

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

MUNICIPIO DE VEGA BAJA
AUDITORIA 2004-2005
30 DE JUNIO DE 2005

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**MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SINGLE AUDIT REPORT
JUNE 30, 2005
(INDEPENDENT AUDITOR'S REPORT)**

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SINGLE AUDIT REPORT
JUNE 30, 2005

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**MUNICIPALITY OF VEGA BAJA
MANAGEMENT'S DISCUSSION AND ANALYSIS**

As management of the Municipality of Vega Baja, we offer the reader of the Municipality's financial statements this narrative overview of the financial activities of the Municipality for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with the Municipality's financial statements.

Fiscal year 2004-2005 operations except, for the general fund sustain the Municipality's track of solvency and sound fiscal condition. The Governmental Wide Financial statement also supports our statement. This condition is achieved in a time of economic constraints and low revenue growth rates.

FINANCIAL HIGHLIGHTS

- The assets of the Municipality exceeded its liabilities at the close of the current fiscal year by \$39,160,739 millions (net assets).
- All government funds, except, the general fund ended with a favorable fund balance amounting to \$240,196.
- The adjusted actual of the General Fund operations resulted in an unfavorable variance of (\$665,453) as compared to the revised budget.
- As June 30, 2005 the Municipality's General Fund (the primary operating fund) reported a fund balance of \$16,342 a increase of \$839,916 in comparison with the prior year of \$823,574.
- Of the total unrestricted cash of \$22,313,827 there was investment in certificates of deposit amounting to \$10,644,253 millions.
- Long Term Debt loans principal payments were \$2,197,685 millions during fiscal year 2004-05. Loan proceeds from new debt issued amounted to \$1,375,000 millions during the same fiscal year.
- The net operating changes resulted with a loss of \$1,248,392 of the Debt Service Fund.

MUNICIPALITY OF VEGA BAJA MANAGEMENT DISCUSSION AND ANALYSIS

New Requirements for the Financial Reporting

The new approach on the preparation of the Municipality's financial statements emphasize on a government wide (consolidated) view of its financial operations. Nevertheless major individual funds are presented and evaluated in all of its details. Simultaneous implementation of both of these perspectives allows user to address relevant questions about municipality's performance and provides a basis for comparisons and evaluation of services quality.

Because of the implementation of these new reporting standards, much of the information will not be easily comparable with prior year. However, in future years, comparisons will be more meaningful and will provide a better understanding of the municipality's financial position and results of its operations.

Financial Statements Components

The basic financial statement consist of government wide financial statements, the major individual funds financial statements, and notes to the financial statements that provides more details.

The Statement of Net Assets reports information of the municipality as a whole. Increase or decrease of net assets may serve as an indicator of whether municipality's financial position is improving or deteriorating. Those statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most privet sector companies. Accrual of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The statement of Activities is focused on both the gross and net cost of various activities, which are supported by the Municipality's property tax, municipal licenses tax and other revenues. It is intended to summarize and simplify the user's analysis of the costs of governmental services. The governmental activities reflect basic services, including police, public works, solid waste disposal, community services, and general administration. Property tax, municipal license tax, state and federal appropriations finance most of the services.

MUNICIPALITY OF VEGA BAJA MANAGEMENT'S DISCUSSION AND ANALYSIS

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Major Governmental Funds presentation provides detailed information about the most significant funds, not the Municipality as a whole. The Municipality uses fund accounting to ensure and demonstrate compliance with financial related legal requirements. The Municipality's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are 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 funds statement provides a detailed short-term view of the Municipality general governmental operations and the basic services it provides. Governmental funds information help you determine whether there are more or fewer financial resources that can be spend in the near future to finance Municipality's programs. We describe the relationship between governmental activities and governmental funds in reconciliation besides the fund financial statements.

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statement.

Infrastructure Assets

The Municipality implemented the major model portions of GASB statement 34 during the current fiscal year. Historically, the governmental larger group of assets have not been reported nor depreciated in governmental financial statement. The new statement required that this asset be valued and reported within the Governmental column of the Governmental Wide Statement. Additionally, the government must elect to either depreciate these assets over their estimated useful life or develop a system of assets management designated to maintain the service delivered potentially to near perpetuity. If the government develops the assets managements system, which periodically, by category, measures and demonstrate its maintenance of locally established level of services standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statements users in evaluating a local government and its performance over time.

**MUNICIPALITY OF VEGA BAJA
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Government-Wide Statement

Statement of Net Assets

The Statement of Net Assets reports information of the municipality as a whole. Increase or decrease of net assets may serve as an indicator of whether municipality's financial position is improving or deteriorating. In the case of the Municipality primary government assets exceeded liabilities by \$39,160,739 millions at the close of the recent fiscal year. The following reflects the condensed Statement of Net Assets.

**Statement of Net Assets
As of June 30, 2005 and 2004**

	2005	2004
Current assets	\$ 25,382,418	\$18,422,814
Restricted and other assets	3,441,767	13,722,907
Capital assets	58,859,597	43,185,205
Total assets	87,683,782	75,330,926
Current	13,432,801	14,776,326
Long-term liabilities	35,090,242	33,017,113
Total liabilities	48,523,043	47,793,439
Net assets:		
Invested in capital assets, net related debt	28,399,282	22,265,830
Debt service	2,641,767	1,756,358
Special and other funds	1,309,089	2,803,721
Capital project fund	12,947,371	15,023,119
Unrestricted (deficit)	(6,136,770)	(14,311,541)
Total Net assets	\$39,160,739	\$27,537,487

The principal increase of the net assets was due mainly to the inclusion of the capital assets of the municipality. Such amount will increase as the infrastructure assets are identified and included in the financial statements.

**MUNICIPALITY OF VEGA BAJA
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Activities

The following reflects the condensed Statement of Activities of the Primary Government:

For the year ended June 30, 2005 and 2004

	2005	2004
Revenues:		
Program Revenues	\$ 17,295,604	\$ 15,903,309
General Revenues	25,281,953	30,819,382
Total Revenue	42,577,557	46,722,391
Expenses:		
Governmental Activities	46,913,712	41,835,389
Change in Net Assets	\$ (4,336,155)	\$ 4,887,302

**MUNICIPALITY OF VEGA BAJA
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following reflects the condensed Balance Sheet of the Governmental Fund:

**Governmental Funds
Balance Sheet
June 30, 2005 and 2004**

	2005	2004
Assets:		
Cash	\$22,313,827	\$16,567,905
Restricted Cash	3,441,767	13,722,907
Accounts Receivable	6,062,622	3,325,208
Total assets	31,818,216	33,616,020
Liabilities and Fund Balance		
Liabilities:		
Accounts payable	6,928,573	4,788,103
Deferred Revenue	7,751,221	7,893,941
Mature bonds, notes and interests	-	2,174,352
Total Liabilities	14,679,794	14,856,396
Fund Balances	17,138,422	18,759,624
Total liabilities and Fund Balances	\$31,818,216	\$33,616,020

The most significant changes in this statement were as follows:

- Noticeably, the fund balances are mostly in cash and cash restricted.
- The increase in liabilities is due mainly to the accounts payable of special and capital project funds. The decrease in assets to increase in construction in progress.

**MUNICIPALITY OF VEGA BAJA
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Statement of Revenue, Expenditures and Changes in Fund Balances
June 30, 2005 and 2004**

	2005	2004
Revenues:		
Property taxes	\$ 7,755,624	\$ 10,969,191
Volume of business tax	8,791,297	7,424,072
Federal grants	14,860,884	14,443,887
Other	10,005,124	13,327,670
Total Revenues	41,412,929	46,164,820
Expenditures:		
General Government	12,083,765	9,689,775
Public works	8,073,370	7,074,380
Public safety	1,887,821	1,766,718
Health	2,499,434	2,427,950
Capital projects	5,982,347	6,800,438
Culture and recreation	2,131,617	1,141,312
Bonds, notes and interests	4,031,029	4,914,735
Education and training	8,242,633	7,873,575
Other expenditures	222,765	5,026,878
Total expenditures	45,154,781	46,715,761
Excess of revenues over expenditures	\$ (3,741,852)	\$ (550,941)

The most significant changes of this statement is as follows:

- The larger decrease in revenues is related to intergovernmental revenue for the amount of \$2.6 millions.
- The most significant change sin the expenditures were an increase in capital project for approximately \$818,091 related with capital outlays.



ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL DE VEGA BAJA

MANAGEMENT'S DISCUSSION AND ANALYSIS

Economic Factors and Next Year Budget

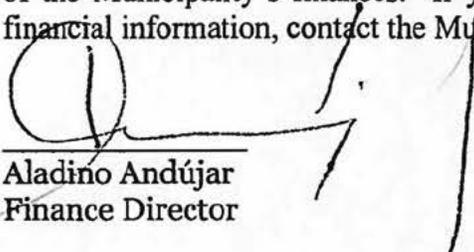
The Municipality is a political legal entity with full legislative and administrative powers in every area of municipal government, with perpetual existence and legal personality, separate and independent from the central governmental of Puerto Rico. The Municipal Government comprises the executive and legislative branches. The Mayor exercises the executive power and the legislative power by the Municipal Legislature, which has 14 members.

The Municipality provides a full range of services including public works, education Public safety, public housing, health, community development, culture, recreation and other administrative services. The Municipality's principal sources of revenues are property taxes, municipal license taxes, contributions by the state government and federal grants.

The municipality has a wide industrial base which included the International Airport, hotels, large pharmaceuticals, wholesalers, retail stores, financial institutions, restaurants, among others. This industrial base has increased substantially during the most recent years.

Contacting the Municipality's Financial Management

The Municipality's financial statements are designed to present users with general overview of the Municipality's finances. If you have questions about the report or need additional financial information, contact the Municipality's Director of Finance.


Aladino Andújar
Finance Director

JUAN A. FELICIANO CHARNECO
Certified Public Accountant

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Tel. (787) 879-4433
Fax (787) 880-1402

INDEPENDENT AUDITOR'S REPORT

Mayor of the Municipality of Vega Baja
Vega Baja, Puerto Rico

I have audited the accompanying financial statements of the Governmental Activities, each major fund and the remaining fund information of the **Municipality of Vega Baja**, Puerto Rico, as of and for the year ended June 30, 2005, which collectively comprise the **Municipality of Vega Baja** basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. My responsibility is to express opinions on these financial statements based on my audit.

Except as discussed in the following paragraphs, I have conducted my 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 of America. Those standards require that I 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. I believe that my audit provides a reasonable basis for my opinion.

The Municipality has not maintained complete and adequate records in order to obtain sufficient and competent evidential matter related with the Capital Assets additions and depreciation for the year reported in the governmental activities. Accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonably determinable.

In my opinion, except for the effects as described in the preceding paragraph the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities of each major fund and the aggregate remaining fund information and governmental activities of the **Municipality of Vega Baja**, Puerto Rico, as of June 30, 2005, and the respective changes in financial position, thereof the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, I have also issued my report dated September 20, 2005 on my consideration of **Municipality of Vega Baja**, Puerto Rico internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. The additional report is not an integral part of a governmental auditing standard audit in considering the results of the audit the separate report should be read in conjunction with the auditor's report considering the results of our audit.

My audit was performed for the purpose of forming an opinion on the Governmental Activities financial statements of **Municipality of Vega Baja**, Puerto Rico taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-profit Organizations, and is not a required part of the general purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and in my opinion, is fairly stated in all material respects, in relation the by general purpose financial statement a taken as whole.

As described in Note 1, on July 1, 2004, **the Municipality** implemented a new financial reporting model required by GASB Statement No. 34, (GASB No. 34), *Basic Financial Statements – And Management's Discussion and analysis-for State and Local Governments*. In conjunction with the adoption of BASB No. 34, the Municipality has also adopted the following pronouncements: (1) BASB Statement No. 37-*Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, (2) GASB Statement No.38-*Certain Financial Statement Note Disclosures*, and (3) GASB Interpretation No. 6-*Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

The Management's Discussion and Analysis, on pages 1 through 7, are not a required part of the basic financial statements but is supplementary information required by the Accounting Principles Generally Accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audited the information and express no opinion on it.

San Juan, Puerto Rico
November 3, 2005

The stamp number
was affixed to the
original of this report

2108528

Juan A. Feliciano Charneco
CPA JUAN A. FELICIANO CHARNECO
License No. 1263
Expires December 1, 2007



MUNICIPALITY OF VEGA BAJA, PUERTO RICO
STATEMENT OF NET ASSETS
JUNE 30, 2005

<u>ASSETS</u>	Governmental Activities
Cash and investments	\$ 22,313,827
Cash with fiscal agent and other	3,441,767
Accounts receivable	342,232
Accounts receivable government	1,726,359
Capital assets	59,859,597
Total assets	\$ 87,683,782
 <u>LIABILITIES AND FUND EQUITY</u> 	
Liabilities:	
Accounts payable and accrued liabilities	\$ 2,174,279
Due to government entity	760,263
Deferred revenue	7,751,221
Non-current liabilities:	
Due within one year	2,747,038
Due in more than one year	35,090,242
Total liabilities	48,523,043
 <u>NET ASSETS</u> 	
Invested in capital assets, net of related debt	28,399,282
Restricted for:	
Reserve for debt service	2,641,767
Special funds	1,309,089
Capital project fund	12,947,371
Unrestricted (deficit)	(6,136,770)
Total net assets	39,160,739
Total liabilities and net assets	\$ 87,683,782

See notes to financial statement.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
STATEMENTS OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

Functions/Programs	Expenses	Program Revenues			Net (expense) revenue and change in Net Assets in Net Assets Governmental Activities
		Charges for Services	Capital Grants and Contributions	Operating Grants and Contributions	
<u>EXPENDITURES:</u>					
General government	\$ 12,637,691	\$ (293,117)	\$ (3,657,984)	\$ (1,279,816)	\$ 7,406,774
Public safety	2,876,975	-	-	-	2,876,975
Public works	9,814,281	(976,975)	-	-	8,837,306
Capital projects	5,982,347	-	(2,726,579)	-	3,255,768
Health	2,823,877	-	-	-	2,823,877
Education and training	8,242,633	-	(8,242,633)	-	-
Culture and recreation	2,479,799	-	-	-	2,479,799
Other expenditure	222,765	-	(118,500)	-	104,265
Interest and fiscal charges	1,833,344	-	-	-	1,833,344
Total governmental activities	46,913,712	(1,270,092)	(14,745,696)	(1,279,816)	\$ 29,618,108
<u>GENERAL REVENUES</u>					
Property taxes					\$ 7,755,624
Municipal licenses tax					8,791,297
Licenses, permits and fines					1,918,206
Intergovernmental revenues					5,845,372
Interests					392,865
Other revenues					578,589
Total general revenues					25,281,953
Changes in net assets					(4,336,155)
Net assets at beginning of year					24,457,244
Prior year adjustment					19,039,650
Net assets at end of year					\$ 39,160,739

See notes to financial statements.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2005

<u>ASSETS</u>	General Fund	2005 Bond Issue Fund	HUD Programs	Head Start Programs	Capital Projects Fund	Debt Service Fund	Other Funds	Total Governmental Funds
Cash and investments	\$ 10,523,988	\$ 1,368,934	\$ 386,530	\$ 77,687	\$ 9,367,056	\$ -	\$ 589,632	\$ 22,313,827
Cash with fiscal agent and other	-	-	800,000	-	-	2,641,767	-	3,441,767
Accounts receivable (volume business)	114,122	-	-	-	-	-	-	114,122
Accounts receivable federal government	-	-	942,724	783,635	-	-	-	1,726,359
Due from general fund	1,463,563	-	-	-	2,530,468	-	-	3,994,031
Accounts receivable government	228,110	-	-	-	-	-	-	228,110
Total assets and other debits	<u>\$ 12,329,783</u>	<u>\$ 1,368,934</u>	<u>\$ 2,129,254</u>	<u>\$ 861,322</u>	<u>\$ 11,897,524</u>	<u>\$ 2,641,767</u>	<u>\$ 589,632</u>	<u>\$ 31,818,216</u>
<u>LIABILITIES AND FUND BALANCES</u>								
Liabilities:								
Accounts payable and accrued liabilities	\$ 1,047,636	\$ -	\$ 993,729	\$ 132,914	\$ -	\$ -	\$ -	\$ 2,174,279
Due to capital project fund	2,530,468	-	-	-	-	-	-	2,530,468
Due to general fund	-	-	-	664,157	799,406	-	-	1,463,563
Due to government entity	760,263	-	-	-	-	-	-	760,263
Deferred revenue	7,751,221	-	-	-	-	-	-	7,751,221
Total liabilities	<u>12,089,588</u>	<u>-</u>	<u>993,729</u>	<u>797,071</u>	<u>799,406</u>	<u>-</u>	<u>-</u>	<u>\$ 14,679,794</u>
Fund balances								
Reserve for debt services	-	-	-	-	-	2,641,767	-	2,641,767
Encumbrances	29,500	-	-	-	-	-	-	29,500
General Fund	210,695	-	-	-	-	-	-	210,695
Special and other funds	-	-	655,206	64,251	-	-	589,632	1,309,089
Capital project fund	-	1,368,934	480,319	-	11,098,118	-	-	12,947,371
Total fund balances	<u>240,195</u>	<u>1,368,934</u>	<u>1,135,525</u>	<u>64,251</u>	<u>11,098,118</u>	<u>2,641,767</u>	<u>589,632</u>	<u>17,138,422</u>
Total liabilities and fund balance	<u>\$ 12,329,783</u>	<u>\$ 1,368,934</u>	<u>\$ 2,129,254</u>	<u>\$ 861,322</u>	<u>\$ 11,897,524</u>	<u>\$ 2,641,767</u>	<u>\$ 589,632</u>	<u>\$ 31,818,216</u>

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

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

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

Accrued compensated absence
 Bonds payable
 Legal claims
 Landfill post-closure cost

\$ 3,284,274
31,460,315
12,448
<u>3,080,243</u>
<u>37,837,280</u>
<u>\$ 39,160,739</u>

Total net assets of governmental activities

See notes to financial statements.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	General Fund	2004 Bond issue Fund	HUD Programs	Head Start Programs	Capital Project Funds	Debt Service Fund	Other Funds	Total Governmental Funds
REVENUES								
Property taxes	\$ 6,275,468	\$ -	\$ -	\$ -	\$ -	\$ 1,480,156	\$ -	\$ 7,755,624
Municipal license tax	8,791,297	-	-	-	-	-	-	8,791,297
Licenses, permits and fines	1,918,206	-	-	-	-	-	-	1,918,206
Intergovernmental revenues	4,680,744	-	-	-	1,164,628	-	-	5,845,372
Landfill	976,975	-	-	-	-	-	-	976,975
Rent of properties	293,117	-	-	-	-	-	-	293,117
Interest income	356,802	-	-	-	-	36,063	-	392,865
Other revenues	578,589	-	-	-	-	-	-	578,589
Federal financial award	-	-	5,293,534	8,287,534	-	-	1,279,816	14,860,884
Total revenues	23,871,198	-	5,293,534	8,287,534	1,164,628	1,516,219	1,279,816	41,412,929
EXPENDITURES:								
General government	8,942,449	-	2,586,709	-	-	-	554,607	12,083,765
Public safety	1,887,821	-	-	-	-	-	-	1,887,821
Public works	8,073,370	-	-	-	-	-	-	8,073,370
Health	2,499,434	-	-	-	-	-	-	2,499,434
Capital projects	-	-	1,561,951	-	3,695,055	-	725,341	5,982,347
Culture and recreation	2,131,617	-	-	-	-	-	-	2,131,617
Other Expenditures	104,265	-	118,500	-	-	-	-	222,765
Education and training	-	-	-	8,242,633	-	-	-	8,242,633
Debt service:								
Principal retirement	-	-	-	-	-	2,197,685	-	2,197,685
Interest and fiscal charges	-	-	-	-	-	1,833,344	-	1,833,344
Total expenditures	23,638,956	-	4,267,160	8,242,633	3,695,055	4,031,029	1,279,948	45,154,781
Excess of revenues over (under) expenditures	232,242	-	1,026,374	44,901	(2,530,427)	(2,514,810)	(132)	(3,741,852)
Other financing source (uses):								
Transfer in (out) to debt service fund	(215,900)	-	(1,088,795)	-	-	1,304,695	-	-
Interest expenditure	-	-	-	-	-	(38,277)	-	(38,277)
Net bond issued debt	-	1,368,934	-	-	-	-	-	1,368,934
Total other financing source (uses)	(215,900)	1,368,934	(1,088,795)	-	-	1,266,418	-	1,330,657
Excess of revenues and other sources over (under) expenditures and other uses	16,342	1,368,934	(62,421)	44,901	(2,530,427)	(1,248,392)	(132)	(2,411,195)
Fund balance June 30, 2004	(823,574)	-	1,197,946	-	14,801,549	3,890,159	715,341	19,781,421
Prior period adjustment	1,047,427	-	-	19,350	(1,173,004)	-	(125,577)	(231,804)
Fund balance June 30, 2005	\$ 240,195	\$ 1,368,934	\$ 1,135,525	\$ 64,251	\$ 11,098,118	\$ 2,641,767	\$ 589,632	\$ 17,138,422

See notes to financial statements.

04/07/2005

**MUNICIPALITY OF VEGA BAJA
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
JUNE 30, 2005**

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

Net change in fund balance - total governmental funds	\$	(2,411,195)
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.		

Expenditures for capital assets		
Less: current year depreciation	<u>(3,956,616)</u>	(3,956,616)

The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets.

Net bond proceeds of bond issue	1,368,934	
Principal payments	2,197,668	
		3,566,602

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.		(1,241,829)
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Change in net assets of governmental activities	\$	<u>(4,043,038)</u>
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MUNICIPALITY OF VEGA BAJA, PUERTO RICO
STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL (BUDGET BASIS) GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

	Budgeted Amounts		Adjusted	Variance
	Original	Final	Actual Note 1	Favorable (Unfavorable)
REVENUES				
Property taxes	\$ 1,557,730	\$ 1,557,730	\$ 1,557,730	\$ -
Local taxes	7,500,000	8,565,517	8,609,182	43,665
Intergovernmental revenues	4,271,904	4,271,904	4,680,744	408,840
Licenses, Permits and Fines	1,320,000	1,558,682	1,918,206	359,524
Interest income	560,000	273,813	356,802	82,989
Landfill	1,000,000	926,704	748,864	(177,840)
Rent	200,000	254,994	293,117	38,123
Other revenues	615,050	1,455,409	578,589	(876,820)
Other financial sources	4,850,160	4,850,160	4,850,160	-
Principal and interest	2,246,038	2,246,038	1,516,219	(729,819)
Total revenues	24,120,882	25,960,951	25,109,613	(851,338)
EXPENDITURES:				
Current:				
General Government	7,217,341	9,129,285	8,797,734	331,551
Public Work	7,523,589	7,815,457	7,892,257	(76,800)
Public Safety	1,898,828	1,886,257	1,887,821	(1,564)
Health	2,674,933	2,488,782	2,499,434	(10,652)
Culture and Recreation	1,443,447	2,067,612	2,131,617	(64,005)
Other Expenditure	901,806	111,620	104,265	7,355
Transfer-out	215,900	215,900	215,900	-
Principal and interest	2,246,038	2,246,038	2,246,038	-
Total expenditures	24,121,882	25,960,951	25,775,066	185,885
Excess of revenues over (under) expenditures			\$ (665,453)	\$ (665,453)
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 25,109,613
Differences - budget to GAAP:				
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes.				(1,238,415)
Total revenues as reported on the statement of revenue, expenditure, and changes in fund balances				\$ 23,871,198
Uses/outflow of resources				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 25,775,066
Differences - budget to GAAP:				
Non budgeted expenditures				(1,920,210)
Other financial resources transferred to debt service				(215,900)
Total expenditures as reported on the statement of revenue, expenditures and change in fund balances				\$ 23,638,956

See notes to budgetary comparison schedule.

See notes to financial statements.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

GENERAL ORGANIZATION

The **Municipality of Vega Baja** was founded in 1776. The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of Puerto Rico. The legislative body consists of fourteen (14) assemblymen also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public safety, sanitation, recreation and sports, education, housing, transportation, welfare, construction and/or improvements of highways and streets, and other general and administrative services.

The financial statements of the **Municipality of Vega Baja** have been prepared in accordance with Generally Accepted Accounting Principles (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which along with subsequent GASB Pronouncement (Statements and Interpretations,) constitute GAAP for governmental units. A summary of **the Municipality's** significant accounting policies consistently applied in the preparation of the accompanying basic financial statements follows:

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Reporting Entity

The Municipality's financial statements include the operations of all departments and separate legal entities for which **the Municipality** is financially accountable.

In June 1999, the GASB issued Statement No. 34 *Basic Financial Statement and Management Discussion and Analysis for State and Local Governments*. This Statement establishes new financial reporting requirements for state and local governments. It requires new information and restructures much of the information that governments have reported in the past. Comparability with reports issued in prior years is affected. In June 2001, the GASB issued Statement No. 37 *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments Omnibus*, which in part addressed the Management Discussion and Analysis (MD&A) requirements, Program Revenue Classifications and Major Fund criteria requirements in the reporting model in Statement No. 34.

The Municipality of Vega Baja was required to implement this Standard for the fiscal year ended June 30, 2003.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

b. Financial Reporting Entity

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor, and (2) whose funds are under the legal custody and control of **the Municipality's** Director of Finance, as prescribed by Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico*. **The Municipality's** management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their financial statements from those of **the Municipality** would cause **the Municipality's** basic financial statements to be misleading or incomplete according to GASB Statement No. 14, *-The Financial Reporting Entity* (GASB No. 14.)

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of **the Municipality** as of June 30, 2005 nor for the year then ended.

c. Basic Financial Statement – GASB Statement No. 34

The basic financial statements include both government-wide and fund financial statements. While the previous model emphasized fund types (the total of all funds of particular type), in the new reporting model the focus is on major individual funds (within the fund financial statements). Both the government-wide and fund financial statements categorize activities as governmental activities. In the government-wide Statement of Net Assets the governmental activities (a) are presented on a consolidated basis in one column, and (b) are reflected, on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

The basic financial statements include both government-wide and fund financial statements. While the previous model emphasized fund types (the total of all funds of a particular type), in the new reporting model the focus is on major individual funds (within the fund financial statements). Both the government-wide and fund financial statements categorize activities as governmental activities. In the government-wide Statement of Net Assets the governmental activities (a) are presented on a consolidated basis in one column, and (b) are reflected, on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Basic Financial Statements-GASB Statement No. 34 (Continuation)

The government-wide Statement of Activities reflects both the gross and net cost per functional category. The Statement of Activities reduces gross expenses (including depreciation) by related operating grants and contributions. The operating grants include operating-specific grants.

This government-wide focus is more on the substantiality of **the Municipality** the change in aggregate economic position resulting from the activities of the fiscal period.

The fund financial statements are, in substance, very similar to the financial statements presented in the previous model. Emphasis here is on the major funds in the governmental category. Non-major funds are aggregated into a single column.

The governmental funds financial statements are presented on a current financial resource measurement focus and modified accrual basis of accounting. This is the manner in which these funds are normally budgeted. This presentation is deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how **the Municipality** actual experience conforms to the budget or fiscal plan. Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statement, reconciliation is presented on the fund statement, which briefly explains the adjustments necessary to transform the fund statements into the governmental wide statements.

d. Basis of Presentation

The new model as defined in Statement No. 34 establishes criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of either fund category or the governmental and enterprise combined) for the determination or major funds. **The Municipality** reports the following major funds on **Fund Financial Statements**:

Major Funds

General Fund – Always a major fund. The general fund is the main operating fund of **the Municipality**. It is used to account for all financial resources except those required to be accounted for in other funds.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Basis of Presentation (Continuation)

Major Funds

Special Revenue Fund Head Start – The special revenue fund of Head Start is a major fund used by **the Municipality** to account for revenues derived from the grant that is legally restricted by outside parties for use on specific purpose. The uses and limitations of this revenue fund is specified by municipal ordinances or federal and state statutes.

However, resources restricted to expenditure for purpose normally financed from the general fund are reported in **the Municipality's** general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

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

Capital Projects Fund – Capital projects fund is used to account for the financial resources for the acquisition of personal property and/or construction of major improvements which are not financed by other funds.

Other Funds (not mayor funds) – Special revenue funds are used to account for the proceeds of specific revenues sources that are legally restricted to expenditures for specified purposes. Capital projects fund is used to account for the financial resources for the acquisition of personal property and/or construction of major improvements, which are not financed by other funds.

e. Basis of Accounting

The accounts of **the Municipality** are organized on the basis of funds, each of which is considered to be a separate accounting entity. **The Municipality** has created various types of funds. Each fund is accounted for by a separate set of self-balancing accounts, which include its assets, liabilities, fund balances, and revenues and expenditures/expenses, as applicable. The individual funds accounts for the governmental resources allocated to **the Municipality** for the purpose of carrying on specific activities in accordance with laws, regulations, or other restrictions.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Basis of Accounting (Continuation)

Measurement Focus, Basis of Accounting

Government-wide Financial Statements. The government wide financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which **the Municipality** gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants. Revenue from grants is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Funds Financial Statement. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Available means collectible within the current period or 60 days after the end of the period to use them to pay liabilities of the current period. Miscellaneous revenues are recorded when collected. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the year to which they apply. Expenditures are generally recognized when the related fund liability is incurred. General capital asset acquisitions are reported as expenditures in governmental funds.

Governmental Fund Types/Governmental Activities. Governmental funds are those through which most governmental functions of **the Municipality** are financed. The acquisition, use, and balances of **the Municipality's** expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination.

Licenses and permits, charges for services, fines and forfeits and miscellaneous revenues (except investment earnings) are recorded as revenues when received. Investment earnings (interest) are recorded as earned since they are measurable and available.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

f. Encumbrances

Governmental funds employ encumbrances accounting. Under the encumbrance system, all purchase orders; contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation. Under generally accepted accounting principles, encumbrances outstanding at year-end are reported as reservations of fund balance and they constitute neither expenditures, nor liabilities. Encumbrances constitute the equivalent of expenditures for budgetary purposes only, and accordingly, are reported with expenditures in all budgetary basis statements.

g. Budgetary Data

The Municipality follows these procedures, which are in accordance with the municipal law in establishing the budgetary date reflected in the basic financial statements.

- (1) On or prior to May 15, the Mayor submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1st. The proposed budget includes estimated expenditures and their financing sources.
- (2) The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- (3) Prior to July 1st., the annual budget is legally enacted through passage of the annual appropriation ordinance.
- (4) Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget.

The budget is prepared following the modified accrual basis of accounting except for the encumbrances as described below.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINACIAL STATEMENTS
JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Budgetary Data (Continuation)

The actual results of operations, presented in the Statement of Revenues, Expenditures and Changes in Fund Balances-Budget and Actual-General Fund, are reflected in conformity with the budgetary accounting of **the Municipality** for a better comparison with the budget information.

Amendments to the budget, and budgetary transfers related to personal expenditures, require the approval of the Municipal Assembly. Non-capital encumbrances lapse at the end of the next fiscal year. During the fiscal year **the Municipality** readjusted its original budget of the General Fund Balance by \$1,840,069 from current year resources increase.

Since the budgetary basis differs from generally accepted accounting principles (GAAP), actual amounts for the general fund and debt service fund in the accompanying Statement of Revenues and Expenditures-Budget and Actual are presented on the budgetary basis to enhance comparability. The principal differences are as follows:

- (1) Encumbrances are recorded as expenditures under the budgetary basis and as reservations of fund balance under the GAAP basis.
- (2) The property tax advances are presented as revenue in the budgetary basis and as other financing sources in the GAAP basis.
- (3) The Municipality receives certain revenues as contributions from governmental entities, legislative and private parties, which are not included therein nor are the related expenditures.
- (4) Certain debt issuance to acquire personal property is reflected in the general fund and is restricted for that purpose.

The budget is prepared following the modified accrual basis of accounting except for the encumbrances as described below.

The Municipality has not legally adopted a budget for the Head Start special revenue and capital projects funds. Accordingly, it has not presented an annual comparison of budget and actual for these major funds.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINACIAL STATEMENTS
JUNE 30, 2005

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

h. Deposits

Substantially all cash balances are commingled in a general checking account and several special purpose bank accounts, except for cash and investments restricted by law. Each fund records its equity interest in the pooled cash balance. The available cash balance in the general checking account beyond immediate needs is invested in interest-bearing deposits. Generally, cash is deposited in interest-bearing bank accounts. Investment earnings are credited to the respective fund.

i. Inventories

The general fund purchases office and printing supplies, gasoline, oil, medicines and other items. The cost of purchases is recorded as an expenditures and the inventory is not recorded in the basis financial statements since amount is insignificant.

j. Capital Assets

Fund Financial Statements

The capital assets acquired are recorded as expenditures at cost in the governmental funds.

Government Wide Financial Statement

Purchased capital assets are recorded at cost. Donated capital assets are recorded at their estimated fair value at the time they are received by **the Municipality** and are capitalized in the Statement of net Assets. Major renewals and betterment are capitalized: replacement, maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to operations.

Depreciation is provided over the estimated useful life of the respective assets on straight-line basis.

k. Vacation and Sick Leave and Other Compensated Absences

Municipal employees are granted 30 days of vacation and 18 days of sick leave annually. Vacation may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years or more of service who are entitled to sick leave pay to the maximum allowed. The Municipality is required to pay excess sick leave over 90 days on or before March 31 of the accumulated excess at December 31 of prior year. Employees' maximum allowed accumulated vacation, with the employer's share of payroll taxes, are accounted in the Statement of Net Assets.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

l. Insurance

The Municipality has insurance coverage for its public facilities and equipment, primarily to provide protection in case of disaster and other losses. Also, principal officials of **the Municipality** are covered under various surety bonds. The Secretary of the Department of the Treasury of the Commonwealth of Puerto Rico is the designated agency to obtain the necessary insurance coverage for **the Municipality**.

m. Restricted Assets

Investments and Certificates

Certain proceeds of as well as certain resources set aside for their repayment are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants. The "revenue bond" maintenance account is used to report those rental proceeds that are restricted for use in maintenance of the properties. The "revenue bond fund account" is used to segregate resources accumulated for debt service payments over the next twelve months. The "Debt Service Account" is used to report resources set aside to make up potential future deficiencies in the "revenue bond fund account".

Cash with fiscal agent

The cash with fiscal agent pertaining to the debt service represents property tax collections retained by the Government Development Bank for Puerto Rico and another financial institution restricted for the payment of **Municipality's** debt service (See Note 11) and unused proceeds from bonds and notes issued principally for the acquisition or construction of permanent improvements are accounted in the capital project fund.

n. Reservations of Fund Balance

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

- * *Encumbrances* – Represent future expenditures under purchase order, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
- * *Debt Service* – Represents net assets available to finance future debt service payments.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINACIAL STATEMENTS
JUNE 30, 2005

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Reservations of Fund Balance (Continuation)

- * *Capital Projects* – Represent net assets available to finance future capital outlays.
- * *For Other Purpose* – Represent mainly resources set aside for use in federal and state grant programs accounted for in the special revenue funds, and resources available in the general fund for the payment of certain accounts payable and commitments approved by GDB.

o. Claims and Judgments

The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund and in the Statement of Net Assets.

p. Use of Estimates

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

q. Totals Column (Memorandum Only) Governmental Funds Statement

The total data under this column is presented only to facilitate financial analysis. Data in these columns do not present financial position or results of operations in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation, since inter-fund eliminations have not been made.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

2. PROPERTY TAXES

The "Centro de Recaudación de Ingresos Municipales"(CRIM) is responsible for the assessment of all real and personal property located within **the Municipality of Vega Baja** and for the levy, administration and collection of the corresponding taxes.

The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are established at the estimated current value existing in the year 1957 and of personal property at the current value at the date of the assessment.

Real property taxes are billed by the CRIM and are due in two equal installments in July and January following the assessment date. Personal property taxes are self-assessed and are due in May 15, when the property tax return is required to be filed.

The tax rate per annum is 8.43% for real property and 6.43% for personal property of which 3.58% and 1.58%, respectively, belongs to the Commonwealth of Puerto Rico and 4.85% of both percents belong to **the Municipality**. From the portion belonging to **the Municipality**, 3.25% represents **the Municipality's** basic rate, which is appropriated for general purposes and, therefore, accounted for through the general fund. The remaining portion belonging to **the Municipality** of 1.6% represents the ad-valorem" tax withheld by the CRIM as fiscal agent, and restricted for debt service, which is accounted for through the debt service fund (See note 2).

The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first \$15,000 of the assessed valuation of owner occupied residential units. However, **the Municipality** receives the full amount levied, except for residential units assessed at less than \$3,500, on which a complete exemption is granted. Veterans have additional exemption from taxes of \$5,000 of the assessed value of real property. The Department of Treasury instead of the property taxpayer becomes the source of payment in these cases.

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

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINACIAL STATEMENTS
JUNE 30, 2005

PROPERTY TAXES (Continuation)

The CRIM reports annually to the Municipality the estimated basic property tax and the tax to be used for the debt service, which will be collected in the fiscal year. The basic tax is advanced to **the Municipality** during such fiscal year. It is the practice to amortize these advances through the subsequent collection by the CRIM of the basic tax from the taxpayers.

The basic property tax advances from the CRIM are recorded in the general fund as other financing sources. As this tax is collected and reported by the CRIM, it is recorded in the general fund as revenue. The property tax received from the Department of Treasury, which is related to the exoneration granted by the Commonwealth of Puerto Rico is reflected as revenue in the general fund.

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, **the Municipality** recognized as an expenditure the operational expenses allocated by the CRIM to **the Municipality**, which amounted to \$126,505 during 2005.

The following is a summary of the property tax advances, which resulted as an account receivable, for the year ended June 30, 2005. The resulting receivable is presented as deferred revenue in the general fund for Fund Financial Statement and as revenue in the Government Wide Financial Statements. The debt has been presented in the Statement of Net Assets as a non-current liability since payment is not anticipated to be pay in near future.

Accounts Payable:

Amortization through collections of property taxes by the CRIM	
07-01-04 – 06-30-05	\$8,619,317
Advance received, 07-01-04 – 06-30-05	8,752,739
Due to CRIM - 2005	\$ 133,422

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

3. DEPOSITS

Deposits include certificates of deposits amounting to \$10,044,253. **The Municipality's** cash and investments at June 30, 2005, were entirely covered by the Federal Depository Insurance Corporation by collateral provided by the banks and held by the Department of the Treasury pursuant to applicable laws and regulations. Cash with fiscal agent is maintained in interest-bearing accounts in the Government Development Bank for Puerto Rico and is collateralized by the Commonwealth of Puerto Rico.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. **The Municipality** is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws. During the year, **the Municipality** invested its funds in interest-bearing bank accounts, and short-term certificates of deposit.

4. CONCENTRATION OF CREDIT RISK

The Municipality maintains its cash account in local commercial banks, whose accounts are warranty by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. Deposits in excess of \$100,000 are collateralized by the bank securities to property safeguard such funds.

Nevertheless, Management believes that concentration of credit risks is limited because balances are deposited with high standing financial institutions.

5. MUNICIPAL LICENSE TAXES

The volume of business tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this under the industrial Incentives Acts of Puerto Rico. All taxpayers are required to file their declarations by April 15 of each year.

The tax rates are as follow:

- 1.5% for financial institutions
- for all other organizations 0.5%

Taxes are payable in two equal semiannual installments on July 1 and January 1 following the levy date. If they are paid before their maturity, the taxpayer is granted certain discounts.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

MUNICIPAL LICENSE TAXES (Continuation)

The deferred revenue of the general fund correspond to the business tax levied received from the next fiscal year.

The minimum gross revenue to file the Volume of Business Tax Declaration is \$5,000 and the minimum tax payable is \$25. The date to file the Volume of Business Tax Declaration is April 15. **The Municipality** grants a 5% discount, if the taxes are paid on or before April 15. Otherwise, 50% of taxes payable must be paid within the first 15 days of each semester beginning with the first semester ending December 31.

The Municipality recognized an account receivable for the estimated municipal license taxes to be collected during the first three months of next year, but corresponding to current year. Municipal license taxes collected prior to June 30, but pertaining to the next fiscal year are recorded as deferred revenues.

6. INTERFUND TRANSACTIONS

Due From/To Other Funds (Fund Financial Statement)

Interfund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures. The balance are as follows:

Funds	Due From	Due To
General	\$1,436,563	\$ -
Head Start Special Revenue	-	664,157
Capital Project	-	799,406
	\$1,436,563	\$1,436,563

The Inter-fund receivables and payables on fund financial statement are eliminated on Statement of Net Assets (Government Wide Financial Statement).

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

7. INTERGOVERNMENTAL REVENUES

Sources of intergovernmental revenue consist primarily of governmental payments from the Commonwealth of Puerto Rico "in lieu of tax" payments from certain "quasi-public" corporations, such as the Puerto Rico Electric Power Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements. Almost all these intergovernmental revenues are accounted for in the general fund.

8. FROM (DUE TO) GOVERNMENTAL ENTITIES

As of June 30, 2005 balances from (due to) governmental entities of the general fund consists of the following:

Name	Due to
Centro de Recaudación de Ingresos Municipales (CRIM)	\$ 133,422
Electric Puerto Rico Power Authority	181,113
Puerto Rico Water and Sewer Authority	26,996
Puerto Rico Retirement System	157,534
Puerto Rico Telephone Co.	157,910
Puerto Rico Department of Treasury	103,288
Totals	\$ 760,263

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

9. CAPITAL ASSETS

Fund Financial Statements

The Municipality charged costs of capitalizable outlays as expenditures categories in the Governmental Fund Financial Statements.

Governmental activities:	Balance 6/30/2004	Additions	Retirements and Transfers dispositions	Balance 6/30/2005
Capital assets, not being depreciated:				
Land	\$ 10,199,261	\$ -	\$ -	\$ 10,199,261
Construction in progress	1,866,233	-	836,782	1,029,451
Total capital assets not being depreciated	12,065,494	-	836,782	11,228,712
Capital assets, being depreciated				
Buildings and building improvements	36,827,607	1,080,152	-	37,907,759
Infrastructure	22,161,722	1,181,443	-	23,343,165
Vehicles and equipment	9,642,914	848,389	-	10,491,303
Total capital assets being depreciated	68,632,243	3,109,984	-	71,742,227
Less accumulated depreciation for:				
Buildings and building improvements	(8,695,967)	-	(831,859)	(9,527,826)
Infrastructure	(3,542,357)	-	(2,216,172)	(5,758,529)
Vehicles and equipment	(6,916,402)	-	(908,585)	(7,824,987)
Total accumulated depreciation	(19,154,726)	-	(3,956,616)	(23,111,342)
Total capital assets being depreciated, net	49,477,517	3,109,984	(3,956,616)	48,630,885
Governmental activities capital assets, net	\$ 61,543,011	\$ 3,109,984	\$ (4,793,398)	\$ 59,859,597

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

Governmental activities:	
General government	\$ 553,926
Public safety	989,154
Public works	1,740,911
Culture and recreation	348,182
Health	324,443
Total depreciation expense-governmental activities	\$ 3,956,616

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

Government Wide Financial Statements

Capital assets purchased are carried at historical costs. Contributed assets are recorded at fair 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 on capital assets is calculated using the straight-line method over the following estimated useful lives:

Vehicles, Heavy Equipment	5-25	\$300
Furniture and Fixture	5-10	\$300
Computer and Electronic Equipment	5	\$300
Buildings	50	\$1
Infrastructure	60	\$1
Improvements	20-40	\$1

In addition, the Municipality assigned a 10% residual value on most Capital Assets.

10. CHANGES IN GENERAL LONG-TERM DEBT (continued)

General in General Long – Term Debt

The principal long-term obligation of the Municipality is obligation bonds issue to finance permanent improvements and purchases of equipment. The Municipality's long-term debt retirements are appropriated and paid from resources accumulated in the debt service fund.

The following is a summary of bonds of the Municipality of Vega Baja for year ended June 30, 2005.

Description	Beginning Balance	Additions	Reductions	Ending Balance
General Obligations Bonds	\$32,283,000	\$1,375,000	\$2,197,685	\$31,460,315

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

Long-term debt at June 30, 2005 is composed of the following:

11. GENERAL AND SPECIAL OBLIGATIONS (continuation)

Description	Balance 06-30-2005	Due within One year
Series of 1991, \$2,700,000 payable in annual installment of \$225,000 to \$315,000 until 2005; with interest ranging from 5.913% to 6.313%.	\$ 315,000	\$315,000
Series of 1994, \$1,635,000 payable in annual installments of \$55,000 to \$160,000 until 2014; with interest at 6.906% to 7.706%.	1,125,000	75,000
Series of 1995, \$6,665 payable in annual installments of \$275,000 to \$720,000 until 2012; with interest at 5.50% to 6.30%.	4,320,000	390,000
Series of 1997, \$4,340,000 payable in annual installments of \$75,000 to \$375,000 until 2022; with interest at 5.17% to 6.50%.	3,815,000	100,000
Series of 1999, \$3,115,000 payable in annual installments of \$70,000 to \$290,000 until 2019; with interest at 5.19% to 6.51%.	2,665,000	100,000
Series of 1987, \$3,175,000 payable in annual installments of \$170,000 until 2007; with interest at 9%.	510,000	170,000
Series of 1991, \$510,000 payable in annual installments of \$140,000 to \$60,000 until 2006; with interest ranging from 5.913% to 6.363%.	115,000	55,000
Series of 2001, \$825,000 payable in annual installments of \$140,000 to \$195,000 until 2005; with interest at 5.0% to 8.0%.	195,000	195,000

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

General Obligations-Bonds (Continuation)

Series of 2002, \$1,410,000 payable in annual installments of \$20,000 to \$120,000 until 2026; with interest at 5.0% to 7.0%.	1,340,000	25,000
Series of 2002, \$310,000 payable in annual installments of \$5,000 to \$25,000 until 2026; with interest at 5.0% to 7.0%.	295,000	5,000
Series of 2003, \$2,900,000 payable in annual installments of \$50,000 to \$230,000 until 2027; with interest at 2.89% to 5.6%.	2,800,000	55,000
Series of 2003, \$215,000 payable in annual installments of \$5,000 to \$15,000 until 2027; with interest at 5% to 6.5%.	205,000	5,000
\$1,760,000 payable in annual installments of \$30,000 to \$130,000 until 2028; with interest at 6%.	1,730,000	35,000
Series of 2003, \$910,000 payable in annual installments of \$105,000 to \$130,000 until 2006; with interest at 5.0% to 6.5%.	690,000	120,000
Series of 2003, \$545,000 payable in annual installments of \$10,000 to \$45,000 until 2027; with interest at 5.0% to 6.5%.	525,000	10,000
\$472,000 payable in annual installments of \$64,000 to \$78,000 until 2005; with interest at 4.5%.	5,315	5,315

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

GENERAL AND SPECIAL OBLIGATIONS (Continuation)

General Obligations-Bonds (Continuation)

DUE WITHIN
ONE YEAR

\$465,000 payable in annual installments of \$35,000 to \$70,000 until 2008; with interest at 5.0% to 8%.	235,000	50,000
\$1,375,000 payable in annual installments of \$65,000 to \$125,000 until 2019; with interest at 4.37% to 5.0%.	1,375,000	65,000
\$6,455,000 payable in annual installments of \$300,000 to \$455,000 until 2015; with interest at 5.85% to 7.66%.	4,005,000	350,000
\$2,370,000 payable in annual installments of \$125,000 to \$185,000 until 2019; with interest at 7.5%.	1,995,000	125,000
\$3,200,000 payable in annual installments of \$35,000 to \$175,000 until 2023; with interest at 5.85% to 7.5%.	3,200,000	-
TOTAL	\$31,460,315	\$2,250,315

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

GENERAL AND SPECIAL OBLIGATIONS (Continuation)

The annual requirements to amortize the general long-term debt outstanding at June 30, 2005, including interest are as follows:

Year Ending	Principal	Interest	Total
2006	\$2,250,315	\$1,802,930	\$4,053,245
2007	1,075,000	1,020,625	2,095,625
2008	1,065,000	959,072	2,024,072
2009	1,085,000	894,957	1,979,957
2010	2,000,000	1,379,657	3,379,657
Subsequent years	23,985,000	8,726,387	32,711,387
TOTAL	\$31,460,315	\$14,783,628	\$46,243,943

The Municipality is subject to certain laws of the Commonwealth of Puerto Rico, which limit the amount of bond obligations than can be issued to 10% of the assessed valuation of the property located at the **Municipality of Vega Baja**.

11. DEBT SERVICE FUND

The revenues of the debt service fund arise from the additional property tax and are recognized when collected and informed by the CRIM (See Note 2). The CRIM retains these collections for the payment of principal and interest of bonds and notes issued by the Municipality. Interest income is for the payment of interest or special obligations notes and property taxes are for the debt service requirements of the general obligations bonds and notes.

The Government Development Bank pays principal and interest on these obligations for Puerto Rico from funds obtained from the Following:

Property taxes	\$1,516,219
General funds	215,900
Special Revenue fund	1,088,795
From fund balance	1,209,115
TOTAL	\$ 4,031,029

12. DEBT SERVICE FUND (Continuation)

Expenditures for year 2004-2005 were as follows:

Principal	\$ 2,197,685
Interest	1,833,344
TOTAL	\$ 4,031,029

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

13. RETIREMENT SYSTEM

Plan Description

Regular employees of **the Municipality** contribute to a cost sharing multiple-employer defined benefit retirement plan, administered by the Employee' Retirement System of the Government of Puerto Rico and its instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirements pensions, death and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS at G.P.O. Box 42003, San Juan Puerto Rico. 00940.

The annual retirement benefits for those regular full-time employees hired on or before March 31, 1990 or those attaining permanent status before that date (Old Plan) and for those hired or attaining permanent status on or after April 1, 1990 (New Plan) are as follows:

OLD PLAN

<u>Eligibility</u>	<u>Pension Benefits</u>
Age 55 and 30 years of service	75% of average highest compensation during any years of credited service
Under 55 and 30 years of service	65% of average highest compensation during any 3 years of credit service

Participant in the System who retire prior to 30 years of credited service are entitled to an annual retirement benefit equal to 1.5% of the highest compensation in any 3 years of credited service for each year of service up to 20 years, and 2% for each year in excess of 20 years.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

NEW PLAN

Eligibility

Age 65 with 10
years of service

Pension Benefits

1.5% of average compensation during the
final 5 years of credited services multiples
by the numbers of years credited service

For both plants, the employees are vested when attaining ten years of credited services. Disability and death are available with certain limitations and all annuities in pay status will be increased every three years by 3% subject to the approval by the Legislature of Puerto Rico.

Funding Policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employer and other contributing entities are established or may be amended. The required contributions made by **the Municipality** were based on percentages established by the Administrator of the System. Such percentages were not based on actuarial studies as required by generally accepted accounting principles. An actuarial computation of the annual contribution applicable to **the Municipality** has not been prepared. Accordingly, the amounts by which the actual contributions differ from the required actuarial contributions are not known. The annual employer and employees contribution for the year ended June 30, 2005 amounted approximately \$795,335. Members' contributions are 5.775% for gross salaries up to \$6,600 plus 8.275% of the gross salary in excess of \$6,600. **The Municipality** is required to contribute 9.275% of gross salary.

Municipality is subject to certain laws of the Commonwealth of Puerto Rico, which limit the amount of bond obligations that can be issued to 10% of the assessed valuation of the property located at the **Municipality of Vega Baja**.

Actuarial Valuation

The actuarial determined present value of benefits accrued as of July 1, 2003 (latest date available) for the System as whole, determined through an actuarial valuation performed at such date, amounted to \$11.2 billion. The net assets available for benefits at such date were \$2.0 billion, resulting in an excess of accrued benefits over net assets available (actuarial deficiency) of \$9.2 billion. This information is not available by each participant government agencies or municipalities.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

Actuarial Valuation (Continuation)

Net assets of the System consist principally of investments in stocks and bonds and loans to participants. The projected unit credit actuarial cost method was used for the actuarial calculation. Significant assumptions were as follows:

- | | |
|--|---|
| a) Interest rate | 8.5% a year |
| b) Salary increase | 5.0% a year |
| c) Mortality | GAM'83 Mortality Table set forward two years. |
| d) Termination | Medium Turnover Table commensurate with anticipated experience. |
| e) Disability | 65% of Third Railroad Retirement Table Rates. |
| f) Retirement age | Graded scale of retirement ages commensurate with anticipated experience. |
| g) Proportion of participants with spouses | 80% of participants assumed to be married, with wives assumed to be four years younger than husbands. |
| h) Number of employees electing higher contributions | 15% of retiring employees assumed to pay retroactive contributions at retirement. |
| i) Cost-of-living adjustment | 3% every third year. |

15. LONG TERM LIABILITIES

Compensated Absences

Account for vacation and sick leave absences to be financed with governmental funds. The liability for compensated absences was recorded in the Government-wide financial statements. The balance consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method. In which sick leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

The changes in Compensated absences for the year ended June 30, 2005 are as follows:

Governmental activity	June 30, 2004	Net Decrease	June 30, 2005	Due within One year
Compensated Absences	\$3,664,025	\$728,549	\$2,935,476	\$412,156

In addition, the liabilities for retirement obligations were recorded in the Government-Wide Financial Statements. The balance consists of unpaid, accumulated pension obligations.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

16. LEASES

Operating Leases

The Municipality has several short-term operating lease agreements covering some of the Municipality's premises and equipment. Most of the agreements are renewed annually. Total rental charges for the year ended June 30, 2005, were approximately \$682,073 included in all funds.

17. CLAIMS AND CONTINGENCIES

Contingencies

On July 1, 1997, there was an amendment to Act No. 72 in which it was established that the balance due to HIA from October 1994 to June 30, 1997 would be earned on the additional lottery games. During the year the Municipality pay to Health Insurance of PR Administration \$1,236,487.

Federal Programs

The Municipality participates in a number of federal financial assistance programs. Although the Municipality's grant programs have been audited in accordance with the provisions of the Single Audit Act of 1984, as amended, during the year ended June 30, 1996, these programs are still subject to financial and compliance audits and resolution of previously identified questioned costs. These grants are also subject to audit on behalf of the grantors to assure compliance with grant provisions. If expenditures are disallowed due to noncompliance with grant program requirements, the Municipality may be required to reimburse to the grantor agency. Accordingly, the Administrations compliance with applicable grant requirements will be established at some future date. Nevertheless, the Municipality's management expects the amount of expenditures, which may be disallowed by the granting agencies from such audits, to be immaterial.

Comptroller's Office Audits

The Municipality of Vega Baja, Puerto Rico, has been audited by the Comptroller's Office of the Commonwealth of Puerto Rico. The Comptroller's Office has not issued a final report related to the financial operations of the Municipality for the period of the single audit. These audit report do not cover any findings subsequently disclosed to Municipality operation by the Comptroller's Office.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

18. PRIOR PERIOD ADJUSTMENTS

General Fund

Ordinance number 101 to increase of the fund balance by \$1,173,004 adjusted the general fund balance of prior year and the net effect of account payable canceled and accounts receivable recorded from prior years.

19. CLOSURE AND POST-CLOSURE CARE COST OF LANDFILL

The Municipality operated a 40 acres solid waste landfill of which 23 acres are currently in use. The remaining 17 acres have not been used. The state and federal laws and regulations require **the Municipality** to estimate the total current cost of Municipal Solid Waste Landfill Closure and Post-Closure Care Costs. **The Municipality** recognized \$650,000 as the estimated obligation for landfill closure and \$4,000,000 for post closure care cost for a total of \$4, 650,000 which at present value represents approximately \$3,080,243. Actual costs may be higher due to inflation changes in technology or changes in regulations. The amount was reported in the non-current liabilities because is expected to be paid after June 30, 2005. **The Municipality** expects to finance this obligation with the issuance of general obligation bonds. The estimated useful life of the 26 acres is 2-5 years.

JUAN A. FELICIANO CHARNECO
Certified Public Accountant

406 Tnt. César González
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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Mayor and Municipal Council
Municipality of Vega Baja, Puerto Rico

I have audited the accompanying financial statements of the **Municipality of Vega Baja, Puerto Rico**, as of and for the year ended June 30, 2005, and have issued an unqualified report thereon dated November 3, 2005 which was qualified at the fund financial statements level, but adverse at the government wide financial statements level because we were unable to obtain competent evidential matter related to the Capital Assets reported in the Governmental Activities. I conducted my audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtain reasonable assurance about whether the **Municipality of Vega Baja** financial statements are free of material misstatement, I performed tests of its compliance with certain provision of law, regulations, contracts and grants, non-compliance 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 my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of non-compliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered **Municipality of Vega Baja**, Puerto Rico, internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purposes financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

I noted no matters involving the internal control over financial reporting and its operation that I consider being material weaknesses. However, I noted other matters involving the internal control over financial reporting that I have reported to management of **Municipality of Vega Baja**, in a separate dated November 3, 2005.

This report is intended for the information of the Municipal Assembly, management and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by any one other than these specified parties.

San Juan, Puerto Rico
November 3, 2005

The stamp number
was affixed to the
original of this report

2108529

Juan A. Feliciano
CPA JUAN A. FELICIANO CHARNECO
License No. 1263
Expires December 1, 2007



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

Mayor of the Municipality of Vega Baja
Vega Baja, Puerto Rico

Compliance

I have audited the compliance of the **Municipality of Vega Baja**, Puerto Rico, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2005. The **Municipality of Vega Baja** major federal programs is identified in the summary of auditor's result 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 Vega Baja Management. My responsibility is to express an opinion on **Municipality of Vega Baja** compliance based on my audit.

I conducted my audit in accordance with generally accepted auditing standards, 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 and Local Governments and Non-Profit Organizations. Those standards and OMB Circular A-133 require that I require that I 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 Vega Baja**, compliance with those requirements and performing such other procedures, as I considered necessary in the circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination on **Municipality of Vega Baja** compliance with those requirements.

In my opinion, **Municipality of Vega Baja**, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005. However, the results of my auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2005-01, 2005-02 and 2005-03.

Internal Control Over Compliance

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

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

This report is intended for the information of the Municipal Assembly, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by any one other than these specified parties.

San Juan, Puerto Rico
November 3, 2005

The stamp number
was affixed to the
original of this report

2108530

Juan A. Feliciano
CPA JUAN A. FELICIANO CHARNECO
License No. 1263
Expires December 1, 2007



MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

Federal Grantor / Pass-through Grantor Program Title	Federal CFDA Number	Pass-through Grantors Number	Federal Expenditures
U.S. Of Housing and Urban Development			
Direct Program			
Community Planning and Development			
Community Development Block Grant (Entitlement Grants)			
CDBG - 2004	14-218	B-04-MC-72-0014	\$ 1,905,027
CDBG - 2003	14-218	B-03-MC-72-0014	38,199
CDBG - 2002	14-218	B-02-MC-72-0014	207,491
CDBG - 2001	14-218	B-01-MC-72-0014	11,623
CDBG - 2000	14-218	B-00-MC-72-0014	17,651
CDBG - 1999	14-218	B-99-MC-72-0014	337
CDBG - 1998	14-218	B-98-MC-72-0014	45,000
CDBG - 1997	14-218	B-97-MC-72-0014	75,284
CDBG - 1996	14-218	B-96-MC-72-0014	57,144
CDBG - 1995	14-218	B-04-MC-72-0014	9,662
			2,367,418
Emergency Shelters Grant Program			
Passed-through Governors Office of Federal Emergency Management			
Emergency Shelter Grant	14-231	S-03-MC-72-0015	31,162
Emergency Shelter Grant	14-232	S-02-MC-72-0015	7,240
Emergency Shelter Grant	14-233	S-01-MC-72-0015	33,658
Emergency Shelter Grant	14-234	S-00-MC-72-0015	1,164
Emergency Shelter Grant	14-235	S-98-MC-72-0015	24,857
Emergency Shelter Grant	14-236	S-97-MC-72-0015	3,295
Emergency Shelter Grant	14-237	S-96-MC-72-0015	94
			101,470
Section 108 loan guarantee	14-228		41,021
Section 108 loan guarantee	14-229		212,263
Section 108 loan guarantee	14-230		226,616
Section 108 loan guarantee	14-231		6,897
			486,797
Direct Program:			
Public and Indian Housing			
Section 8- Voucher	14-871	RQ-032-V-00045	1,733,461
Section 8- Modern Rehabilitation	14-856	RQ-032-MR-0001	423,078
Section 8 - Hopua	14-241	-	46,906
			2,203,445
U.S. Department of Health and Human Services:			
Administration for children and families			
Passed-through Governors Office for Human Development:			
Head Start	93-600	02-CH-0483	7,351,797
Child Care (Escuela Maternal)	93-994		109,675
Child Care	93-575	CHC-0421	781,161
			8,242,633
Administration on Aging			
Passed through -Governors Office (Sendec)			
Special Program for the Aging	93-044	Title III	319,501

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

Federal Grantor / Pass-through Grantor Program Title	Federal CFDA Number	Pass-through Grantors Number	Federal Expenditures
U.S. Department of Agriculture:			
Direct Program - Rural Business			
Rural Development Grant	10-769	UDAG	107,373
Direct Program - Economic Development Administration			
Economic Development State and Local Economic Development	10-305		225,184
Passed-through Federal Transportation Administration			
Federal Transportation Act.	20-506	PR-90-X141	100,000
Federal Transportation Act	20-500	PR-90X151	229,454
Federal Transportation Act	20-500	PR-90X176	28,586
Federal Transportation Act	20-500	PR-90X185	42,890
Federal Transportation Act	20-500	PR-90X197	107,089
			<u>508,019</u>
U.S. Department of Justice			
Office of Community Oriented Policing Service Troops to Cops	16-711		40
U.S. Federal Emergency Management Agency			
Passed-through Emergency Management State and Local Assistance			
Federal 1552 (Tormenta Jeanne)	83-534		18,361
Total Federal Assistance			<u><u>\$ 14,580,241</u></u>

See notes to the schedule of expenditures of federal awards.

MUNICIPALITY OF VEGA BAJA, PUERTO RICO
NOTES TO SCHEDULE OF FEDERAL FINANCIAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

1. GENERAL

The accompanying Schedule of Federal Financial Awards presents the expenditures of all Federal financial awards programs of the **Municipality of Vega Baja**, Puerto Rico. The **Municipality of Vega Baja** reporting entity is defined in Note 1-A to the basic financial statements. Federal financial awards received directly from Federal agencies as well as Federal financial awards passed through other government agencies are included in the schedule.

(2) MAJOR FEDERAL AWARDS

The Community Development Block grants, Housing Assistance Payments Programs, Health and Human Services Programs represents the major federal financial awards of the Municipality. Major federal awards represent 87% of total expenditures.

(3) FEDERAL CFDA NUMBER

The CFDA numbers included in this schedule were determined based on the program name review of grant contract information and the office of management and budget catalog of Federal Domestic Assistance.

(4) RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

Federal financial assistance expenditures are reported in the Municipality of Vega Baja, Puerto Rico combined Statement of Revenues, Expenditures and Change in Fund Balances all Governmental and Types as follow:

Description	HUD Programs	Head Start Programs	Other funds	Total
Federal Programs Expenditures	\$4,267,160	\$8,242,633	\$1,279,948	\$13,789,241
Debt service	-	-	-	791,000
Total Expenditures	\$4,267,160	\$8,242,633	\$1,279,948	\$14,580,241

**MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

SECTION I – SUMMARY OF AUDITOR’S RESULTS

Part I – Financial Statements

- | | | |
|---|--------------|------------------|
| 1. Type of auditor’s report issued | | qualified |
| 2. Internal control over financial reporting: | | |
| * Material weakness(es) identified? | <u>X</u> Yes | ___ No |
| * Reportable condition(s) identified that are not considered to be Material weaknesses? | <u>X</u> Yes | ___ No |
| 3. Noncompliance material to financial statements noted? | <u>X</u> Yes | ___ No |

Part II – Federal Awards

- | | | |
|--|--------------|-------------|
| 1. Internal control over major programs: | | |
| * Material weakness(es) identified? | ___ Yes | <u>X</u> No |
| * Reportable condition(s) identified that are not considered to be Material weaknesses? | ___ Yes | <u>X</u> No |
| 2. Type of auditor’s report issued on compliance for major programs was unqualified . | | |
| | <u>X</u> Yes | ___ No |
| 3. Any audit findings disclosed that are required to be reported in accordance with Section 510 (a) of Circular A-133? | | |
| | <u>X</u> Yes | ___ No |

Identification of major programs:

<u>CFDA Number (s)</u>	<u>Name of Federal Program or Cluster</u>
93.600	Head Start
14.218	Community Development Block Grant
20-506	Federal Transportation
14-871	Section 8 Voucher

Dollar threshold used to distinguish between type A and type B programs: \$500,000

Auditee qualified as low-risk auditee? X Yes ___ No

**MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**U.S. Department of Health and Human Services
Direct Program of Administration Department of Family
CFDA No. 93-600
Grant No. 02-CH-0483
Year ended June 30, 2005**

Ref. No.	Finding / Noncompliance
-----	-----
2005-01	<u>Statement of Condition and Criteria</u>

The OMB Circular A-133 requires that Head Start Program must comply with applicable state and local requirements concerning licensing. In our examination, we found that the Municipality has not obtained the licenses for 2 of 56 Head Start Centers tested, from the "Administración de 3 Reglamentos y Permisos: (ARPE), and 1 of 56 from the Health Department 13 of 56 from the Administration for Children and Families State Agency (Acuden) at June 30, 2005.

Cause

The administrative personnel in charge of the program has filed the request for the licenses before ARPE but, the Puerto Rico Health Department has not completed their evaluation. The State Agency (Acuden) has not completed their evaluation.

Effect

The federal program is not complying with the program requirement related with current state licenses.

Auditor's Recommendation

Municipality officials should ensure that all Head Start Programs submit all required documents to obtain the current state and local licenses required by the federal regulation.

Municipality Response:

We agree with finding and have communicated with the person responsible to obtain the licenses from the Administration of Licenses and Permits (ARPE), Department of Health and State Agency (Acuden).

**MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**U.S. Department of Housing and Urban Development
Direct Program Community Development Block Grant
CFDA No. 14-218
Grant No. CDBG
Year ended June 30, 2005**

Ref. No. Finding / Noncompliance

2005-02 Statement of Condition and Criteria

The 24 CFR, Section 570.506 requires that when CDBG funds are used for rehabilitation, the grantee must assure that the work was properly completed. As per our rehabilitation test, we found that the Municipality has not performed any re-inspection procedures for eligible rehabilitation cases that were approved during the audited fiscal year ended on June 30, 2005.

Cause

The administrative personnel in charge of the program did not perform re-inspection procedures.

Effect

The federal program is not complying with the program requirement related with current state licenses.

Auditor's Recommendation

Municipality officials should ensure that all CDBG Program funds that were used for rehabilitation, a re-inspection of work completed must be performed.

Municipality Response:

Administrative personnel in charge of the program have been instructed to document re-inspection procedures for rehabilitation program under CDBG federal program.

**MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**Department of Housing and Urban Development
Direct Program: Community Development Block Grant
CFDA No. 14-218
Grant No. Community Development
Block Grant Entitlement Grants CDBG
Year ended June 30, 2005**

Ref. No.	Finding / Noncompliance	Questioned Cost
-----	-----	-----
2005-03	<p><u>Statement of Condition and Criteria</u> It was noted in my test of compliance that the Municipality is not complying with the criteria established by the Standards of Financial management Systems, Sub-part C, Section 21, b., 24 CFR, Section 570.503 Uniform Administrative Requirements.</p> <ol style="list-style-type: none"> 1. Accurate, current and complete disclosure of the financial results of federally sponsored projects of programs. 2. Records that identify adequately the source and application of funds. The records shall contain information pertaining to federal awards, authorization, obligations, un-obligated balances, assets, outlays, income and interest. 3. Effective controls and accountability for funds, property and other assets. <p>To established procedures to comply with Financial and Program Management Standards of funds of he CDBG Program. It was noted during my audit that Municipality does not maintain proper accounting records general ledger by grant.</p> <p><u>Cause</u> The Municipality does not comply with the Financial and Program Management System Standards. The municipality does not maintained General Ledger by Fund to properly segregate fund by grant.</p>	-0-

**MUNICIPALITY OF VEGA BAJA, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

Effect

The Municipality does not maintain and adequate procedures for the Administration of funds from SDBG Program by grant funds.

Auditors Recommendation

The Municipality must establish adequate procedures in order to control in a more effective manner the financial and Program Management System Standards

Municipality Response:

We concur with auditor's recommendations. The Municipality will evaluate the actual administrative procedures followed to establish a procedure, to comply with proper financial and program management system standards.

**MUNICIPALITY OF VEGA BAJA
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

2004 – Finding No. 1: U.S. Department of Health and Human Services
Direct Program of Administration Department of Families
CFDA No. 93-600
Grant – No. 02-CH-0483
Year ended June 30, 2004
Finding reporting again.

2004 – Finding No. 2: U.S. Department of Housing and Urban Development
Direct Program Community Development Block Grant
CFDA No. 14-218
Grant No. CDBG
Year ended June 30, 2005
Finding reporting again.

**CORRECTIVE ACTION PLAN
YEAR ENDED JUNE 30, 2005
(continue)**

Ref. No.	<u>Finding /Corrective Action</u>	Anticipated
2005-01	<u>Planned/Person Responsible:</u>	<u>Completion Date</u>
	<u>Statement of Condition:</u> The Head Start Program Standards for financial management System.	On or before end of 2005-06 Fiscal year.
	<u>Corrective Action Planned:</u> Person responsible to obtain the licenses from the Administration of Licenses and Permits (ARPE), Department of Health and State Agency (Acuden).	
	<u>Person Responsible:</u> Mr. Aladino Andújar, Finance Director	
Ref. No.	<u>Finding /Corrective Action</u>	Anticipated
2005-02	<u>Planned/Person Responsible:</u>	<u>Completion Date</u>
	<u>Statement of Condition:</u> The CDBG funds are used for rehabilitation, the grantee must assure That the work was properly completed. As per our rehabilitation test, We found that the Municipality has not performed any re-inspection procedures for eligible rehabilitation cases that were approved during the audited fiscal year ended on June 30, 2005.	On or before end of 2005-06 fiscal year
	<u>Corrective Action Planned:</u> Person responsible to re-inspect housing rehabilitation projects has instructions to document re-inspection procedures for rehabilitation program under CDBG federal program.	
	<u>Person Responsible:</u> Mr. Aladino Andújar, Finance Director	



ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL DE VEGA BAJA

**CORRECTIVE ACTION PLAN
YEAR ENDED JUNE 30, 2005
(continue)**

Ref. No. Finding /Corrective Action
2005-03 Planned/Person Responsible:

Anticipated
Completion Date

Statement of Condition:

The CDBG, Program Management System Standards.

On or before
end of 2005-06
fiscal year

Corrective Action Planned:

The CDBG Program Administrator established adequate procedures to control and use in an effective manner, federal funds.

Person Responsible:

Mr. Aladino Andújar, Finance Director