

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE SAN SEBASTIAN

AUDITORIA 2006-2007

30 DE JUNIO DE 2007

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2007**

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

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Hoja de Trámite

**MUNICIPIO AUTÓNOMO DE SAN SEBASTIAN
DEPARTAMENTO DE FINANZAS**

**DE: FELIX M. IRIZARRY HERNÁNDEZ, CPA
Director de Finanzas**

**A: LCDO. ANGEL M. CASTILLO RODRIGUEZ
COMISIONADO ASUNTOS MUNICIPALES**

Asunto

ORTIZ, RIVERA, RIVERA & CO.

ENTREGA DE SINGLE AUDIT TERMINADO EN JUNIO 30
DE 2007.

PARA SU CONOCIMIENTO Y ACCION CORRESPONDIENTE

Recibido por: _____

Fecha: _____ 2008

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

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American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
Services Division

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Municipal Legislature
Municipality of San Sebastián
San Sebastián, 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 Sebastián, as of and for the year ended June 30, 2007, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Villa Soigal Project, as of June 30, 2007. Those financial statements were audited by other auditors whose report thereon has been furnished to, and our opinion, insofar as it relates to the amounts included for Villa Soigal Project, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the discretely presented component unit, each major fund and the aggregate remaining fund information of the Municipality of San Sebastián as of June 30, 2007, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds for the fiscal

year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2007, 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 grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 10 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
November 16, 2007

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to the original of this report



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**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

Our discussion and analysis of the Municipality of San Sebastian "the Municipality" financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2007. Please read it in conjunction with the financial statements, which begin on page 11.

FINANCIAL HIGHLIGHTS

- The asset of the Municipality, on a government-wide basis, exceeded its liabilities at the end of fiscal year 2007 by \$19,155,392 (net assets), of which \$24,971,880 represents investment in capital assets (net of accumulated depreciation, and related debt), \$2,217,043 represents restricted assets for debt services, \$ 1,255,408 represents restricted net assets for capital projects and unrestricted fund balance (\$9,288,939).
- The Municipality's total net assets increased by \$ 7,225,729 from prior year restated balance.
- At the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$ 4,630,927 an increase of \$ 3,650,712 in comparison with the prior year restated.
- The General Fund, on a current financial resources basis, reported the excess in revenues and other financing sources over expenditures and other financing uses of \$ 1,124,963. This excess is mainly due to the fact that during the current year the Municipality's operation resulted on an excess of revenues over expenditures of \$ 1,203,760 and related transfer-in of \$271,369 and transfer-out of \$ 350,166.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$ 1,045,599.
- The investment in capital assets, net of related debt, for this year is \$ 24,971,880.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 11 through 12) provide information about the activities of the Municipality as a whole and present a long-term view of the Municipality's finances. Fund financial statements start on page 13. For governmental activities, these statements show how these services were financed in the short term as well as what remains for future spending. Fund financial statements report the Municipalities' operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds.

Reporting the Municipality as a Whole

The Statement of Net Assets and the Statement of Activities

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

These two statements report the Municipality's *net assets* and related changes. The Municipality's net assets, represents the difference between assets and liabilities therefore we can measure or determine the financial health and/or financial position. The *increases or decreases* in the Municipality's net assets are indicator of whether its *financial health* is improving or deteriorating. However, you will need to consider other non-financial factors, such as, changes in the Municipality's property tax base and the roads' conditions, in order to asses the *overall health* of the Municipality of San Sebastián.

In the Statement of Net Assets and the Statement of Activities, we showed the Municipality activities as of basic services are reported here, including the municipal police, public works, garbage disposal, public energy and health services, and general administration. Property taxes, municipal license tax, sales and use tax, state and federal grants finance most of these activities.

Reporting the Municipality's Most Significant Funds

Fund Financial Statements

Our analysis of the Municipality's major funds begins on page 7. The Fund financial statements begin on page 13 and provide detailed information about the most significant funds, not the Municipality as a whole. Certain bond covenant required that the Municipality establish the Debt Service Fund in order to keep a proper accounting for the resources.

The Municipality's basic services are reported in the governmental funds, that uses an accounting approach which focus on how money was received and disbursed and the balances left at year-end that are available for spending. These funds were reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the Municipality's general government operations and the basic services it provides.

Governmental fund information helps you to determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation on pages 15 and 17 of this report.

**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

THE MUNICIPALITY AS A WHOLE

The change in fund balance during the year ended June 30, 2007 was \$ 7,225,729. Our analysis below focuses on the net assets and changes in net assets (Table 1) of the Municipality's governmental activities.

**Table 1
Net Assets
Governmental Activities**

	2007	2006 as restated	Increase (Decrease)	%
Current and other assets	\$9,008,946	\$5,150,533	\$3,858,413	74.91%
Capital assets	36,206,880	30,776,747	5,430,133	17.64%
Total Assets	<u>\$45,215,826</u>	<u>\$35,927,280</u>	<u>\$9,288,546</u>	<u>25.85%</u>
Other liabilities	\$4,378,019	\$5,647,595	(\$1,269,576)	-22.48%
Long term debt outstanding	21,682,415	18,350,022	\$3,332,393	18.16%
Total liabilities	<u>\$26,060,434</u>	<u>\$23,997,617</u>	<u>\$2,062,817</u>	<u>8.60%</u>
Net Assets				
Investment in Capital Assets, net of related debt	\$24,971,880	\$21,271,747	\$3,700,133	17.39%
Restricted for:				
Debt services	2,217,043	2,044,567	172,476	8.44%
Capital projects	1,255,408	-	1,255,408	
Unrestricted	(9,288,939)	(11,386,651)	2,097,712	-18%
Total net assets	<u>\$19,155,392</u>	<u>\$11,929,663</u>	<u>\$7,225,729</u>	<u>60.57%</u>

Governmental Activities

Revenues for the Municipality's governmental activities increase by \$ 6,026,870 or 29% and total expenses decreased by \$ 407,825 or 2%. The increase in revenues was mainly due to net effect of \$ 2,568,731 in donated capital assets, \$ 1,380,188 of sales and use tax, increase of \$ 1,848,284 in grants and contributions not restricted to specific programs and a reduction of \$ 405,470 in operating grand contributions. Decrease in expenses is directly related to the net effect of a decrease of \$ 897,925 in public works; increase of \$ 648,786 in general government and a decrease of \$ 145,015 in health and welfare.

**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

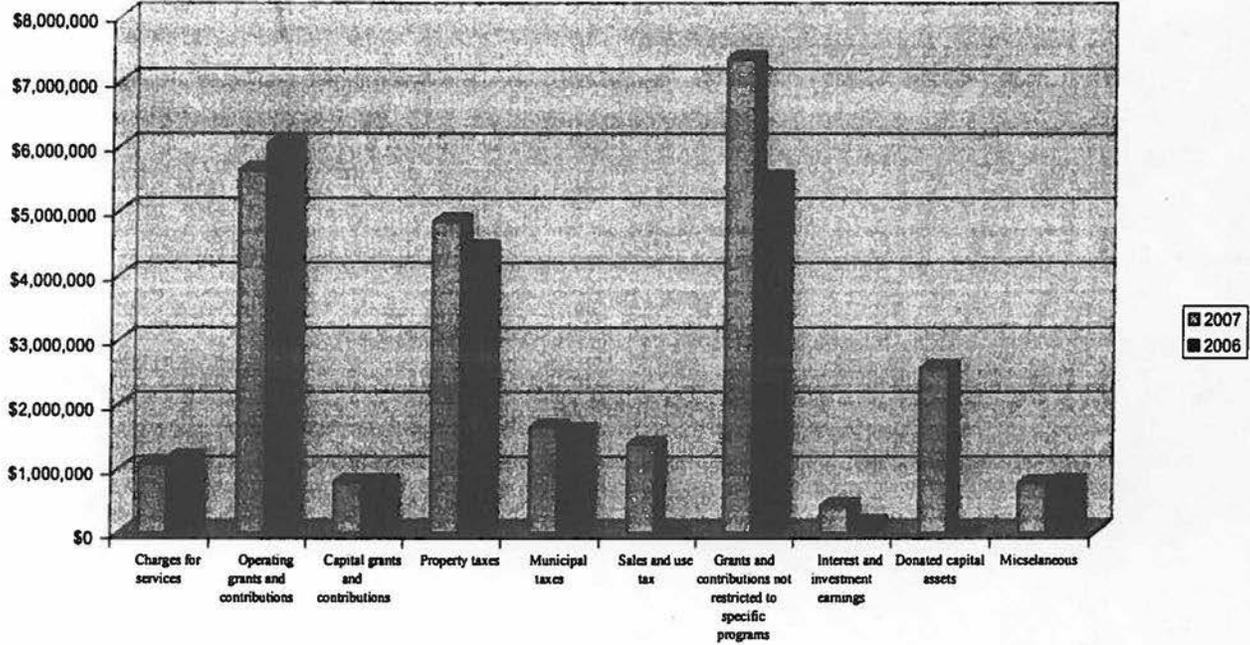
The following table summarizes the changes in net assets for the fiscal years ended 2007 and 2006:

**Table 2
Changes in Net Assets
Governmental Activities**

	2007	% of Total	2006 as restated	Change	% of Change
Revenues:					
Program revenues:					
Charges for services	\$1,087,876	4%	\$1,176,100	(\$88,224)	(8%)
Operating grants and contributions	5,637,754	21%	6,043,224	(405,470)	(7%)
Capital grants and contributions	793,944	3%	794,052	(108)	0%
General revenues:					
Property taxes	4,840,867	18%	4,424,398	416,469	9%
Municipal taxes	1,652,248	6%	1,599,011	53,237	3%
Sales and use tax	1,380,188	5%	-	1,380,188	
Grants and contributions not restricted to specific programs	7,353,985	28%	5,505,701	1,848,284	34%
Donated capital assets	2,568,731	10%	0	2,568,731	
Interest and investment earnings	424,490	2%	153,237	271,253	177%
Miscellaneous	780,356	3%	797,846	(17,490)	(2%)
Total revenues	26,520,439	100%	20,493,569	6,026,870	29%
Expenses:					
General government	6,426,400	33%	5,777,614	648,786	11%
Public safety	1,019,544	5%	1,007,847	11,697	1%
Public works	3,343,376	17%	4,241,301	(897,925)	(21%)
Culture	258,572	1%	320,761	(62,189)	(19%)
Recreation	346,018	2%	399,543	(53,525)	(13%)
Health and welfare	5,979,611	31%	6,124,626	(145,015)	(2%)
Depreciation	1,161,133	6%	1,205,834	(44,701)	(4%)
Interest on long-term debt	760,056	4%	625,009	135,047	22%
Total expenses	19,294,710	100%	19,702,535	(407,825)	(2%)
Increase(decrease) in net assets	7,225,729		791,034	6,434,695	813%
Special items:					
Gain on sale of capital assets			659,692	(659,692)	(100%)
Increase in net assets	7,225,729		1,450,726	5,775,003	398%
Net assets at beginning of year as restated	11,929,663		10,231,217	1,698,446	17%
Net assets end of year	<u>\$19,155,392</u>		<u>\$11,681,943</u>	<u>7,473,449</u>	64%

**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

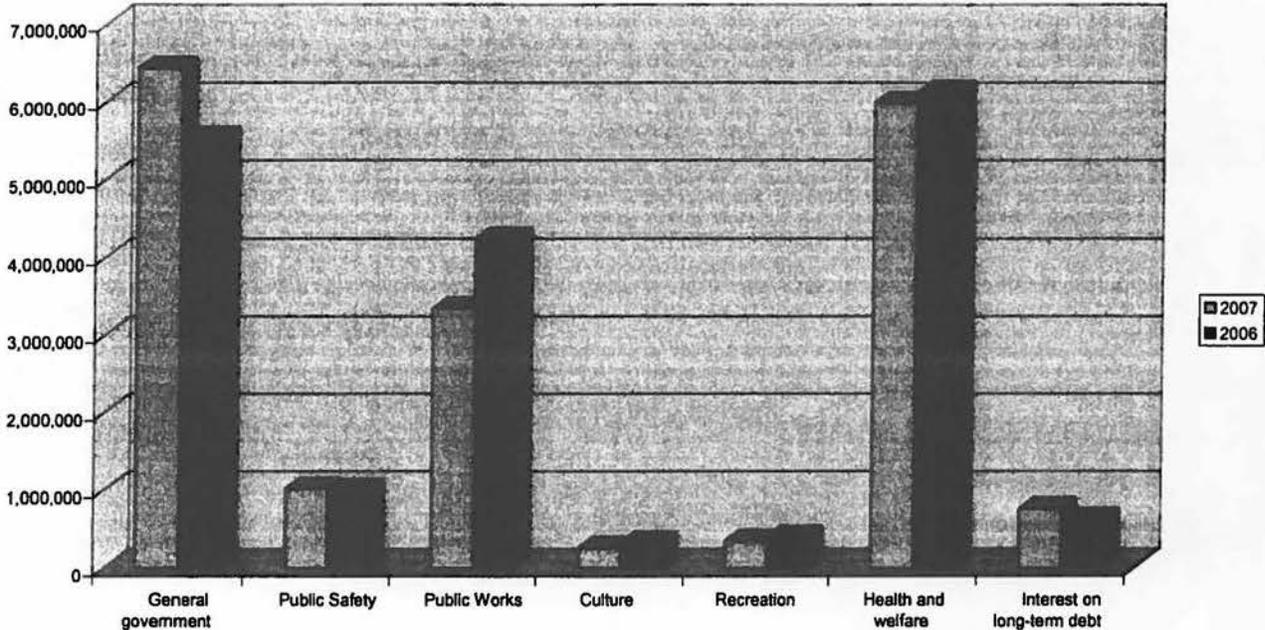
**Municipality of San Sebastian
Governmental Activities - Revenues by Sources
Fiscal Years Ended June 30, 2007 and 2006**



Approximately 28% of the Municipality's revenues came from grant and contributions not restricted operating and capital grants, 21% from operating and contributions and 18% from property taxes. Based on our analysis in Table 2, revenues increased approximately by 29% in comparison with fiscal year 2006. The most significant change, considering it's participation in total revenues, is an increase of 34% in grants and contributions not restricted to specific program due to a donated fund of bonds state issuance. Moreover, the Municipality received \$ 2,568,731 of donated funds assets and \$1,380,188 on implementation of sales and use tax.

**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

**Municipality of San Sebastian
Governmental Activities - Expenditure by Function
Fiscal Years Ended June 30, 2007 and 2006**



The Municipality's principal expenses are general government, which approximately represents a 33% of total expenses reported for the fiscal year ended June 30, 2007, health and welfare benefits provided to citizens represents a 31%, and public work represents a 17% related to federal programs. The increase of 11% on general government and 22% on interest of long-term debt are due to an investment in construction of capital assets.

Expenses decreased 2% in comparison with previous year. This includes the net effect of the following events: an increase of interest on long-term debt and general government, a decrease in public works due to a capitalization of public constructions.

THE MUNICIPALITY'S FUND

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. Specifically, 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, 2007, the governmental funds reported combined ending fund balances of \$ 4,630,927 a net increase of \$ 3,650,712 in comparison with the prior year. From total combined fund balances, \$ 884,018 constitutes unreserved fund balance. The remaining fund balance is not available for new spending.

**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Investment in capital assets for governmental activities as of June 30, 2007, amounted to \$ 36,206,880 (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, vehicles, machinery and equipment, park facilities, roads, bridges and construction in progress.

Capital assets as of June 30, 2007 and 2006 follow:

Table 3

**Capital Assets, net
As of June 30,**

	Governmental Activities	
	2007	2006
Non-depreciable assets:		
Land	\$5,626,376	\$2,159,416
Construction in progress	255,347	0
Depreciable assets:		
Buildings and improvements	24,205,095	24,808,509
Furniture and mixtures	210,708	251,693
Vehicles, machinery and equipment	572,905	596,568
Infrastructures	5,336,449	2,960,561
Total	\$36,206,880	\$30,776,747

This year's major capital assets additions (approximately) included:

- \$ 2,568,731 of a transfer of cost-free land from the State Government.
- \$ 898,229 of an acquisition of a land for the construction of a Sport Complex.
- \$ 2,375,888 of Infrastructure in Municipal Roads.

More detailed information about the Municipality's capital assets and future projects is presented in Note 11 to the financial statements.

**MUNICIPALITY OF SAN SEBASTIAN, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2007**

Debt

Debt Administration

Long term debt as of June 30, 2007 and 2006 follows:

Table 4

	Outstanding Long-term Debt	
	Fiscal years ended June 30,	
	Governmental Activities	
	2007	2006 (as restated)
Bonds payable	\$ 11,235,000	\$ 9,505,000
Notes payable	1,660,747	1,812,163
CRIM debt repayment plan	259,053	307,913
Landfill obligation	5,370,362	5,607,386
P.R. Health Insurance Administration	433,405	770,024
Compensated absences	1,951,042	1,230,613
Claims and judgments	265,000	265,000
Total	\$ 21,174,609	\$ 19,498,099

At the end of the current fiscal year, the Municipality had a total bonded debt and notes payable outstanding of \$ 12,895,747. Other obligations include a \$ 5,370,362 in landfill obligation \$ 1,951,042 in compensated absences, \$ 433,405 in P.R. Health Insurance Administration, and \$ 259,053 in CRIM debt repayment plan. Compensated absences are paid when due.

More detailed information about the Municipality's long-term liabilities is presented in Note 15 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 2007-2008 budget. The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2008 are \$14,241,978, an increase of approximately \$658,402, or 6% with respect to prior year estimates.

CONTACTING FINANCE DIRECTOR

This financial report is design to provide our citizens, taxpayers and customers and creditors with a general overview of the Municipality finances and to show accountability for the money it receives. If you have any questions about this report or need any additional information contact the Finance Department at the Municipality of San Sebastián, PO Box 1603, San Sebastián, P.R. 00685.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
STATEMENT OF NET ASSETS
JUNE 30, 2007**

<u>Assets</u>	<u>Governmental Activities</u>	<u>Villa Soigal Project</u>
Cash (Notes 2 and 5)	\$ 3,800,283	\$ 85,610
Cash with fiscal agent (Notes 2 and 5)	4,931,439	
Accounts receivables:		
Municipal license taxes (Note 7)	16,971	
Sales and use taxes (Note 8)	127,284	
Rent, licenses, and permits	95,593	
Other		5,453
Due from other agencies (Note 9)	28,707	
Other assets	8,669	24,841
Restricted deposits		433,931
Capital assets, net (Note 11)	36,206,880	1,805,818
 Total assets	 \$ 45,215,826	 \$ 2,355,653
<u>Liabilities and Net Assets</u>		
Liabilities		
Accounts payable and accrued liabilities	\$ 1,431,747	\$ 30,940
Due to other agencies (Note 12)	427,579	
Deferred revenues (Note 13):		
Municipal license tax	1,380,002	
Other	1,138,691	
Accrued interest	507,806	7,333
Noncurrent liabilities (Note 15):		
Due within one year	1,330,300	71,531
Due in more than one year	19,844,309	1,208,337
Total liabilities	26,060,434	1,318,141
Net Assets		
Investment in capital assets, net of related debt	24,971,880	
Restricted for:		
Debt service	2,217,043	
Capital projects	1,255,408	
Unrestricted	(9,288,939)	1,037,512
Total net assets	\$ 19,155,392	\$ 1,037,512

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

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets	
		Charges for	Operating Grants	Capital Grants	Primary Government	Component Unit
		Services	and Contributions	and Contributions	Governmental	Villa Soigal
				Activities	Project	
Primary Government:						
General government	\$ 6,426,400	\$ 1,087,876	\$ -	\$ -	\$ (5,338,524)	\$ -
Public safety	1,019,544				(1,019,544)	
Public works	3,343,376			793,944	(2,549,432)	
Culture	258,572				(258,572)	
Recreation	346,018				(346,018)	
Health and welfare	5,979,611		5,637,754		(341,857)	
Depreciation	1,161,133				(1,161,133)	
Interest on long-term debt	760,056				(760,056)	
Total primary government	\$ 19,294,710	\$ 1,087,876	\$ 5,637,754	\$ 793,944	(11,775,136)	-
Component Unit:						
Villa Soigal Project	\$ 542,656	\$ 550,721	\$ -	\$ -		8,065
General revenues:						
Property taxes					4,840,867	
Municipal license tax					1,652,248	
Sales and use tax					1,380,188	
Grants and contributions not restricted to specific programs					7,353,985	
Interest and investment earnings					424,490	14,913
Miscellaneous					780,356	1,115
Donated capital assets					2,568,731	
Total general revenues					19,000,865	16,028
Change in net assets					7,225,729	24,093
Net assets at beginning of year, as restated (Note 22)					11,929,663	1,013,419
Net assets at end of year					\$ 19,155,392	\$ 1,037,512

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2007**

<u>Assets</u>	<u>General</u>	<u>HUD Programs</u>	<u>HHS Program</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash (Notes 2 and 5)	\$ 2,631,376	\$ 88,307	\$ 75,075	\$ -	\$ 88,551	\$ 916,974	\$ 3,800,283
Cash with fiscal agent (Notes 2 and 5)				2,217,043	2,052,365	662,031	4,931,439
Accounts receivable:							
Municipal license taxes (Note 7)	16,971						16,971
Sales and use tax	127,284						127,284
Rent, licences, and permits	95,593						95,593
Due from agencies (Note 9)	28,707						28,707
Due from other funds (Note 10)	647,895	198	137			246,392	894,622
Other assets		6,814	808			1,047	8,669
Total assets	\$ 3,547,826	\$ 95,319	\$ 76,020	\$ 2,217,043	\$ 2,140,916	\$ 1,826,444	\$ 9,903,568

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2007**

<u>Liabilities and Fund Balance (Deficit)</u>	<u>General</u>	<u>HUD Programs</u>	<u>HHS Program</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities							
Account payable and accrued liabilities	\$ 546,511	\$ 313,717	\$ 69,642	\$ -	\$ 339,851	\$ 162,026	\$ 1,431,747
Due to other agencies (Note 12)	412,675					14,904	427,579
Due to other funds (Note 10)	246,529	7,848	255			639,990	894,622
Deferred revenues (Note 13):							
Municipal license tax	1,380,002						1,380,002
Other						1,138,691	1,138,691
Total liabilities	<u>2,585,717</u>	<u>321,565</u>	<u>69,897</u>	<u>-</u>	<u>339,851</u>	<u>1,955,611</u>	<u>5,272,641</u>
Fund Balance (Deficit)							
Reserved for:							
Encumbrances	274,458						274,458
Debt service				2,217,043			2,217,043
Restricted for specific purposes					1,255,408		1,255,408
Unreserved fund balance (deficit)	687,651	(226,246)	6,123		545,657	(129,167)	884,018
Total fund balance (deficit)	<u>962,109</u>	<u>(226,246)</u>	<u>6,123</u>	<u>2,217,043</u>	<u>1,801,065</u>	<u>(129,167)</u>	<u>4,630,927</u>
Total liabilities and fund balance	<u>\$ 3,547,826</u>	<u>\$ 95,319</u>	<u>\$ 76,020</u>	<u>\$ 2,217,043</u>	<u>\$ 2,140,916</u>	<u>\$ 1,826,444</u>	<u>\$ 9,903,568</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Total fund balances - governmental funds	\$ 4,630,927
Amounts reported for governmental activities in the statement of net assets are different because:	
• Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet	36,206,880
• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. (Note 4)	<u>(21,682,415)</u>
Net assets of governmental activities	<u>\$ 19,155,392</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) - GOVERNMENTAL (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

	General	HUD Programs	HHS Program	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
REVENUES							
Property taxes (Note 6)	\$ 3,724,702	\$ -	\$ -	\$ 1,116,165	\$ -	\$ -	\$ 4,840,867
Municipal license taxes (Note 7)	1,652,248						1,652,248
Sales and use taxes (Note 8)	1,291,637						1,291,637
Licenses and permits	501,460				88,551		590,011
Charges for service and rents	586,416						586,416
Intergovernmental revenues (Note 14):							
Federal grants and contributions		2,058,073	3,455,153			124,528	5,637,754
State contributions	5,384,897				1,969,088	793,944	8,147,929
Interest, fines, and penalties	258,202			79,970	60,518	25,800	424,490
Other revenues	326,309					454,047	780,356
Total revenues	<u>13,725,871</u>	<u>2,058,073</u>	<u>3,455,153</u>	<u>1,196,135</u>	<u>2,118,157</u>	<u>1,398,319</u>	<u>23,951,708</u>
EXPENDITURES							
General government	6,107,866						6,107,866
Public safety	1,019,544						1,019,544
Public works	3,580,400						3,580,400
Culture	258,572						258,572
Recreation	346,018						346,018
Health and welfare	1,209,711	2,154,927	3,403,864				6,768,502
Capital outlays					1,940,063	1,293,581	3,233,644
Debt service:							
Principal retirement				710,000			710,000
Interest and other				581,450			581,450
Total expenditures	<u>12,522,111</u>	<u>2,154,927</u>	<u>3,403,864</u>	<u>1,291,450</u>	<u>1,940,063</u>	<u>1,293,581</u>	<u>22,805,996</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,203,760</u>	<u>(96,854)</u>	<u>51,289</u>	<u>(95,315)</u>	<u>178,094</u>	<u>104,738</u>	<u>1,345,712</u>
OTHER FINANCING SOURCES (USES)							
Bonds issuance					1,150,000	1,155,000	2,305,000
Transfers in	271,369			345,457	511,138		1,127,964
Transfers out	(350,166)			(77,666)		(700,132)	(1,127,964)
Total other financing sources (uses)	<u>(78,797)</u>	<u>-</u>	<u>-</u>	<u>267,791</u>	<u>1,661,138</u>	<u>454,868</u>	<u>2,305,000</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses	<u>1,124,963</u>	<u>(96,854)</u>	<u>51,289</u>	<u>172,476</u>	<u>1,839,232</u>	<u>559,606</u>	<u>3,650,712</u>
FUND BALANCES (DEFICIT) AT BEGINNING OF YEAR AS RESTATED (Note 22)							
	<u>(162,854)</u>	<u>(129,392)</u>	<u>(45,166)</u>	<u>2,044,567</u>	<u>(38,167)</u>	<u>(688,773)</u>	<u>980,215</u>
FUND BALANCES (DEFICIT) AT END OF YEAR							
	<u>\$ 962,109</u>	<u>\$ (226,246)</u>	<u>\$ 6,123</u>	<u>\$ 2,217,043</u>	<u>\$ 1,801,065</u>	<u>\$ (129,167)</u>	<u>\$ 4,630,927</u>

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

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1351
162,719
162,854
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Net change in fund balances - total governmental funds \$ 3,650,712

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 and reported as depreciation expense. 4,022,535
- Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds. (1,161,133)
- Governmental funds report issuance of long-term debt as other financial sources because provides current financial resources. (2,305,000)
- Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds - doanted capital assets. 2,568,731
- Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities. 710,000
- Change in accrued interest expense which does not require the use of current financial resources. (178,606)
- Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds. (81,510)

Changes in net assets of governmental activities \$ 7,225,729

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
STATEMENT OF REVENUES AND EXPENDITURES - GENERAL BUDGET AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

	General Fund				Debt Service Fund			
	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)
	Original	Final			Original	Final		
REVENUES								
Property taxes	\$ 3,497,033	\$ 3,486,533	\$ 3,695,995	\$ 209,462	\$ 920,072	\$ 920,072	\$ 1,116,165	\$ 196,093
Sales tax	901,063	1,206,063	1,196,174	(9,889)				
Municipal license taxes	1,750,000	2,049,000	2,046,580	(2,420)				
Licenses and permits	784,500	455,500	501,460	45,960				
Charges for service and rents	575,000	566,000	586,416	20,416				
Intergovernmental revenues:								
State contributions	5,136,788	5,283,455	5,286,199	2,744				
Interest, fines and penalties	136,000	81,000	258,203	177,203			79,970	79,970
Other revenues	327,500	295,000	326,311	31,311				
Total revenues	<u>13,107,884</u>	<u>13,422,551</u>	<u>13,897,338</u>	<u>474,787</u>	<u>920,072</u>	<u>920,072</u>	<u>1,196,135</u>	<u>276,063</u>
EXPENDITURES								
General government	6,326,992	6,504,190	6,305,808	198,382				
Public safety	1,093,846	1,026,949	1,023,806	3,143				
Public works	3,882,748	4,046,430	3,696,107	350,323				
Culture	129,210	259,039	258,693	346				
Health and welfare	1,301,634	1,235,854	1,218,066	17,788				
Recreation	373,454	350,089	349,259	830				
Debt service:								
Principal					425,072	425,072	465,000	(39,928)
Interest					495,000	495,000	480,993	14,007
Total expenditures	<u>13,107,884</u>	<u>13,422,551</u>	<u>12,851,739</u>	<u>570,812</u>	<u>920,072</u>	<u>920,072</u>	<u>945,993</u>	<u>(25,921)</u>
Excess of revenues over expenditures	\$ -	\$ -	\$ 1,045,599	\$ 1,045,599	\$ -	\$ -	\$ 250,142	\$ 250,142

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

1. ORGANIZATION

The Municipality of San Sebastián, Puerto Rico (Municipality) was founded in 1752. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession existence and legal identity, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including: public safety, public works, culture, recreation, health and welfare, education and other miscellaneous services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial information of the Municipality is presented in this report as follows:

- **Management's Discussion and Analysis** - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- **Government - Wide Financial Statements** - The reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).
- **Statement of Net Assets** - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.

- **Statement of Program Activities** - The government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- **Budgetary comparison schedules** - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the new reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

a. Reporting Entity

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

The Villa Soigal Project is included in the basic financial statements as a discretely component unit because of the nature of the services they provide and the Municipality's ability to impose its will

Villa Soigal Project is a 120-unit multi-family housing project owned by the Municipality as authorized transfer from the Special Trustee for the Liquidation of the Accounts of the Puerto Rico Urban Renewal and Housing Corporation. The Project is operated under Section 515 of USDA, Rural Development (USDA-RD) and regulated by the U. S. Department of Housing and Urban Development (HUD) with respect to rental charges and operating methods. The project is also subject to Section 8 Housing Assistance Payments agreements with HUD, and a significant portion of the Project's rental income is received from HUD. Also, the Project is financed by a Mortgage of Section 515 Direct Loan.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

c. Measurement Focus, Basis of Accounting and Financial Statement Presentation

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

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The Municipality reports the following major governmental funds:

1) General Fund

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

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

2) Housing and Urban Development Programs (HUD Programs)

This fund account for revenue sources for the development of viable urban communities, decent housing, suitable living environment, rental assistance to help very low-income families afford decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low-income family.

3) Health and Human Services Programs (HHS Programs)

This fund account for revenue sources to provide essential human services such as health insurance for elderly and low-income people, improving maternal and infant health, pre-school education and services, prevent child abuse and domestic violence and medical and social science research including the prevention of outbreak of infections disease and immunization services.

4) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

5) Capital Projects Fund

This fund is used to account for the financial resources used for the acquisition and construction of major capital facilities, financed with the proceeds of general obligation bonds.

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

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

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

d. Cash and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

Cash with fiscal agent in the capital projects fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

e. 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 to/from other funds (i.e., the current portion of interfund loans) or advances to/from other funds (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as due to/from other funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

f. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure (which is normally immovable and of value only to the Municipality, such as roads, bridges, streets sidewalks, and drainage system), are reported in the applicable governmental or component units columns in the government-wide financial statements.

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	25-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-10 years
Vehicles and equipment	5-20 years

g. Reservation of Fund Balance

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

1) Encumbrances

Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

2) Debt Service

Represents net assets available to finance future debt service payments.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

3) Capital Projects Fund

Represents the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. The committed amounts generally will become liabilities in future periods as the projects are completed.

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2007 amounted to approximately \$339,437. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$328,000 for workers compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

j. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

k. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality has not yet adopted:

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
48	Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues	2007-08
49	Accounting and Financial Reporting for Pollution Remediation Obligations	2007-08
50	Pension Disclosures - an amendment of GASB Statements No. 25 and No. 27.	2007-08
51	Accounting and Financial Reporting for Intangible Assets	2009-10

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

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

The Municipality prepares its annual budget including the operations of the general and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

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

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

The annual budget is presented in the Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) is the budget ordinance to June 30, 2007 representing the original and the amended budget.

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b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues over expenditures for the year ended June 30, 2007 is presented below for the general fund:

	<u>General</u>
Excess of revenues over expenditures - budgetary basis	\$1,045,599
Timing differences:	
Prior year encumbrances recorded as current year expenditures for GAAP basis	(157,843)
Current year encumbrances recorded as expenditures on the budgetary basis	274,458
Basis of accounting differences:	
Net decrease in receivables	(3,364)
Net increase in accounts payable and other liabilities	(<u>33,887</u>)
Excess of revenues over expenditures - GAAP basis	<u>\$1,124,963</u>

c. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures.

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4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the

current period and therefore are not reported in the funds. The details of the approximately \$21.7 million difference are as follows:

Bonds payable	\$11,235,000
Landfill obligation	5,370,362
Notes payable	1,919,800
Compensated absences	1,951,042
Other long-term liabilities	433,405
Accrued interest payable	507,806
Claims and judgments	<u>265,000</u>
 Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	 <u>\$21,682,415</u>

5. DEPOSITS - CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The deposits at GDB of approximately \$2.7 million that are restricted principally for capital projects, and the \$2.2 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its deposits in banks located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000.

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The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.08% for real property and 5.08% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	6.00%	3.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	1.25%	1.25%
Discounts made by state to tax payer	< .20% >	< .20% >
	<u>8.08%</u>	<u>5.08%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

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Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to merchants with an annual volume of net sales less than \$150,000.

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2006-07, but not the final settlement as the six months period after fiscal year end, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2007, the amount collected by CRIM exceeded the amount received from CRIM for the same period by approximately \$28,000. Such amount is presented as intergovernmental receivable in the general fund in the basic financial statements due from CRIM. (See Note 9).

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7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2007. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of San Sebastián, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality of San Sebastián, are as follows:

Savings and loans associations	= 1.00%
Financial institutions	= 1.50%
Other organizations:	
Up to \$500,000	= .40%
Over \$500,000	= .50%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately \$1.4 million, corresponding to the next fiscal year municipal license.

8. SALES AND USE TAXES

On July 4, 2006, the Legislature of the Commonwealth of Puerto Rico approved Act No. 117 ("Act 117") which amends the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a sales and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth's sales and use tax.

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

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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.

The Municipal Legislature approved the imposition of the municipal sales and use tax, effective on November 15, 2006. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. Tax is due each 20th day of each month based on tax collected in the preceding month. The Municipal Ordinance does not impose specific restrictions or limitations on the use of the municipal sales and use tax resources. Resources are recorded in the general fund of the Municipality.

9. DUE FROM OTHER AGENCIES

Represents contributions due from the Municipal Revenues Collection Center for the amount of \$28,707.

10. INTERFUND TRANSACTIONS

a. Due From/To Other Funds:

The due from and due to other fund balances as of June 30, 2007, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Other Governmental Funds	\$639,792
HUD Programs	Other Governmental Funds	198
General	HUD Programs	7,848
General	HHS Programs	255
Other Governmental Funds	General	246,392
HHS Programs	General	<u>137</u>
Total		<u>\$894,622</u>

The balance of \$246,392 due from the other governmental funds to the general fund represents advances for various construction projects.

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All remaining balances resulted from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

b. Interfund Transfers:

Interfund transfers for the year ended June 30, 2007 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
Capital Projects	General Fund	\$ 4,709
Debt Service	General Fund	345,457
General Fund	Other Governmental Funds	193,703
Capital Project	Other Governmental Funds	506,429
General Fund	Debt Service	<u>77,666</u>
 Total		 <u>\$1,127,964</u>

The transfer from other governmental funds to the capital projects fund of \$506,000, represents monies received for the construction of various construction projects, which were received through other governmental funds.

Remaining transfers are used to (1) move revenues from the fund that statute or budget revenues to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the fund collection the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

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11. CAPITAL ASSETS

Capital asset activity for the Municipality for the year ended June 30, 2007 was as follows:

<u>Primary Government</u>	<u>Balance July 1, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2007</u>
Governmental Activities:				
Capital assets, not being depreciated:				
Land	\$ 2,159,416	\$ 3,466,960		\$ 5,626,376
Construction in progress	-	255,347		255,347
Total capital assets, not being depreciated	<u>2,159,416</u>	<u>3,722,307</u>	<u>-</u>	<u>5,881,723</u>
Capital assets, being depreciated:				
Buildings and building improvements	29,290,066	96,654		29,386,720
Furniture and fixtures	1,541,150	79,435		1,620,585
Vehicles and equipment	5,526,715	251,080		5,777,795
Infrastructure	3,295,119	2,441,790		5,736,909
Total capital assets, being depreciated	<u>39,653,050</u>	<u>2,868,959</u>	<u>-</u>	<u>42,522,009</u>
Less accumulated depreciation for:				
Buildings and building improvements	4,481,557	700,068		5,181,625
Furnitures and fixtures	1,289,457	120,420		1,409,877
Vehicles and equipment	4,930,147	274,743		5,204,890
Infrastructure	334,558	65,902		400,460
Total accumulated depreciation	<u>11,035,719</u>	<u>1,161,133</u>	<u>-</u>	<u>12,196,852</u>
Total capital assets, being depreciated, net	<u>28,617,331</u>	<u>1,707,826</u>	<u>-</u>	<u>30,325,157</u>
Governmental activities capital assets, net	<u>\$ 30,776,747</u>	<u>\$ 5,430,133</u>	<u>\$ -</u>	<u>\$ 36,206,880</u>

**COMMONWEALTH OF PUERTO RICO
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Capital asset activity for Villa Soigal Project, a discretely presented component unit, for the year ended June 30, 2007 was as follows:

<u>Component Unit- Villa Soigal Project</u>	<u>Balance July 1, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2007</u>
Capital assets, not being depreciated:				
Land	\$ 58,350	\$ -	\$ -	\$ 58,350
Total capital assets, not being depreciated	<u>58,350</u>	<u>-</u>	<u>-</u>	<u>58,350</u>
Capital assets, being depreciated:				
Land improvements	739,624			739,624
Buildings and building improvements	3,567,955			3,567,955
Building equipment	419,544	4,456		424,000
Furniture and fixtures	33,356			33,356
Equipment	9,898			9,898
Total capital assets, being depreciated	<u>4,770,377</u>	<u>4,456</u>	<u>-</u>	<u>4,774,833</u>
	4,828,727			
Less accumulated depreciation for:				
Land improvements	449,938	18,490		468,428
Buildings and building improvements	2,134,331	86,844		2,221,175
Building equipment	265,848	30,569		296,417
Furnitures and fixtures	31,295	235		31,530
Equipment	9,565	250		9,815
Total accumulated depreciation	<u>2,890,977</u>	<u>136,388</u>	<u>-</u>	<u>3,027,365</u>
Total capital assets, being depreciated, net	<u>1,879,400</u>	<u>(131,932)</u>	<u>-</u>	<u>1,747,468</u>
Villa Soigal Project capital assets, net	<u>\$ 1,937,750</u>	<u>\$ (131,932)</u>	<u>\$ -</u>	<u>\$ 1,805,818</u>

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12. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2007 are as follows:

Puerto Rico Treasury Department	\$ 19,960
Retirement System Administration	158,465
Puerto Rico Power Authority	7,081
Puerto Rico Water and Sewer Authority	51,066
U. S. Internal Revenue Services	54,024
Municipality of Moca	133,333
Puerto Rico Labor Department	<u>3,650</u>
	<u>\$ 427,579</u>

13. DEFERRED REVENUES

Municipal License Tax

The deferred revenues of approximately \$1.4 million in the general fund related to municipal license tax collected in fiscal year 2006-07 that will be earned in fiscal year 2007-08.

14. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, payments in lieu of taxes from the Puerto Rico Electric Power Authority and federal financial assistance received from the federal government.

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15. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2007 are as follows:

Bonds

\$3,420,000 series of 1996, payable in annual installments of \$70,000 to \$315,000 until July 1, 2016, interest ranging from 4.7% to 6.875%.	\$2,290,000
\$1,010,000 series of 1996, payable in annual installments of \$20,000 to \$95,000 until July 1, 2015, interest ranging from 4.7% to 6.58%.	640,000
\$1,800,000 series of 1997, payable in annual installments of \$20,000 to \$165,000 until July 1, 2021, interest ranging from 6.69% to 8.00%.	1,500,000
\$1,510,000 series of 2001, payable in annual installments of \$20,000 to \$135,000, until July 1, 2026; interest ranging from 5% to 8%.	1,390,000
\$1,110,000 series of 2005, payable in annual installments of \$50,000 to \$105,000 until July 1, 2019, interest ranging from 3.27% to 5%.	1,005,000
\$2,810,000 series of 2005, payable in annual installments of \$225,000 to \$345,000 until July 1, 2014, interest ranging from 4.5% to 6%.	2,105,000
\$1,150,000 series of 2007, payable in annual installments of \$25,000 to \$90,000 until July 1, 2031, interest ranging from 6.6% to 7%.	1,150,000
\$485,000 series of 2007, payable in annual installments of \$30,000 to \$65,000 until July 1, 2016, interest ranging from 6.6% to 7%.	485,000

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\$670,000 series of 2007, payable in annual installments of \$85,000 to \$120,000 until July 1, 2013, interest ranging from 6.6% to 7.5%. \$ 670,000

Total bonds payable \$ 11,235,000

Notes Payable

\$1,010,000 series of 2004, payable in annual installments of \$124,700 to \$174,250 until July 1, 2010, interest rate at 5%. \$ 625,000

Note payable of represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in annual aggregate installments of \$81,269 including interest rate of 6.158%. 1,035,747

Note payable to CRIM (LIMS) - On June 27, 2001, the Municipality entered into a financing agreement with the CRIM in the amount of \$495,559 for the payment of the Municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$33,232 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 sent to the Municipality by the Municipal Revenue Collection Center (CRIM). 259,053

Total notes payable \$ 1,919,800

Due to Puerto Rico Health Insurance Administration

Due to the Puerto Rico Health Insurance Administration of \$433,405 represents the municipal contribution related to the Health Care Reform corresponding to the period

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from December 1, 1995 through June 30, 1997. This balance will be paid through amounts retained by the CRIM from the participation in the Municipal Equalization Fund of the Additional Lottery System.

The annual debt service requirements for the bonds and notes payable at June 30, 2007, are as follows:

	<u>Bonds Payable</u>		<u>Notes Payable</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 735,000	\$ 657,539	\$ 214,258	\$ 102,517
2009	790,000	657,038	223,483	92,088
2009	840,000	597,350	237,966	80,922
2010	895,000	543,956	252,722	68,836
2012	950,000	486,877	54,536	59,965
2013-2017	4,175,000	1,514,965	134,145	272,199
2018-2022	1,590,000	635,871	181,928	224,417
2023-2027	850,000	280,240	246,730	159,614
2028-2032	410,000	76,300	334,615	71,729
2033-2037	-	-	39,417	1,219
	<u>\$ 11,235,000</u>	<u>\$ 5,450,136</u>	<u>\$ 1,919,800</u>	<u>\$ 1,133,506</u>

Component Unit

The mortgage payable by the discretely component unit is owed by Villa Soigal Project and consists of a 8% mortgage note, payable in monthly installments of \$13,203, including interest, until 2019, collateralized with land and building.

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The principal maturities of the mortgage in each of the next five years and thereafter are as follows:

<u>Year Ended June 30,</u>	<u>Amount</u>
2008	\$ 71,531
2009	77,468
2010	83,897
2011	90,861
2012	98,402
Thereafter	<u>857,709</u>
Total	<u>\$1,279,868</u>

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

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
Governmental Activities:					
Bonds payable	\$ 9,505,000	\$ 2,305,000	\$ 575,000	\$ 11,235,000	\$ 735,000
Notes payable	1,812,163		151,416	1,660,747	196,810
CRIM Debt Repayment Plan	307,913		48,860	259,053	17,448
Total long-term debt	<u>11,625,076</u>	<u>2,305,000</u>	<u>775,276</u>	<u>13,154,800</u>	<u>949,258</u>
Other long-term liabilities:					
Landfill obligation	5,607,386		237,024	5,370,362	248,875
Puerto Rico Health Insurance Administration	770,024		336,619	433,405	
Compensated absences	1,230,613	720,429		1,951,042	132,167
Claims and judgments	265,000			265,000	
Total other long-term liabilities	<u>7,873,023</u>	<u>720,429</u>	<u>573,643</u>	<u>8,019,809</u>	<u>381,042</u>
Total noncurrent liabilities, governmental activities	<u>\$ 19,498,099</u>	<u>\$ 3,025,429</u>	<u>\$ 1,348,919</u>	<u>\$ 21,174,609</u>	<u>\$ 1,330,300</u>
Component Unit:					
Villa Soigal Project mortgage payable	<u>\$ 1,345,917</u>	<u>\$ -</u>	<u>\$ 66,049</u>	<u>\$ 1,279,868</u>	<u>\$ 71,531</u>

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16. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. ERS System was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity will be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

(55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

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

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. 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 upon 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 rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2007 was approximately \$409,000. The Municipality's payroll for employees covered by ERS was approximately \$4.7 million. The Municipality total payroll for all employees was approximately \$8.5 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2007, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

17. RISK MANAGEMENT

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

18. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place and Transportation center under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2007 was approximately \$48,000.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Leasing arrangements with the Municipality as lessee:

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

19. MUNICIPAL SOLID WASTE LANDFILL POSTCLOSURE

The Municipality discontinued its landfill operations and ceased to accept solid waste in January 1993. State and Federal laws and regulations require the Municipality to perform certain postclosure procedures on its solid waste landfill after discontinuing of operations and perform certain maintenance and monitoring functions at the landfill site for thirty years. Postclosure care procedures were assumed by Municipality and directed by an external consultant. The closure process was completed in January 17, 1997. The total estimated liability for postclosure care costs has been determined in approximately \$5.4 million as of June 30, 2007. (See Note 15).

20. CONTINGENCIES

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.
- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.
- c. The Municipality received a claim of \$368,884 from the Employer's Retirement System of the Government of Puerto Rico due to certain laws that affect years 2002 thru 2006, for increases in benefits to ex-employees not assumed by the Municipality. The Municipality will contest this claim vigorously because such laws affect the municipal fiscal autonomy and impose an additional charge to the Municipality. Such amount has not been recorded in the accompanying financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

21. COMMITMENTS

The Municipality of San Sebastián has a contract for deposit of solid waste with the Municipality of Moca landfill for \$33,333 monthly renewable each six months and has also a contract with Atlantic Waste Disposal for \$8,874.94 weekly for deposit of solid waste.

22. RESTATEMENTS

a. Fund Balance

The beginning fund balance of the general fund, the capital project fund and other governmental funds has been restated to recognize corrections of accounting errors. The following schedule reconciles the fund balance at July 1, 2006 as previously reported to the beginning fund balance, as restated:

Fund	Balance at Beginning of Year as Previously Reported	Correction of Errors	Balance at Beginning of Year as Restated
General Fund	\$ 135	\$ (162,989)	\$ (162,854)
Other Governmental Funds	(690,063)	1,290	(688,773)
HHS	(41,992)	(3,174)	(45,166)
HUD	(130,574)	1,182	(129,392)
Total	\$ (862,494)	\$ (163,691)	\$ (1,026,185)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

b. Net Assets

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

Net assets at beginning of year as previously reported	\$ 12,093,354
Overstatement of revenues from property taxes (CRIM)	(161,699)
Correction of errors	<u>(1,992)</u>
Net assets at beginning of year as restated	<u>\$ 11,929,663</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Housing and Urban Development (HUD)		
Community Development Block Grant Program, Entitlement Grants	14.218	\$ 1,509,357
Emergency Shelter Grant Program	14.231	8,788
Section 8 - Rental Housing Choice Voucher Program	14.871	610,846
Pass through Commissioner Office of Municipal Affairs - Community Development Block Grants/State Program - SBGP	14.228	<u>25,936</u>
Subtotal U.S. Department of HUD		<u>2,154,927</u>
U.S. Department of Health and Human Services (HHS)		
Pass through Governor's Office of Child Services and Community Development:		
Head Start Program	93.600	3,192,629
Pass through Administration of Families and Children:		
Child Care and Development Block Grant	93.575	187,434
Pass through the Puerto Rico Elderly Commission		
Special Programs for the Aging Title III, Part D, Disease Prevention and Health Promotion Services	93.043	<u>23,801</u>
Subtotal U.S. Department of HHS		<u>3,403,864</u>
U.S. Department of Agriculture		
Pass-through Education Department:		
Child and Adult Care Food Program	10.558	<u>180,240</u>
Subtotal U.S. Department of Agriculture		<u>180,240</u>
U.S. Department of Justice		
Pass-through Department of Justice		
Local Law Enforcement Block Grant	16.592	<u>157,782</u>
Subtotal U.S. Department of Justice		<u>157,782</u>
U.S. Department of Transportation - National Highway Traffic Safety Administration		
Pass-through Department of Transportation (Traffic Safety Commission)		
State and Community Highway Safety	20.600	<u>3,120</u>
Subtotal U.S. Department of Transportation		<u>3,120</u>
U.S. Department of Homeland Security - Federal Emergency Management Agency (FEMA)		
Pass-through the Puerto Rico Governor's Office -(Governor's Authorized Representative-GAR)	96.067	<u>44,100</u>
Subtotal U.S. Department of FEMA		<u>44,100</u>
TOTAL		<u>\$ 5,944,033</u>

See notes to Schedule of Expenditures of Federal Awards.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of San Sebastián and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u>Expenditures</u>
Expenditures as per basic financial statements:	
Housing and Urban Development Programs	\$2,154,927
Health and Human Services Programs	3,403,864
Included within other governmental funds	<u>385,242</u>
	<u>\$5,944,033</u>
 Total expenditures per schedule of expenditures of federal awards	 <u>\$5,944,033</u>



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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of San Sebastián, as of and for the year ended June 30, 2007, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated November 16, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

likelihood that a misstatement of the Municipality's financial statements that is more than inconsequential will not be prevented or detected by the Municipality's internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of San Sebastián's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

San Juan, Puerto Rico
November 16, 2007

Ortiz Rivera, Rivera & Co.

The stamp 2286493 was affixed
to the original of this report.



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

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

Compliance

We have audited the compliance of Municipality of San Sebastián with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. Municipality of San Sebastián's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of San Sebastián's management. Our responsibility is to express and opinion on Municipality of San Sebastián's compliance based on our audit.

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

provide a legal determination on Municipality of San Sebastián's compliance with those requirements.

In our opinion, Municipality of San Sebastián complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 07-1 through 07-2.

Internal Control over Compliance

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

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

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
November 16, 2007

The stamp 2286494 was affixed to the original of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expresses an unqualified opinion on the basic financial statements of the Municipality of San Sebastián.
- b. There were no significant deficiencies on internal controls over financial reporting.
- c. No instances of noncompliance material to the financial statements of Municipality of San Sebastián were disclosed during the audit.
- d. There were no significant deficiencies on internal controls over major programs.
- e. The auditor's report on compliance with requirements applicable to federal award programs for Municipality of San Sebastián expressed an unqualified opinion.
- f. Audit finding relative to the major program for Municipality of San Sebastián is reported in number 3 of this schedule.
- g. The programs tested as major programs included:
 - Section 8 - CFDA 14.871
 - Head Start - CFDA 97.600
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of San Sebastián was determined to be a high-risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

None

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM
AUDIT**

a. Section 8 Voucher - CFDA 14.871

● **Condition 07-1**

The program did not comply with the procedures require for minimizing the time elapsing between the transfer funds and the disbursement by grantees. In addition, the program of Section 8 to June 2007 has a balance of \$84,832.55 which has been accumulated by leftover of approximately 10 years from the previous year. The Grantor indicated to the Municipality of San Sebastián to use the leftover to grant more vouchers.

Criteria

The 24 CFR 85.20 (b) (7) establishes that the federal funds recipient should adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements of expenditures.

Cause

The program does not have an effective control procedures for cash management.

Effect

The program does not comply with the cash management requirement.

Recommendation

The Municipality should establish a control procedures, in order to make disbursements after received the federal funds. In addition, the Municipality should identify the purpose of the balance in bank, in order to avoid a surplus on the bank account.

Questioned Costs

-0-

-57-

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

b. Head Start - CFDA 97.600

● **Condition 07-2 - Cash Management**

The Municipality's compliance with the administrative requirement to remit interest in excess of \$100 per year on federal fund deposit accounts is not effective. We noted that the program did not remit to the federal grantor and/or pass-through agency the interest income credited to the program cash account as required by federal regulations. The program cash account earned interest income of \$737 for the fiscal year 2006-07.

Criteria

The 45CFR 92.20(b)(7) establishes that the federal funds recipient will adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.

Cause

The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.

Effect

The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursing immediately after receipt, or within three (3) business days.

Questioned Costs

None

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
Head Start CFDA No. 93.600	Condition 05-1 The Municipality's compliance with the administrative requirement to remit interest in excess of \$100 per year on federal fund deposit accounts is not effective. We noted that the program did not remit to the federal grantor and/or pass-through agency the interest income credited to the program cash account as required by federal regulations. The program cash account earned interest income of \$825 for the fiscal year 2004-05.	Condition was corrected.
Section 8 Housing Choice Voucher CFDA No. 14.871	Condition 06-1 During the audit, we reviewed 1 participant file. We observed that this file does not include evidence of corrections to be realized as result of unit inspection.	Condition was observed.
Section 8 Housing Choice Voucher CFDA No. 14.871	Condition 06-2 The program did not comply with the procedures require for minimizing the time elapsing between the transfer of federal funds and the disbursement by grantees. In addition, the program maintains a high balance in bank.	Condition was not corrected.
Section 8 Housing Choice Voucher CFDA No. 14.871	Condition 06-3 The program did not adjust the utility data schedule within the last twelve months.	Condition was corrected.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
<p>Section 8 Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-4</p> <p>During the audit, we reviewed 15 participants' files. We observed that none of the files observed contains one or more release forms to allow the Municipality to obtain information from third parties, a federally prescribed general release for employment information and the Privacy Act Notice.</p>	<p>Condition was corrected.</p>
<p>Section 8 Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-5</p> <p>During the audit, we reviewed 15 participants' files. We observed that none of the files observed contains evidence of the method used by the Program to determine that the rent to owner is reasonable in comparison to the rent for other comparable unassisted units.</p>	<p>Condition was corrected.</p>



ESTADO LIBRE ASOCIADO DE PUERTO RICO
MUNICIPIO AUTÓNOMO DE SAN SEBASTIÁN
 DEPARTAMENTO DE FINANZAS



**COMMONWEALTH OF PUERTO RICO
 MUNICIPALITY OF SAN SEBASTIAN
 CORRECTIVE ACTION PLAN
 FOR THE YEAR ENDED JUNE 30, 2007**

The Municipality of San Sebastián is submits the following corrective action plan for the year ended June 30, 2007:

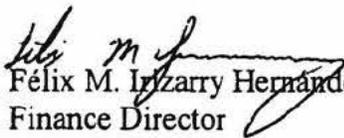
FINDING OF FINANCIAL STATEMENT AUDIT

Finding	Reportable condition	Recommendation	Action Taken
3-a- Section 8 Voucher- CFDA 14.871	The program did not comply with the procedures require for minimizing the time elapsing between the transfer funds and the disbarment by grantees. In addition the program of Section 8 to June 2007 has a balance of \$84,832.55 which has been accumulated by leftover of approximately 10 years from the previous year. The Grantor indicated to the Municipality of San Sebastián to use the leftover to grant more vouchers.	The Municipality should establish control procedures, in order to make disbursements after received the federal funds. In addition, the Municipality should identify the purpose of the balance in bank, in order to avoid a surplus on the bank account.	The Municipality of San Sebastián according to instructions given by the Grantor will be granting the maximum of vouchers allowed to eliminate this balance in a term of four years. In addition, the balance in a voucher account will be invested in order that the account stays in a minimum balance and continues generating interests for the benefit of the Program.
3-b-Head Start- CFDA 97.600	The Municipality's compliance with the administrative requirement to remit interest in excess of \$100 per year on federal fund deposit accounts is not effective. We noted that the program did not remit to the federal grantor and/or pass-through agency the interest	The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursing	We will design and establish adequate internal control to minimize interest income and remit to the grantor immediately accumulated interest income generated into the account.

	income credited to the program cash account as required by federal regulations. The program cash account earned interest income of \$737 for the fiscal year 2006-07.	immediately after receipt, or within three (3) business days.	
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Any questions please contact to Mr. Félix M. Irizarry, Finance Director at (787) 896-2300.

Cordially,


Félix M. Irizarry Hernández, CPA
Finance Director