000	-	-
Christmas Bonus	309,437	322,414	309,437	322,414	322,414
Compensated absences	2,999,229	417,779	231,207	3,185,801	192,618
Claims and judgments	56,000	58,327	56,000	58,327	58,327
Property Taxes Advances – CRIM	364,297	65,402	-	429,699	364,297
Total other liabilities	<u>7,339,221</u>	<u>863,922</u>	<u>3,693,513</u>	<u>4,509,630</u>	<u>990,863</u>
	<u>\$ 14,788,993</u>	<u>\$ 5,558,922</u>	<u>\$ 4,544,013</u>	<u>\$ 15,803,902</u>	<u>\$ 2,169,567</u>

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**NOTE H – LONG TERM LIABILITIES - Continued**

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

<b>Original Amount</b>	<b>Description</b>	<b>Maturity</b>	<b>Interest Rate</b>	<b>Installments</b>	<b>Outstanding Balance</b>
\$ 400,000	Public Improvement Bond	January 1, 2007	5.00%	\$23,000 to \$27,204	\$ 27,204
1,150,000	Special Obligation Bond	July 1, 2006	8.5%	\$57,500	57,500
765,000	Public Improvement Bond	January 1, 2011	6.38%	\$39,000 to \$60,000	262,341
400,000	Public Improvement Bond	January 1, 2013	6.13%	\$17,000 to \$32,000	180,000
616,000	Public Improvement Bond	January 1, 2012	5.00%	\$30,000 to \$45,227	237,227
3,500,000	Public Improvement Bond	July 1, 2015	4.7 - 6.6%	\$140,000 to \$330,000	2,400,000
455,000	General Obligation Bond	July 1, 2011	3.27- 5.00%	\$55,000 to \$75,000	400,000
2,100,000	General Obligation Bond	July 1, 2013	2.7 - 4.6%	\$120,000 to \$235,000	1,465,000
1,435,000	General Obligation Bond	July 1, 2006	2.7 - 3.2%	\$285,00 to \$335,000	335,000
830,000	General Obligation Bond	July 1, 2026	2.7 - 5.6%	\$15,000 to \$75,000	780,000
130,000	General Obligation Bond	July 1, 2026	2.7 - 5.6%	\$5,000 to \$10,000	110,000
355,000	General Obligation Bond	July 1, 2028	2.36-6.00%	\$5,000 to \$30,000	345,000
3,000,000	General Obligation Bond	January 1, 2031	5.00%	\$67,000 to \$194,000	3,000,000
1,695,000	General Obligation Bond	July 1, 2012	4.23- 5.32%	\$200,000 to 285,000	1,695,000
					<u>\$11,294,272</u>

The annual requirements to amortize general obligation bonds and operational loans outstanding as of June 30, 2006 are as follows:

<b>Maturing at June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2007	\$ 1,178,704	\$ 467,761	\$ 1,646,465
2008	813,000	490,910	1,303,910
2009	873,000	442,569	1,315,569
2010	927,000	397,514	1,324,514
2011	979,341	348,835	1,328,176
2012 – 2016	3,486,227	1,081,197	4,567,424
2017 – 2021	867,000	635,134	1,502,134
2022 – 2026	1,117,000	395,229	1,512,229
2027 – 2031	1,053,000	128,535	1,181,535
<b>TOTALS</b>	<u>\$ 11,294,272</u>	<u>\$ 4,387,684</u>	<u>\$ 15,681,956</u>

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**NOTE H – LONG TERM LIABILITIES - Continued**

Other liabilities follows:

**Note payable to CRIM (LIMS)**

	<b>Amount</b>
<p>On July 3, 2001 the municipality entered into a financing agreement with the CRIM in the amount of \$539,645 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 tax payer's properties located in Puerto Rico. The note is payable in semiannual installments of \$36,188, 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 Municipal Revenue Collection Center (CRIM).</p>	\$ 335,306

Debt service requirements in future years are as follows:

<b>Maturing at June 30,</b>	<b>Principal</b>	<b>Interest</b>
2007	\$ 53,207	\$ 18,907
2008	56,420	15,678
2009	59,827	12,254
2010	63,439	8,624
2011	67,270	4,774
2012	35,143	872
Total	\$ 335,306	\$ 61,109

**Note payable to CRIM (FINANCING OF DELINQUENT ACCOUNTS)**

<p>On March 26, 2002 the municipality entered into a financing agreement with the CRIM in the amount of \$ 470,818 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 non revolving 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 payment 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:</p>	\$ 178,083
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**NOTE H – LONG TERM LIABILITIES - continued**

Debt service requirements in future years are as follows:

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ -	\$ 11,575
2008	-	11,575
2009	3,062	11,485
2010	3,267	11,280
2011	3,486	11,061
2012-2016	21,261	51,476
2017-2021	29,400	44,337
2022-2026	40,654	32,083
2027-2030	56,217	16,520
	20,736	1,084
Total	<u>\$ 178,083</u>	<u>\$ 202,476</u>

	<u>Amount</u>
<b>Compensated absences-</b> 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 will be paid with unrestricted funds.	\$ 3,185,801
<b>Christmas bonus</b> – represent the accrual portion corresponding to fiscal year 2004-2005 of the Christmas bonus to be paid on December 2005. Amount will be paid with unrestricted funds.	\$ 322,414
<b>Claims and judgements-</b> represent the final settlement legal cases paid subsequent to June 30, 2006. The awarded amount will be paid with unrestricted funds.	\$ 58,327
<b>Property tax advances-CRIM</b> – represents amount owed to CRIM due to advances in excess of revenues collected on behalf of the municipality. Amount will be paid with unrestricted funds.	\$ 429,699

**NOTE I – PROPERTY TAXES**

The Municipal Revenue Collection Center (CRIM) (a state governmental agency) is responsible for the assessment, collection and distribution of real and personal property taxes in accordance with the Commonwealth Property Tax Law. The tax levied on property is determined by the Commonwealth and the Municipal Government based on limits established by the Commonwealth Legislature. 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. Real property is assessed by the CRIM.

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**NOTE I – PROPERTY TAXES-Continued**

The tax is general assessed on January 1st on all taxable property located within the Municipality. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid in two equal installments, July 1st and January 1st. Property taxes are recorded as revenue by the Municipality in the year of receipt.

The tax rates in force as of June 30, 2006 are 8.53% for real property (of which 8.33% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.53% for personal property (of which 6.33% is paid by taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.5% and 5.5% respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.5% 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 owners is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amount, 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 advance funds to the Municipality based on an estimate of the property taxes to be levied and which are collected in subsequent periods. The CRIM collects such taxes and delivers to the Municipality's government any excess of taxes collected over the tax advances and amounts assigned for the repayment of the bond obligations. As part of the requirements of the Autonomous Municipal Law (Law number 80 of August 30, 1991), the CRIM determined a final settlement of funds distributed to municipalities. This distribution includes advances of property tax and amounts of municipal equalization fund from the state government. For the fiscal year 2004-2005 the CRIM performed the final settlement and determined that the Municipality has a net debt of \$364,297 and for fiscal year 2005-06 the final settlement determined a net debt of \$65,402 for a total of \$429,679. This amount is recorded as a long term debt.

**NOTE J – INTERGOVERNMENTAL REVENUES**

Intergovernmental revenues in the General Fund are comprised of Christmas bonus reimbursement of \$276,355 and revenues for municipal equalization fund of \$4,040,505 received from the Commonwealth of Puerto Rico. Amount recorded in other governmental funds consists of Commonwealth governmental grants.

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**NOTE K – RETIREMENT PLAN**

a. Plan Description

Regular employees of the Municipality contribute to a cost sharing multiple-employer defined benefit retirement plan, administered by the Employees' Retirement System of the Government of Puerto Rico an its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. 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 for occupational and no 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. 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, which consists of a savings account for each system participant. 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 be subjected to the total accumulated 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 are 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.

**Commonwealth of Puerto Rico  
Municipality of San German  
Notes to the Basic Financial Statements  
June 30, 2006**

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**NOTE K – RETIREMENT PLAN – Continued**

Under the new program the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

b. 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 fiscal year, which is equal to the required contribution, follows:

<u>Fiscal Year</u>	<u>Law No. 447</u>	<u>System 2000</u>
2003-2004	265,904	142,549
2004-2005	237,368	201,431
2005-2006	247,535	224,966

**NOTE L – 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 \$13,841.

**NOTE M - CONTINGENCIES**

1. Federal and state grants

Projects financed by federal and state grants are subject to audit 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 be performed.

2. Claims and judgments

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 will not be covered by insurance. As a result of one case settled subsequent to June 30, 2006 and not to be covered by insurance, the Municipality accrued \$58,327 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsels that based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

---

**NOTE N – COMMITMENTS**

1. Operating leases

The Municipality leases office space and 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 \$35,949. Management believes that the summary of the future minimum rental commitments under noncancelable equipment leases with terms exceeding one year is not significant.

2. Construction

The Municipality has commitments at June 30, 2006 of approximately \$ 1,266,737 for construction, improvements or renovation of certain municipal facilities.

**NOTE O – FUND BALANCE AND NET ASSETS RESTATEMENTS**

1. Fund balances

The Debt Service fund balance was restated to correct an understatement on accrued interest payable:

<u>Description</u>	<u>Debt Service Fund</u>
Fund balance, as previously reported:	\$ 1,946,983
Correction of interest payable to Rural Development on bond anticipation notes	( 291,645)
Fund balance, at beginning of year as restated:	<u>\$ 1,655,338</u>

2. Net assets

Net assets as of July 1, 2005 have been restated to include transactions not recorded in previous years as follows:

<u>Description</u>	<u>Amount</u>
Net Assets at beginning of year as previously reported:	\$ 30,613,617
Adjustments:	
Correction of beginning balance of interest payable to Rural Development on bond anticipation notes	(291,645)
Net Assets at beginning of year as restated:	<u>\$ 30,321,972</u>

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to the Basic Financial Statements**  
**June 30, 2006**

---

**NOTE P – SUBSEQUENT EVENTS**

1. Bond Anticipation Note

On September 13, 2005 the USDA Rural Development approved a \$320,000 bond anticipation note to the Municipality for the construction of a sewer system at a variable rate for seven years.

2. Sales Tax Implementation

Effective on July 1, 2006 the Municipality imposed a sales tax of 1% to be applicable over all direct sales to consumers, including certain services as approved by the Municipal Legislature. Subsequently on November 15, 2006 this tax was raised to 1.50% as 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.

3. Additional funds for capital projects

Subsequent to June 30, 2006 the Municipality received from the Governmental Development Bank of Puerto Rico \$1,600,000 of the \$675,000,000 in 2006 Series A Public Improvement Bonds issued by Commonwealth Government. The funds received will be used for the restoration of the downtown area and the construction of an educational park.

**NOTE Q – SPECIAL ITEM**

During the current year the Puerto Rico Department of Transportation and Public Works completed the construction of a parking building at the Municipality. The building was transferred to the municipality on November 2005. Total construction cost amounts to \$3,151,253. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of Municipality's management.

**REQUIRED SUPPLEMENTARY INFORMATION**

Commonwealth of Puerto Rico  
Municipality of San German  
Budgetary Comparison Schedule-General Fund  
For the year ended June 30, 2006

	Budgeted amounts		Actual amounts (Budgetary basis)	Variance with final budget Positive (Negative)
	Original	Final		
<b>Revenues</b>				
Property taxes	\$ 3,984,168	\$ 3,984,168	\$ 3,984,495	\$ 327
Municipal license taxes	3,395,050	3,395,050	3,592,074	197,024
Intergovernmental	3,189,614	2,993,369	3,056,723	63,354
Rental income and charges for services	3,640,478	3,640,478	3,332,620	(307,858)
Fines and forfeitures	20,000	20,000	9,585	(10,415)
Interest	144,000	144,000	277,477	133,477
Other	347,000	407,987	312,220	(95,767)
<b>Total Revenues</b>	<b>14,720,310</b>	<b>14,585,052</b>	<b>14,565,194</b>	<b>(19,858)</b>
<b>Expenditures</b>				
General government	4,854,180	5,022,394	4,836,264	186,130
Public safety	1,478,279	1,361,277	1,350,937	10,340
Public works	4,642,865	5,696,140	5,947,592	(251,452)
Sanitation	1,426,087	1,359,411	1,346,099	13,312
Health	837,755	837,755	786,763	50,992
Welfare	484,438	465,054	461,216	3,838
Culture and recreation	660,917	641,568	629,679	11,889
Education	335,789	335,598	327,776	7,822
<b>Total expenditures</b>	<b>14,720,310</b>	<b>15,719,197</b>	<b>15,686,326</b>	<b>32,871</b>
<b>(Deficiency) of revenues over expenditures</b>	<b>\$ -</b>	<b>(1,134,145)</b>	<b>(1,121,132)</b>	<b>13,013</b>
<b>Other Financial Sources (Uses)</b>				
Transfers - in		17,693	29,415	11,722
Transfers - out		(110,388)	(108,608)	1,780
<b>Total other financial sources (uses)</b>		<b>(92,695)</b>	<b>(79,193)</b>	<b>13,502</b>
<b>Net change in fund balance</b>		<b>(1,226,840)</b>	<b>(1,200,325)</b>	<b>26,515</b>
Readjustment from prior year fund balance (note B)		1,226,840	-	(1,226,840)
		<b>\$ -</b>	<b>\$ (1,200,325)</b>	<b>\$ (1,200,325)</b>

The accompanying notes to required supplemental information are an integral part of this schedule.

**Commonwealth of Puerto Rico**  
**Municipality of San German**  
**Notes to Budgetary Comparison Schedule**  
**June 30, 2006**

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**NOTE A - BUDGET POLICY**

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 time the budget is prepared.

Budget amendments, are approved by the Municipal Legislature. Certain budget transfers within the limitations and restriction of the Autonomous 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, purchases orders, contracts) are considered expenditure when commitment is made. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statement 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 the current year. Encumbrance's appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapse 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 revenues funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternative achieved through general obligation bond indentures and legal contractual grant agreement provisions.

**NOTE B – BUDGET READJUSTMENT**

During the year the approved operational budget was increased by \$ 1,226,840 from previous year excess fund balance. The purpose of this readjustment was to increase the amount assigned to certain expenditures in the general fund.

**NOTE C - RECONCILIATION OF DIFFERENCES BETWEEN BUDGETARY BASIS TO GAAP**

The Municipality's Combined Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds has been prepared in accordance with GAAP and the Budget Comparison Schedule – General Fund has been prepared on the budgetary basis, which is different from GAAP. The following reconciles the net change in fund balance:

**Commonwealth of Puerto Rico  
Municipality of San German  
Notes to Budgetary Comparison Schedule  
June 30, 2006**

**NOTE C - RECONCILIATION OF DIFFERENCES BETWEEN BUDGETARY BASIS TO GAAP  
- Continued**

<b>Net change in fund balance (Budgetary basis):</b>	<b>\$ (1,200,325)</b>
<b>Timing differences:</b>	
Current year encumbrances recorded as expenditures for budgetary basis	399,687
Prior year encumbrances recorded as expenditures for financial reporting purposes	(243,694)
<b>Basis of accounting differences:</b>	
Revenues recorded in budgetary basis but not for financial reporting purposes	(57,212)
Expenditures recorded for financial reporting purposes but not for budgetary basis	(106,620)
<b>Net change in fund balance (GAAP basis)</b>	<b><u>\$ (1,208,164)</u></b>

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FORM **SF-SAC**  
(5-2004)

U.S. DEPT. OF COMM.— Econ. and Stat. Admin. — U.S. CENSUS BUREAU  
ACTING AS COLLECTING AGENT FOR  
OFFICE OF MANAGEMENT AND BUDGET

**Data Collection Form for Reporting on  
AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS  
for Fiscal Year Ending Dates in 2004, 2005, or 2006**

Complete this form, as required by OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

**RETURN  
TO**

**Federal Audit Clearinghouse  
1201 E. 10th Street  
Jeffersonville, IN 47132**

**PART I GENERAL INFORMATION (To be completed by auditee, except for Items 4 and 7)**

<b>1. Fiscal period ending date for this submission</b> Month Day Year 06 / 30 / 2006 Fiscal Period End Dates Must Be In 2004, 2005, or 2006		<b>2. Type of Circular A-133 audit</b> 1 <input checked="" type="checkbox"/> Single audit    2 <input type="checkbox"/> Program-specific audit	
<b>3. Audit period covered</b> 1 <input checked="" type="checkbox"/> Annual    2 <input type="checkbox"/> Biennial    3 <input type="checkbox"/> Other - <input type="text"/> Months		<b>4. FEDERAL GOVERNMENT USE ONLY</b> Date received by Federal clearinghouse	
<b>5. Auditee Identification Numbers</b>			
<b>a. Primary Employer Identification Number (EIN)</b> 66 - 0433531		<b>b. Are multiple EINs covered in this report?</b> 1 <input type="checkbox"/> Yes    2 <input checked="" type="checkbox"/> No	
<b>d. Data Universal Numbering System (DUNS) Number</b> 09 - 112 - 8991		<b>e. Are multiple DUNS covered in this report?</b> 1 <input type="checkbox"/> Yes    2 <input checked="" type="checkbox"/> No	
		<b>f. If Part I, Item 5e = "Yes," complete Part I, Item 5f on the continuation sheet on Page 4.</b>	

<b>6. AUDITEE INFORMATION</b>		<b>7. AUDITOR INFORMATION (To be completed by auditor)</b>	
<b>a. Auditee name</b> MUNICIPALITY OF SAN GERMAN		<b>a. Auditor name</b> RODRIGUEZ, RIVERA & TORO, LLP	
<b>b. Auditee address (Number and street)</b> P.O. BOX 85 City SAN GERMAN State                      ZIP + 4 Code PR                              00686		<b>b. Auditor address (Number and street)</b> P.O. BOX 1080 City MAYAGUEZ State                      ZIP + 4 Code PR                              00681-1080	
<b>c. Auditee contact</b> Name MRS. ELI EIDA ORTIZ-FELICIANO Title FINANCE DIRECTOR		<b>c. Auditor contact</b> Name JOSE A. TORO-MERCADO, CPA Title MANAGING PARTNER	
<b>d. Auditee contact telephone</b> ( 787 ) 892 - 3500		<b>d. Auditor contact telephone</b> ( 787 ) 834 - 3100	
<b>e. Auditee contact FAX</b> ( 787 ) 892 - 1060		<b>e. Auditor contact FAX</b> ( 787 ) 831 - 2909	
<b>f. Auditee contact E-mail</b> DIRFINSANGERM@YAHOO.COM		<b>f. Auditor contact E-mail</b> JTORO@RRTL.PNET	

**9. AUDITEE CERTIFICATION STATEMENT** - This is to certify that, to the best of my knowledge and belief, the auditee has: (1) engaged an auditor to perform an audit in accordance with the provisions of OMB Circular A-133 for the period described in Part I, Items 1 and 3; (2) the auditor has completed such audit and presented a signed audit report which states that the audit was conducted in accordance with the provisions of the Circular; and, (3) the information included in **Parts I, II, and III** of this data collection form is accurate and complete. I declare that the foregoing is true and correct.

Signature of certifying official: *Elida Ortiz Feliciano*  
 Date: 03 / 07 / 07  
 Printed Name of certifying official: ELI EIDA ORTIZ-FELICIANO  
 Printed Title of certifying official: FINANCE DIRECTOR

**9. AUDITOR STATEMENT** - The data elements and information included in this form are limited to those prescribed by OMB Circular A-133. The information included in Parts II and III of the form, except for Part III, Items 7, 8, and 9a-9f, was transferred from the auditor's report(s) for the period described in Part I, Items 1 and 3, and is not a substitute for such reports. The auditor has not performed any auditing procedures since the date of the auditor's report(s). A copy of the reporting package required by OMB Circular A-133, which includes the complete auditor's report(s), is available in its entirety from the auditee at the address provided in Part I of this form. As required by OMB Circular A-133, the information in **Parts II and III** of this form was entered in this form by the auditor based on information included in the reporting package. The auditor has not performed any additional auditing procedures in connection with the completion of this form.

Signature of auditor: *Rodriguez Rivera & Toro*  
 Date: 3 / 07 / 07

FORM SF-SAC (5-2004)

**PART III FEDERAL PROGRAMS - Continued**

**9. FEDERAL AWARDS EXPENDED DURING FISCAL YEAR**

**10. AUDIT FINDINGS**

CFDA Number		Research and development (c)	Name of Federal program (d)	Amount expended (e)	Direct award (f)	Major program (g)		Type(s) of compliance requirement(s) <sup>4</sup> (a)	Audit finding reference number(s) <sup>5</sup> (b)
Federal Agency Prefix <sup>1</sup> (a)	Extension <sup>2</sup> (b)					Major program (g)	If yes, type of audit report <sup>3</sup> (h)		
1	0766	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	COMMUNITY FACILITIES LOANS AND GRANTS	\$ 11,722.00	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
1	4218	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	COMMUNITY DEVELOPMENT BLOCK GRANT-ENTITLEMENT GRANT	\$ 923,845.00	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	Q	DN	2006 III-1, 2006 III-2
1	4228	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	COMMUNITY DEVELOPMENT BLOCK GRANT-STATES PROGRAM	\$ 151,369.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	Q	DN	2006 III-1, 2006 III-2
1	4871	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	SECTION 8 HOUSING CHOICE VOUCHERS	\$ 384,652.00	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
1	6710	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	PUBLIC SAFETY PARTNERSHIP AND COMMUNITY POLICY GRANTS-COPS	\$ 29,358.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
2	0600	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	STATE AND COMMUNITY HIGHWAY SAFETY	\$ 38,358.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
9	3044	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	SPECIAL PROGRAM FOR THE AGING TITLE III PART B GRANTS FOR SUPPORTIVE SERVI	\$ 69,198.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
9	3569	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	COMMUNITY SERVICES BLOCK GRANT	\$ 23,414.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
9	7036	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	DISASTER GRANTS-PUBLIC ASSISTANCE	\$ 66,560.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
		1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No		\$ .00	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No			

**TOTAL FEDERAL AWARDS EXPENDED** →

\$ 1,698,476.00

IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS

<sup>1</sup> See Appendix 1 of instructions for valid Federal Agency two-digit prefixes.

<sup>2</sup> Or other identifying number when the Catalog of Federal Domestic Assistance (CFDA) number is not available. (See Instructions)

<sup>3</sup> If major program is marked "Yes," enter only one letter (U = Unqualified opinion, Q = Qualified opinion, A = Adverse opinion, D = Disclaimer of opinion) corresponding to the type of audit report in the adjacent box. If major program is marked "No," leave the type of audit report box blank.

<sup>4</sup> Enter the letter(s) of all type(s) of compliance requirement(s) that apply to audit findings (i.e., noncompliance, reportable conditions (including material weaknesses), questioned costs, fraud, and other items reported under § 510(a)) reported for each Federal program.

- A. Activities allowed or unallowed
- B. Allowable costs/cost principles
- C. Cash management
- D. Davis - Bacon Act

- E. Eligibility
- F. Equipment and real property management
- G. Matching, level of effort, earmarking
- H. Period of availability of Federal funds

- I. Procurement and suspension and debarment
- J. Program income
- K. Real property acquisition and relocation assistance

- L. Reporting
- M. Subrecipient monitoring
- N. Special tests and provisions
- O. None
- P. Other

<sup>5</sup> N/A for NONE

**PART I** Item 5 Continuation Sheet

c. List the multiple Employer Identification Numbers (EINs) covered in this report.												f. List the multiple DUNS covered in the report.																			
1	N	/	A					21	-			41	-					1	N	/	A					21	-				
2								22	-			42	-					2								22	-				
3								23	-			43	-					3								23	-				
4								24	-			44	-					4								24	-				
5								25	-			45	-					5								25	-				
6								26	-			46	-					6								26	-				
7								27	-			47	-					7								27	-				
8								28	-			48	-					8								28	-				
9								29	-			49	-					9								29	-				
10								30	-			50	-					10								30	-				
11								31	-			51	-					11								31	-				
12								32	-			52	-					12								32	-				
13								33	-			53	-					13								33	-				
14								34	-			54	-					14								34	-				
15								35	-			55	-					15								35	-				
16								36	-			56	-					16								36	-				
17								37	-			57	-					17								37	-				
18								38	-			58	-					18								38	-				
19								39	-			59	-					19								39	-				
20								40	-			60	-					20								40	-				

IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS.

December 22, 2006

*Mayor and Municipal Legislature  
Municipality of San German  
San German, Puerto Rico*

In connection with our audit of the basic financial statements of the Municipality of San German (the Municipality) as of and for the year ended June 30, 2006, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements that collectively comprise the Municipality's basic financial statements and not to provide an opinion on the internal control over financial reporting. Also, as part of obtaining reasonable assurance about whether the basic financial statements are free of material misstatements, we performed tests of the Municipality's compliance with certain provisions of laws, regulations, contracts and grants agreements. However, the objective of our audit of the basic financial statements was not to provide an opinion or overall compliance with such provisions.

In addition, as part of our audit of the Municipality's compliance with requirements applicable to major federal award programs, we considered its internal controls in order to determine our auditing procedures for the purpose of expressing our opinion on the Municipality's compliance with requirements applicable to major federal award programs and to report on internal control in accordance with U. S. Office of Management and Budget (OMB) Circular A-133 and not to provide assurance on internal control.

As a result of our audit, we noted certain financial, internal control and compliance matters that are presented for your consideration in the accompanying "Memorandum of Management Letter Comments". These matters are not significant enough to be considered reportable conditions as defined by SAS 60 *Communication of Internal Control Structure Related Matter Noted in an Audit*. A separate report dated December 22, 2006 contains our report 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. This letter does not affect our report dated December 22, 2006 on the basic financial statements of June 30, 2006. In addition, a separate report dated December 22, 2006 contains our report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with Mrs. Eli Eida Ortiz, Finance Director, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to provide advisory or technical assistance to you in implementing the recommendations.

Very truly yours,



José A. Toro Mercado, CPA  
Managing Partner

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SAN GERMAN**

**MEMORANDUM OF MANAGEMENT LETTER COMMENTS**

For the year ended June 30, 2006

Number	Area/ Program	Description
1	Accounts receivable - Municipal license tax	<p>Our examination of the accounts receivable subsidiary of municipal license tax disclosed 322 accounts with balances of less than \$100 for a total amount of \$12,520. Also, we identified 187 accounts with negative balances in the total amount of \$62,533.</p> <p>We recommend a thorough analysis of the accounts receivable subsidiary of municipal license tax at the closing of the fiscal year to eliminate miscellaneous uncollectible amounts and properly classify taxpayers' credits due to overpayments to reflect the correct gross amount of accounts receivable at year end. Also, an estimate of uncollectible accounts should be made for those remaining amounts classified as active for which an allowance has not been determined by management at year end.</p>
2	Salaries expenditures and payroll quarterly returns	<p>Our examination of the summary of the total salaries paid during the fiscal year disclosed a difference of \$55,381 with the amount of salaries reported in the Social Security and Medicare quarterly returns. The Municipality's consultant could not explain the source of this difference.</p> <p>We recommend the Municipality to reconcile the amount of salaries expenditure reported in the quarterly returns with the amounts recognized in the accounting records to facilitate the identification and documentation of any difference.</p>
3	Cash - Disbursements	<p>We noted that the Municipality prepares the purchase orders and disbursement manually using a typewriter.</p> <p>We recommend the preparation of an electronic template of these forms to improve the efficiency of the disbursement process.</p>
4	Cash - Bank conciliations	<p>During our audit procedures, we detected the following accounts with outstanding checks for more than one year:</p> <ul style="list-style-type: none"> <li>• Section 8 - \$1,274</li> <li>• CDBG-State's Program (OCAM) - \$2,120</li> </ul> <p>Also, the list of outstanding checks indicating the check number, date, amount and payee was not included for the following accounts:</p> <ul style="list-style-type: none"> <li>• "Programa Reciclaje" - \$161</li> <li>• "Biblioteca Pública Raquel Quiñones" - \$1,127</li> <li>• CDBG-Entitlement - \$774</li> </ul> <p>We recommend management the review of the mentioned outstanding check lists and the preparation of the ones not included.</p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SAN GERMAN**

**MEMORANDUM OF MANAGEMENT LETTER COMMENTS**

For the year ended June 30, 2006

Number	Area/ Program	Description
5	Collections Office - Other procedures	<p>Based on the interviews made to the Official Collector and the Director of the Finance Department, we found an inconsistency in the description of the process established for the issuance of certifications of payment of construction permits. The Official Collector indicated that once the taxpayer submits his copy of the official collector's receipt as evidence of payment and the construction permit approved by ARPE, she verifies the information with her records and issues the certification without an additional verification by the Finance Department. However, the Finance Director explained to us that a couple of months ago she instructed that any taxpayer who needs a certification must make a formal written request to the Mayor's Office or to the Finance Department. After the Finance Department evaluates the request and approves it, all the information is verified with the Municipality's records, the certification is issued and a copy is filed in the taxpayer's record.</p> <p>We recommend the Municipality to implement a formal written policy for the issuance of certifications to taxpayers, including the use of pre-numbered forms and a control ledger verified periodically by the Finance Department.</p>
6	Capital Assets	<p>Our test of property, plant and equipment additions made during the fiscal year 2005-2006 disclosed a net understatement of \$39,199 in 5 construction projects in progress examined. Also, we detected \$31,879 in net accounts payable not recorded in the financial statements related to these additions.</p> <p>We recommend the Municipality to correct the referred understatement in the current fiscal year and to perform a more complete search for capital asset additions, specifically for those amounts paid after year end.</p>
7	Procurement - Federal and nonfederal funds	<p>Our tests to the procurement files of 2 new construction projects that began during the fiscal year 2005-2006, disclosed that none of the files included the approved construction permits. As of our test date, the permits were not provided for our examination.</p> <p>We recommend the Municipality to review the procedures established for the submittal of the construction permit applications to ensure that it obtains the required permits before the construction project begins and that a copy of the approved permits is included in the procurement file of the construction project.</p>

COMMONWEALTH OF PUERTO RICO  
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MEMORANDUM OF MANAGEMENT LETTER COMMENTS

For the year ended June 30, 2006

Number	Area/ Program	Description
8	Payroll	<p>Our tests to a sample of 25 employee files from a population of 1,254 disclosed 6 cases in which the increase in the monthly salary earned by the employee was notified through a letter issued by the Mayor's Office. However, the official notification of change used by the Human Resources Department, which details the department, previous and current position, previous and current monthly salary and effective date of change was not found in the employee's file.</p> <p>We recommend the Municipality that all employee salary and/or position changes be documented and authorized using the official form implemented by the Municipality.</p>
9	CDBG	<p>We noted that one construction contract examined did not include a required contract clause related to Clean Air and Water Pollution Act.</p> <p>We recommend to the Municipality to follow established procedures related to this program to include all required clauses on construction contracts.</p>