

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

**MUNICIPIO DE VIEQUES**  
**AUDITORIA 2005-2006**  
**30 DE JUNIO DE 2006**

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MUNICIPALES  
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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES**

**BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED  
JUNE 30, 2006**

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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Services Division

## INDEPENDENT AUDITORS' REPORT

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

We were engaged to audit the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Vieques, as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management.

The Municipality did not keep adequate accounting records for the fiscal year under audit, and the accounting records did not contain all the information required to prepare the financial statements. Such information was obtained from different sources, therefore, the accompanying financial statements may not reflect all of the Municipality's assets, liabilities, revenues and expenditures.

Because of the significance of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on these financial statements.

The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain

limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Ortiz Rodriguez, Rivera & Co.*

San Juan, Puerto Rico  
December 20, 2006

The stamp 2190970 was affixed  
to the original of this report.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management of the *Municipality of Vieques* of the Commonwealth of Puerto Rico (the "Municipality") provides this *Management's Discussion and Analysis* of the Municipality's basic financial statements as an overview and analysis of the financial activities of the Municipality for the fiscal year ended **June 30, 2006**. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in the accompanying basic financial statements.

**FINANCIAL HIGHLIGHTS**

- The Municipality's in the Governmental Activities has reported assets and net assets amounting to **\$93,657,342** and **\$83,787,502** respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets (**pending for the property final costs**) amounting to **\$89,865,264 (96 percent of total Municipality's assets)**.
- The Municipality in the same activities has reported total liabilities amounting to **\$9,869,840** in the accompanying statement of net assets, of which the most significant liabilities are bonds, notes and other long-term debt amounting to **\$7,556,063 (77 percent of total liabilities)**.
- The Municipality has reported total revenues amounting to **\$11,057,439** in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Gubernamental Funds, for the Fiscal Year Ended **June 30, 2006**. The most significant revenues amounting in this statement are property taxes and municipal licenses taxes and, licenses and permits were to **\$1,216,082 (11 percent of total revenues)** and **\$384,758 (3 percent of total revenues)**, respectively.
- The Municipality has reported an excess of revenues over expenditures amounting to **\$722,410** in the accompanying statement of revenues, expenditures and changes in fund balances.
- The Municipality's governmental funds reported combined ending fund balances of **\$8,253,022** which represent the fund balances of the general fund, capital projects funds and debt service fund combined (**all known as the Municipality's major funds**).
- The Municipality has reported unreserved fund balance for the general fund amounting to **(\$1,933,082)**.

- The Municipality has reported excess of revenues and other financing sources over expenditures and other financing uses amounting to **\$(6,458,157)** in the governmental funds. Such amount, **\$(6,458,157)** correspond to General Fund, debt service and capital projects fund. As a significant fact, the Municipality's outlays for capital projects during the year amounted **\$3,201,461** while to the disponible funds provine of the fund balance available at beginning of the fiscal year. Such outlays over financing sources and reducing the expected income for the incongruence on the State economy were the principal reasons of the deficiency in the governmental funds.

## **OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The Municipality's financial statements include three components: **(1)** the government-wide financial statements, **(2)** the fund financial statements, and **(3)** the notes to the financial statements (**collectively known as the basic financial statements**). This report also contains additional required supplementary information (**budgetary schedules**) and other supplementary information (**combining financial statements**) in addition to the basic financial statements themselves. These components are described below:

### **Government-Wide Financial Statements**

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended **June 30, 2006** even if cash involved have not been received or paid. The government-wide financial statements include: **(1)** the statements of net assets and **(2)** the statement of activities.

### **Statement of Net Assets**

The statement of net assets presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (**equity**). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

## **Statement of Activities**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended **June 30, 2006**. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (**such as uncollected taxes and earned but unused vacation leave**). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (**such as federal grants**). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

## **Fund Financial Statements**

The Municipality's fund financial statements, which consist of: **(1)** the balance sheet – governmental funds and **(2)** the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

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 Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

The fund financial statements focus on: **(1)** individual parts of the Municipality's government and **(2)** reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: **(1)** general fund, **(2)** debt service fund, **(3)** special revenue funds and **(4)** capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions

reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (**June 30, 2006**). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has four major funds: (1) the General Fund, (2) Housing and Urban Development Program, (3) Capital Projects Fund and (4) the Debt Service Fund.

#### **Notes to the Basic Financial Statements**

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the basic financial statements.

#### **Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information consisting of: (1) a combining financial statements referred in connection to nonmajor governmental funds is presented, and (2) a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

#### **Government-wide Financial Statements Summary**

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, assets exceeded liabilities by **\$83,787,502** at **June 30, 2006**.

As previously discussed, by far the largest portion of the Municipality's net assets reflect its investment in capital assets (e.g., land, buildings, machinery, equipment and all other property), less any related debt used to acquire those assets that is still outstanding. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. The following is a condensed presentation of the Municipality's financial position and results of operations, as reported in the government-wide financial statements:

**Condensed Statement of Net Assets:**

	<b><u>June 30, 2006</u></b>
Current assets	\$ 3,792,078
Capital assets	<u>89,865,264</u>
<b>Total assets</b>	<b><u>\$ 93,657,342</u></b>
Current liabilities	2,313,777
Non-current liabilities	<u>7,556,063</u>
<b>Total liabilities</b>	<b><u>\$ 9,869,840</u></b>
Net assets/(liabilities):	
Invested in capital assets, net of related debt	86,814,024
Restricted	3,708,356
Unrestricted	( 6,734,878)
<b>Total net assets</b>	<b>\$83,787,502</b>

An additional portion of the Municipality's net assets (4 percent) represents resources that are subject to restrictions on how they may be used. At the end of the current fiscal year, the Municipality has reported positive balances in two categories of net assets.

**Condensed Statement of Activities:**

	<b><u>June 30, 2006</u></b>
<b>Revenues:</b>	
Program revenues:	
Charges for services	\$ 818,985
Operating grants and contributions	650,065
Capital grants and contributions	3,575,867

General revenues:	
Property taxes	1,216,082
Municipal license taxes	384,758
Grants and contributions	6,599,785
Interest, fines and penalties	84
Miscellaneous	<u>2,856,730</u>
<b>Total Revenues</b>	<b><u>\$16,102,356</u></b>

<b>Expenses:</b>	
General government	\$ 6,237,947
Public safety	736,862
Public works	10,090,937
Culture	16,778
Recreation	424,181
Health and welfare	1,371,519
Depreciation expense	969,648
Interest on long-term debt	<u>340,967</u>
<b>Total expenses</b>	<b><u>\$20,188,839</u></b>

Change in net assets (4,086,483)

**Net assets – at beginning of year** 87,873,985  
**Net assets – at end of year** \$83,787,502

### **Fund Financial Statements Summary**

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable resources*. Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

#### **Condensed Balance Sheet – Governmental funds:**

	<b>June 30, 2006</b>
Total Assets – Major Funds	\$ 5,113,410
Total Assets – Nonmajor Funds	<u>139,385</u>
<b>Total assets</b>	<b><u>\$ 5,252,795</u></b>
Total Liabilities – Major Funds	\$ 3,286,687
Total Liabilities – Nonmajor Funds	<u>171,243</u>
<b>Total liabilities</b>	<b><u>\$ 3,457,930</u></b>

Fund Balances – Major Funds	\$ 1,826,723
Fund Balances – Nonmajor Funds	(31,858)
<b>Total Fund Balance</b>	<b><u>\$ 1,794,865</u></b>

**Condensed Statement of Operations – Governmental funds:**

Total Revenues – Major Funds	\$15,672,044
Total Revenues – Nonmajor Funds	430,312
<b>Total revenues</b>	<b><u>\$16,102,356</u></b>
Total expenditures – Major Funds	\$21,479,117
Total expenditures – Nonmajor Funds	1,081,396
<b>Total expenditures</b>	<b><u>\$22,560,513</u></b>

Other financing sources (uses) Major	-0-
Other financing sources (uses) Nonmajor	-0-
Revenues Over Expenses – Major	(5,807,073)
Revenues Over Expenses – Nonmajor	(651,084)
Total Fund Balance Beginning of year	8,253,022
Total Fund Balance End of year	<b><u>\$1,794,865</u></b>

**Financial Contact**

The Municipality's financial statements are designed to present users (**citizens, taxpayers, customers, investors and creditors**) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer on the 2nd floor of the **Vieques City Hall, Vieques, Puerto Rico.**

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

<u>Assets</u>	<u>Governmental Activities</u>
Cash (Notes 2 and 5)	\$ 1,526,978
Cash with fiscal agent (Notes 2 and 5)	1,678,285
Accounts receivable - Municipal license tax	1,245
Due from other agencies (Note 8)	585,570
Capital assets, net (Note 10)	<u>89,865,264</u>
 Total assets	 <u>\$ 93,657,342</u>
 <u>Liabilities and Net Assets</u>	
<b>Liabilities</b>	
Accounts payable and accrued liabilities	\$ 997,035
Due to other agencies (Note 11)	263,039
Deferred revenues (Note 12):	
Municipal license tax	306,423
Federal government	430,716
Accrued interest	316,564
Noncurrent liabilities (Note 14):	
Due within one year	321,239
Due in more than one year	<u>7,234,824</u>
Total liabilities	<u>9,869,840</u>
 <b>Net Assets</b>	
Investment in capital assets, net of related debt	86,814,024
Restricted for:	
Debt service	510,847
Capital projects	3,197,509
Unrestricted	<u>(6,734,878)</u>
 Total net assets	 <u>\$ 83,787,502</u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
STATEMENT OF ACTIVITIES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
General government	\$ 6,237,947	\$ 818,985	\$ -	\$ -	\$ (5,418,962)
Public safety	736,862				(736,862)
Public works	10,090,937			3,575,867	(6,515,070)
Culture	16,778				(16,778)
Recreation	424,181				(424,181)
Health and welfare	1,371,519		650,065		(721,454)
Depreciation	969,648				(969,648)
Interest on long-term debt	340,967				(340,967)
<b>Total primary government</b>	<b>\$ 20,188,839</b>	<b>\$ 818,985</b>	<b>\$ 650,065</b>	<b>\$ 3,575,867</b>	<b>(15,143,922)</b>
General revenues:					
Property taxes					1,216,082
Municipal license tax					384,758
Grants and contributions not restricted to specific programs					6,599,785
Interest, fines and penalties					84
Miscellaneous					2,856,730
<b>Total general revenues</b>					<b>11,057,439</b>
Change in net assets					(4,086,483)
Net assets at beginning of year, as restated (Note 21)					87,873,985
Net assets at end of year					<b>\$ 83,787,502</b>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2006**

<u>Assets</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash (Notes 2 and 5)	\$ 179,988	\$ 312,513	\$ -	\$ 895,092	\$ 139,385	\$ 1,526,978
Cash with fiscal agent (Notes 2 and 5)			510,847	1,167,438		1,678,285
Accounts receivable - municipal license tax	1,245					1,245
Due from other agencies (Note 8)	582,570	3,000				585,570
Due from other funds (Note 9)	222,717			1,238,000		1,460,717
<b>Total assets</b>	<b>\$ 986,520</b>	<b>\$ 315,513</b>	<b>\$ 510,847</b>	<b>\$ 3,300,530</b>	<b>\$ 139,385</b>	<b>\$ 5,252,795</b>

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

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2006**

<u>Liabilities and Fund Balance (Deficit)</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>Liabilities</b>						
Account payable and accrued liabilities	\$ 831,421	\$ -	\$ -	\$ 103,021	\$ 62,593	\$ 997,035
Due to other funds (Note 9)	1,238,000	222,717				1,460,717
Due to other agencies (Note 11)	263,039					263,039
Deferred revenues: (Note 12)						
Municipal license tax	306,423					306,423
Federal government		322,066			108,650	430,716
Total liabilities	<u>2,638,883</u>	<u>544,783</u>	<u>-</u>	<u>103,021</u>	<u>171,243</u>	<u>3,457,930</u>
<b>Commitments and Contingencies (Notes 18 and 19)</b>						
<b>Fund Balances (Deficit)</b>						
Reserved for:						
Encumbrances	19,591					19,591
Debt service			510,847			510,847
Capital projects				3,197,509		3,197,509
Unreserved fund balance (deficit)	(1,671,954)	(229,270)			(31,858)	(1,933,082)
Total fund balance (deficit)	<u>(1,652,363)</u>	<u>(229,270)</u>	<u>510,847</u>	<u>3,197,509</u>	<u>(31,858)</u>	<u>1,794,865</u>
Total liabilities and fund balance (deficit)	<u>\$ 986,520</u>	<u>\$ 315,513</u>	<u>\$ 510,847</u>	<u>\$ 3,300,530</u>	<u>\$ 139,385</u>	<u>\$ 5,252,795</u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
RECONCILIATION OF THE GOVERNMENTAL FUNDS  
BALANCE SHEET TO STATEMENT OF NET ASSETS  
JUNE 30, 2006**

Total fund balances - governmental funds \$ 1,794,865

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

- Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet 89,865,264
  
- Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. (Note 4) (7,872,627)

Net assets of governmental activities \$ 83,787,502

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

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF VIEQUES**  
**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

	General	Housing and Urban Development Programs	Debt Service	Capital Project	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>						
Property taxes (Note 6)	\$ 969,992	\$ -	\$ 246,090	\$ -	\$ -	\$ 1,216,082
Municipal license taxes (Note 7)	384,758					384,758
Licenses and permits	780,035					780,035
Charges for service and rents	38,950					38,950
Intergovernmental revenues (Note 13):						
Federal grants and contributions		566,599			83,466	650,065
State contributions	6,599,785			3,229,021	346,846	10,175,652
Interest, fines, and penalties	84					84
Other revenues	2,842,805		13,925			2,856,730
Total revenues	<u>11,616,409</u>	<u>566,599</u>	<u>260,015</u>	<u>3,229,021</u>	<u>430,312</u>	<u>16,102,356</u>
<b>EXPENDITURES</b>						
Current:						
General government	6,179,056					6,179,056
Public safety	736,862					736,862
Public works	2,821,557	240,978				3,062,535
Culture	16,778					16,778
Recreation	424,181					424,181
Health and welfare	715,565	554,891			101,063	1,371,519
Capital outlays				9,249,530	980,333	10,229,863
Debt service:						
Principal retirement			214,777			214,777
Interest and other			324,942			324,942
Total expenditures	<u>10,893,999</u>	<u>795,869</u>	<u>539,719</u>	<u>9,249,530</u>	<u>1,081,396</u>	<u>22,560,513</u>
Excess (deficiency) of revenues over (under) expenditures	<u>722,410</u>	<u>(229,270)</u>	<u>(279,704)</u>	<u>(6,020,509)</u>	<u>(651,084)</u>	<u>(6,458,157)</u>
<b>OTHER FINANCING SOURCES (USES)</b>						
Transfers in	12,367		352,614			364,981
Transfers out	(352,614)		(12,367)			(364,981)
Total other financing sources (uses)	<u>(340,247)</u>	<u>-</u>	<u>340,247</u>	<u>-</u>	<u>-</u>	<u>-</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses	382,163	(229,270)	60,543	(6,020,509)	(651,084)	(6,458,157)
<b>FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR</b>	<u>(2,034,526)</u>		<u>450,304</u>	<u>9,218,018</u>	<u>619,226</u>	<u>8,253,022</u>
<b>FUND BALANCE (DEFICIT) AT END OF YEAR</b>	<u>\$ (1,652,363)</u>	<u>\$ (229,270)</u>	<u>\$ 510,847</u>	<u>\$ 3,197,509</u>	<u>\$ (31,858)</u>	<u>\$ 1,794,865</u>

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

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

Net change in fund balances - total governmental funds	\$(6,458,157)
Amounts reported for governmental activities in the statement of activities are different because:	
• Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.	3,201,461
• Depreciation expense on capital assets is reported in the statement of activities, but do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds.	(969,648)
• Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities.	214,777
• Change in accrued interest expense which does not require the use of current financial resources.	16,025
• Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds.	<u>(90,941)</u>
Changes in net assets of governmental activities	<u><u>\$(4,086,483)</u></u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL - GENERAL AND DEBT SERVICE FUNDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

	General Fund				Debt Service Fund			
	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)
	Original	Final			Original	Final		
<b>REVENUES</b>								
Property taxes	\$ 744,096	\$ 744,096	\$ 969,992	\$ 225,896	\$ 164,896	\$ 164,896	\$ 246,090	\$ 81,194
Municipal license taxes	375,420	375,420	463,851	88,431				
Licenses and permits	1,113,052	1,113,052	780,035	(333,017)				
Charges for services and rent	30,000	30,000	38,950	8,950				
Intergovernmental revenues:								
State contributions	6,373,385	6,373,385	6,581,620	208,235				
Interest, fines and penalties	183,000	183,000	84	(182,916)			13,925	13,925
Other revenues	631,047	631,047	238,472	(392,575)				
Total revenues	<u>9,450,000</u>	<u>9,450,000</u>	<u>9,073,004</u>	<u>(376,996)</u>	<u>164,896</u>	<u>164,896</u>	<u>260,015</u>	<u>95,119</u>
<b>EXPENDITURES</b>								
Current:								
General government	5,195,819	5,195,819	6,463,226	(1,267,407)				
Public safety	756,409	756,409	734,706	21,703				
Public works	2,240,702	2,240,702	2,767,911	(527,209)				
Culture	17,971	17,971	16,778	1,193				
Recreation	437,708	437,708	430,736	6,972				
Health and welfare	801,391	801,391	700,396	100,995				
Debt service:								
Principal					69,732	69,732	214,777	(145,045)
Interest					95,164	95,164	324,942	(229,778)
Total expenditures	<u>9,450,000</u>	<u>9,450,000</u>	<u>11,113,753</u>	<u>(1,663,753)</u>	<u>164,896</u>	<u>164,896</u>	<u>539,719</u>	<u>(374,823)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (2,040,749)</u>	<u>\$ (2,040,749)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (279,704)</u>	<u>\$ (279,704)</u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**1. ORGANIZATION**

The Municipality of Vieques, Puerto Rico (Municipality) was founded in 1844. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession existence and legal identity, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including: public safety, public works, culture, recreation, health and welfare, education and other miscellaneous services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 12 members. The members of these branches are elected every four years in the Puerto Rico general elections.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

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

The following is a summary of the more significant policies.

**a. Reporting Entity**

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**b. Government-Wide and Fund Financial Statements**

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

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

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

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

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

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

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

The Municipality reports the following major governmental funds:

1) General Fund

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

2) Housing and Urban Development Programs (HUD Programs)

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

3) Debt Service Fund

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

4) Capital Project Fund

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

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

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

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

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

**d. Cash, Cash with Fiscal Agent, and Investments**

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

Investments are stated at fair value based on quoted market prices.

**e. Interfund Receivables and Payables**

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either due to/from other funds (i.e., the current portion of interfund loans) or advances to/from other funds (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as due to/from other funds.

**f. Capital Assets**

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**g. Reservation of Fund Balance**

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

1) Encumbrances

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

2) Debt Service

Represents net assets available to finance future debt service payments.

3) Capital Projects Fund

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

**h. Risk Financing**

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2006 amounted to \$143,760. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$281,844 for workers' compensation insurance covering all municipal employees.

**i. Compensated Absences**

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

**j. Future Adoption of Accounting Pronouncements**

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

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
45	Accounting and Financial Reporting for Employers for Post-employment Benefits Other than Pensions	2006-07
48	Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues	2006-07

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

**k. Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

**3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

**a. Budgetary Control**

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**b. Budget/GAAP Reconciliation**

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the deficiency of revenues under expenditures for the year ended June 30, 2006 is presented below for the general fund:

	<u>General Fund</u>
Excess of expenditures over revenues - budgetary basis	(\$2,096,837)
Entity differences:	
Non-budgeted revenues, net	2,604,333
Timing differences:	
Prior year encumbrances recorded as current year expenditures for GAAP basis	( 318,364)
Current year encumbrances recorded as expenditures for budgetary basis	19,591
Basis of accounting differences:	
Net change in receivables	120,085
Net change in account payable	<u>393,602</u>
Excess of revenues over expenditures - GAAP basis	<u>\$ 722,410</u>

**c. Legal Compliance**

The legal level of budgetary control is at the individual department level for general fund expenditures, and principal and interest due for the debt service fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS**

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of the approximately \$8.0 million difference are as follows:

Notes payable	\$2,460,183
Bonds payable	3,051,240
Compensated absences	1,286,239
Accrued interest payable	316,564
Due to Puerto Rico Health Insurance Administration	644,333
Due to CRIM	30,822
CRIM loan digitalization	47,416
Due to Treasury Department	35,830
Other liabilities	<u>675,155</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u>\$7,872,627</u>

**5. DEPOSITS**

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

The deposits at GDB of approximately \$1.2 million that are restricted principally for capital projects, and the \$511,000 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

The Municipality maintains its deposits in one (1) bank located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000.

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

**6. PROPERTY TAXES**

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

The rates are 8.03% for real property and 6.03% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	6.00%	4.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	1.20%	1.20%
Discounts made by state to tax payer	< .20%>	< .20%>
	<u>8.03%</u>	<u>6.03%</u>

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

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

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

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

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2005-06, but not the final settlement as the six months period after a fiscal year end, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2006, the amount collected by CRIM from taxpayers and charges exceeded the

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

amount advanced by CRIM for the same period by approximately \$56,000. Such amount is presented as due from CRIM in the statement of net assets. (See Note 8).

**7. MUNICIPAL LICENSE TAX**

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2006. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of Vieques, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

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

Financial institutions	=	1.5%
Other organizations	=	.4%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately \$306,000, corresponding to the next fiscal year municipal license.

**8. DUE FROM OTHER AGENCIES**

Represents grants and contributions due from local and federal agencies:

Puerto Rico Electric Power Authority	\$526,482
Municipal Revenues Collection Center (CRIM)	56,088
U.S. Department of Housing and Urban Development (HUD Programs)	<u>3,000</u>
 Total	 <u>\$585,570</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**9. INTERFUND TRANSACTIONS**

**a. Due from/to Other Funds:**

The due from and due to other fund balances as of June 30, 2006, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Capital Project	General Fund	\$1,238,000
General Fund	HUD Programs	<u>222,717</u>
Total		<u>\$1,460,717</u>

The balance of \$1,238,000 due to the capital project fund from the general fund and the \$222,717 due to the other governmental fund from general fund represent advances for working capital purposes.

**b. Interfund Transfers:**

Interfund transfers for the year ended June 30, 2006 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
General	Debt Service	\$ 12,367
Debt Service	General	<u>352,614</u>
Total		<u>\$364,981</u>

The transfer from the general fund to the debt service fund of \$352,614 represents funds used for the payment of debt service as become due.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**10. CAPITAL ASSETS**

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

	<u>Balance July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2006</u>
Capital assets, not being depreciated:				
Land	\$ 65,420,752	\$ 100,000	\$ -	\$ 65,520,752
Construction in progress	2,066,601		2,066,601	-
Total capital assets, not being depreciated	<u>67,487,353</u>	<u>100,000</u>	<u>2,066,601</u>	<u>65,520,752</u>
Capital assets, being depreciated:				
Buildings and building improvements	25,896,735	3,720,439		29,617,174
Furniture and fixtures	1,618,860	300,204		1,919,064
Vehicles and equipment	1,135,323	256,973		1,392,296
Infrastructure	30,000	890,446		920,446
Total capital assets, being depreciated	<u>28,680,918</u>	<u>5,168,062</u>	<u>-</u>	<u>33,848,980</u>
Less accumulated depreciation for:				
Buildings and building improvements	6,251,382	705,356		6,956,738
Furnitures and fixtures	1,120,591	234,944		1,355,535
Vehicles and equipment	1,152,347	10,789		1,163,136
Infrastructure	10,500	18,559		29,059
Total accumulated depreciation	<u>8,534,820</u>	<u>969,648</u>	<u>-</u>	<u>9,504,468</u>
Total capital assets, being depreciated, net	<u>20,146,098</u>	<u>4,198,414</u>	<u>-</u>	<u>24,344,512</u>
Governmental activities capital assets, net	<u>\$ 87,633,451</u>	<u>\$ 4,298,414</u>	<u>\$ 2,066,601</u>	<u>\$ 89,865,264</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**11. DUE TO OTHER AGENCIES**

Due to other agencies at June 30, 2006 are as follows:

Puerto Rico Electric Power Authority	\$146,404
Puerto Rico Aqueduct and Sewer Authority	3,940
Puerto Rico Employee's Retirement System	66,074
U. S. Internal Revenue Service	33,161
Puerto Rico Labor Department	12,581
Puerto Rico Ports Authority	11,150
Puerto Rico General Services Administration	720
Puerto Rico Treasury Department	<u>159</u>
 Total	 <u>\$263,039</u>

**12. DEFERRED REVENUES**

**a. Municipal License Tax**

The deferred revenues of \$306,423 in the general fund related to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.

**b. Federal Government**

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant. These were related to the following federal programs/grants:

**Program/Grant Description**

Section 8 Housing Voucher (HUD)	\$322,066
Other governmental funds	<u>108,650</u>
 Total	 <u>\$430,716</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**13. INTERGOVERNMENTAL REVENUES**

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

**14. LONG-TERM DEBTS**

Bonds and notes payable and other debts outstanding at June 30, 2006 are as follows:

**Bonds**

\$720,000 series of 1999, payable in semiannual installments ranging from \$10,000 to \$65,000 until July 1, 2023, excluding interest ranging from 4.86 to 6.5%.	\$ 605,000
\$655,000 series of 2002, payable in semiannual installments ranging from \$5,000 to \$50,000 until July 1, 2026, excluding interest ranging from 2.7% to 5.6%.	590,000
\$283,000 series of 1991, payable in quarterly installments of \$3,640, until October 1, 2011, excluding interest ranging from 3.27% to 7.81%	76,440
\$837,000 series of 2002, payable in semiannual installments ranging from \$12,400 to \$72,700, until July 1, 2026, excluding interest ranging from 5% to 6%.	769,800
\$380,000 series of 2003, payable in semiannual installments ranging from \$5,000 to \$30,000, until July 1, 2029, excluding interest ranging from 5% to 6.5%.	365,000
\$595,000 series of 2005, payable in annual installments ranging from \$70,000 to \$100,000, until July 1, 2011, excluding interest ranging from 4.73% to 5%.	450,000

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

\$260,000 series of 2005, payable in annual installments ranging from \$30,000 to \$45,000, until July 1, 2011, excluding interest of 5% \$ 195,000

Total bonds \$ 3,051,240

**Notes Payable**

Note payable of \$2,460,183 represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in semiannual aggregate principal installments of \$95,748 plus an interest rate of 6.1876%.

Note payable of \$35,830 represents a non-interest bearing property tax advances, payable in annual installments of \$7,166 until July 1, 2010.

The annual debt service requirements for the bonds payable and advances from CRIM at June 30, 2006, are as follows:

	<u>Bonds</u>		<u>Note Payable</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 191,360	\$ 189,351	\$ 39,879	\$ 151,616
2008	197,760	166,336	42,385	149,111
2009	214,160	155,802	45,048	146,448
2010	225,760	144,239	47,878	143,617
2011	237,460	131,897	50,886	140,609
2012-2016	483,540	543,338	306,603	650,873
2017-2021	678,100	378,791	415,815	541,661
2022-2026	768,100	150,999	563,928	393,548
2027-2031	55,000	5,525	764,799	192,677
2032-2036	-	-	182,962	8,534
	<u>\$ 3,051,240</u>	<u>\$ 1,866,278</u>	<u>\$ 2,460,183</u>	<u>\$ 2,518,694</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

As described in Note 6, the Municipality levies an annual special tax of 1.25% of the assessed value of real property. The proceeds of this tax are required to be credited to the Debt Service Fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected and retained by the CRIM.

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
<b>Governmental Activities:</b>					
Bonds payable	\$ 3,231,400	\$ -	\$ 180,160	\$ 3,051,240	\$ 191,360
Note payable	2,497,704		37,521	2,460,183	39,879
Total long-term debt	<u>5,729,104</u>	<u>-</u>	<u>217,681</u>	<u>5,511,423</u>	<u>231,239</u>
Due to CRIM	30,822			30,822	
Due to PR Health Insurance Administration	644,333	-	-	644,333	
Claims and judgements	315,013		315,013	-	
Property tax advance - Treasury Department	35,830			35,830	
CRIM loan digitalization	54,512		7,096	47,416	
Compensated absences	902,335	383,904		1,286,239	90,000
Total other liabilities	<u>1,982,845</u>	<u>383,904</u>	<u>322,109</u>	<u>2,044,640</u>	<u>90,000</u>
Total noncurrent liabilities	<u>\$ 7,711,949</u>	<u>\$ 383,904</u>	<u>\$ 539,790</u>	<u>\$ 7,556,063</u>	<u>\$ 321,239</u>

**15. RETIREMENT PLAN**

**a. Plan Description**

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF VIEQUÉS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

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

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

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

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

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

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created ERS, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January, 2000, will only

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary upon to a maximum of 10%) will be invested in an account which will be either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

**b. Contribution Requirements**

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2006 was approximately \$259,000. The Municipality's payroll for employees covered by ERS was approximately \$2.6 million. The Municipality total payroll for all employees was approximately \$5.5 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2006, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

**16. RISK MANAGEMENT**

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Risk

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

**17. LEASES**

**Operating Leases**

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place and Transportation center under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2006 was \$38,950.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

Leasing arrangements with the Municipality as lessee:

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

**18. CONTINGENCIES**

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.
- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**19. COMMITMENTS**

The Municipality of Vieques had several outstanding or planned construction projects as of June 30, 2006. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$3.2 million.

**20. MUNICIPAL SOLID WASTE LANDFILL POSTCLOSURE**

State and federal laws and regulations require the Municipality to place a final cover on the Municipality's landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with Statement No. 18 of the GASB (GASB 18), "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs," the Municipality has to perform a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. As of June 30, 2006, the Municipality has not performed a study of the estimated closing and postclosing costs that will be recognized in the basic financial statements as required by the GASB 18.

**21. RESTATEMENTS**

**a. Fund Balance**

The beginning fund balance of other governmental funds has been restated to correct an overstatement of accounts payable as follows:

Beginning fund balance, as previously reported	\$578,559
Overstatement of accounts payable	<u>40,667</u>
Beginning fund balance, as restated	<u>\$619,226</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**b. Net Assets**

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

Net assets at beginning of year, as previously reported:	\$87,874,395
Restatements:	
Inclusion of loan to CRIM	( 54,512)
Overstatement of accounts payable	<u>54,102</u>
Net assets at beginning of year, as restated	<u>\$87,873,985</u>

**PART II - SINGLE AUDIT SECTION**

<sup>-43-</sup>  
**ORTIZ, RIVERA, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

<u>Federal Grantor/Program Title</u>	<u>Federal CDFA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Federal Disbursements/ Expenditures</u>
<b>U.S. Department of Housing and Urban Development (HUD)</b>			
Pass-through Office of Commissioner of Municipal Affairs			
State Block Grant Program (SBGP)	14.228		\$240,978
Section 8 - Housing Choice Vouchers	14.871		263,729
Section 8 - Project Based Cluster:			
Lower Income Housing Assistance Program			
Section 8 - Moderate Rehabilitation	14.856		<u>291,162</u>
<b>Total</b>			<u>\$795,869</u>

See notes to schedule of expenditures of federal awards.

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**1. SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Schedule of Expenditures of Federal Awards is a summary of the activity of the Municipality of Vieques' federal award programs presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

**2. BASIS OF PRESENTATION**

The expenditures of the schedule are included in the Municipality's basic financial statements within the U.S. Housing and Urban Development Programs Fund.



ORTIZ, RIVERA, RIVERA & CO.

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Management Consulting  
Services Division

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

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

We were engaged to audit the accompanying financial statements of the Municipality of Vieques, as of and for the year ended June 30, 2006, 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. In our report thereon dated December 20, 2006, we did not express an opinion on the financial statements because the Municipality did not keep adequate accounting records for the fiscal year under audit, and the accounting did not contain all the information required to prepare the financial statements. Such information was obtained from different sources, therefore, the accompanying financial statements may not reflect all of the Municipality's assets, liabilities, revenues and expenditures.

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered the Municipality of Vieques' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable condition. Reportable condition involves matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Municipality's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-A thru 06-D.

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 financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 06-A and 06-D to be material weaknesses.

Compliance and Other Matters

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

We noted certain matters that we reported to management of Municipality of Vieques in a separate letter dated December 20, 2006.

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

San Juan, Puerto Rico  
December 20, 2006

*Ortiz, Rivera, Rivera & Co.*

The stamp 2203967 was affixed to the original of this report.



(Formerly known as Ortiz, Rodríguez, Rivera & Co.)



ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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Services Division

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

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

Compliance

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

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

As described in items 06-1 through 06-12 in the accompanying schedule of findings and questioned costs, the Municipality of Vieques did not comply with requirements regarding cash management, equipment and real property management, reporting, Davis Bacon Act and eligibility that are applicable to its Section 8 - Housing Choice Vouchers and Section 8 - Lower Income Housing Assistance Program Moderate Rehabilitation. Compliance with such requirements is necessary, in our opinion, for the Municipality of Vieques to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality of Vieques 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, 2006.

### Internal Control over Compliance

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

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components do 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. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

San Juan, Puerto Rico  
December 20, 2006

The stamp 2203968 was affixed to the original of this report



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ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**1. SUMMARY OF AUDIT RESULTS**

- a. The auditors' report expressed a disclaimer opinion on the basic financial statements of the Municipality of Vieques.
- b. There were reportable conditions on internal controls over financial reporting.
- c. No instances of noncompliance material to the financial statements of Municipality of Vieques were disclosed during the audit.
- d. There were reportable conditions on internal controls over major programs.
- e. The auditors' report on compliance with requirements applicable to federal award programs for the Municipality of Vieques expressed a qualified opinion.
- f. Audit findings relative to the major federal award programs for Municipality of Vieques are reported in number 3 of this schedule.
- g. The programs tested as major programs include:
  - Section 8 - Housing Choice Vouchers - CFDA No. 14.871
  - Section 8 - Lower Income Housing Assistance Program Moderate Rehabilitation - CFDA No. 14.856
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Vieques was determined to be a high-risk auditee.

**2. FINDINGS - FINANCIAL STATEMENTS AUDIT**

**a. Finding 06-A - General Ledger**

The Municipality does not have the accounting practices, policies or internal controls in place to provide for the preparation of financial statements, on a timely basis, in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). The accounting system does not provide for a self balancing set of accounts for each fund

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

operated by the Municipality, recording cash and other financial resources, together with all related assets, liabilities, revenues, expenditures and changes in fund balances. Therefore, the financial statements must be prepared using financial information obtained from various departments and accounting records. The records are not integrated, and do not follow a double entry system (debits and credits). As a result, the records required significant adjustments in order to present the financial position and results of operations of the Municipality in conformity with generally accepted accounting principles.

The continued failure to have an adequate accounting system prevents the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions when plans and objectives are not being met.

Recommendation

The Municipality should adopt and implement a plan to convert its accounting system to an integrated system that would allow for the monthly closing of the general ledger, as well as the preparation of year-end financial statements in accordance with generally accepted accounting principles.

This plan should provide for:

- Assessment of the financial accounting and reporting needs in order to take the necessary steps to meet the financial reporting requirements of GASB Statement No. 34.
- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for the federal funds.
- The preparation of periodic financial reports to be submitted to the Finance Director and all other interested entities.
- Adequate training of all accounting personnel to improve the understanding of the system and to promote operational efficiency.
- Reconciliation of financial records with the reports prepared and submitted to the federal government.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**b. Finding 06-B**

The Municipality does not have a reliable financial reporting system that ensures the preparation and submission of the Budgetary Liquidation to the Municipal Affairs Commissioner's Office on or before September 30 of each year. This condition results from the failure of the Municipal management to monitor compliance with the required reporting requirements by ensuring the timely preparation and submission of financial reports.

Recommendation

The Municipality should establish a reporting calendar which informs to the Municipality's management of the due dates of each financial report. Chapter II, Section 10 of the Basic Standards requires to the Finance Director to prepare and submit to the Municipal Affairs Commissioner's Office the Budgetary Liquidation on or before September 30.

**c. Finding 06-C - Budget**

The Municipality's system of internal control relating to the Budgeting function does not adequately prevent operating management from incurring expenditures in excess of the level of funds appropriated and available. The Municipality closed its fiscal year ended June 30, 2006 with an unreserved fund balance deficiency in the general fund approximately \$1.7 million.

This occurs because the budgeting system does not reflect actual available revenues and therefore cannot prevent the obligation of expenditures for which current resource will not be available.

Article 8.004 (b) of the Municipalities Law establishes that the Municipality cannot obligate or spend funds in excess of the appropriations or the ensuing fiscal year. In addition, according to Chapter IV, Section 17, of the Basic Standards, the responsibility of oversight to prevent deficits in any municipal fund rest with the Finance Director.

The continued occurrence of this situation could result in the eventual reduction or elimination of municipal services since future revenues will need to be used to pay for accumulated liabilities.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Recommendation

The Municipality should revise and amend the budget as current information related to collections of budgeted revenues became available.

**d. Finding 06-D**

The Municipality realized several transfers from its special revenue fund accounts to its General Fund during prior years amounting to \$1.2 million.

Criteria

Article 8 of the Resource Allocation for the Realization of Permanent Works, Acquisition of Equipment, Purchase of Materials and Other Social Interest Activities Act (Law 179 of August 16, 2002) requires municipalities to utilize funds from state grants only for the intended purpose established by the Joint Resolution of the Puerto Rico Legislature and may not expend these in any activity not specifically and categorically addressed in the legislative grant. The use of funds from state grants in activities other than those mentioned in the Joint Resolution requires the prior approval of the Puerto Rico Legislature.

Cause

The bank transfers were authorized by the Finance Director through letters to bank. These transfers were made to compensate cash deficiency the Municipality was facing to pay current operating obligations. The Mayor and the Finance Director performed these transfers in violation of state law.

Recommendation

We recommend the Municipality refer this case to the appropriate regulatory bodies.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

**a. Section 8 - Housing Choice Vouchers - CFDA No. 14.871**

● **Condition 06-1**

Through our test of activities allowed, we observed some disbursements with Section 8 Vouchers federal funds not allowable by the program. Those disbursements correspond to the SBGP federal program. We do not observe the HUD-approved form to use the funds in those activities.

<u>Check Number</u>	<u>Payee</u>	<u>Date</u>	<u>Amount</u>
12942	Editorial Primera Hora, Inc.	12-15-05	\$393.25
13121	Marta Pérez Guadalupe	02-07-06	142.00
13249	Marta Pérez Guadalupe	03-21-06	<u>142.00</u>
			<u>\$677.25</u>

Criteria

The 24 CFR 990 establishes the use of excess cash it may use for other HUD-approved eligible purpose.

Cause

The Federal Program Office doesn't request the HUD-approved form for use the available funds and used the available funds for activities not allowed.

Effect

The program is not in compliance with federal regulations.

Recommendation

The Municipality should reimburse the federal funds used or request an HUD Approved Form for permission of these activities.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Questioned Cost

Less than \$10,000.00

● **Condition 06-2**

The Section 8 program internal controls relating to compliance with the cash management requirement are not effective since they are not minimizing the time elapsed between the receipt of funds and the final disbursement for payment.

Criteria

Cash management always applies to federal programs. An exception would be a federal award that operates on a cost reimbursement basis only with no cash being advanced.

When entities are funded on a reimbursement basis, program costs must be paid by entity funds before reimbursements are requested from the Federal Government. When funds are advanced, means that a Federal Program Agency transfers the actual amount of federal funds to a State that will be paid by the State, in a lump sum, not more than three business days prior to the day the State issue checks or initiates EFT payments and therefore recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the recipients.

When advance payments procedures are used, recipients must establish similar procedure for sub-recipients. Pass through entities must establish reasonable procedures to ensure receipt of reports on subrecipients as cash balances and cash disbursements in sufficient time to enable the pass-through entity. Pass-through entities must cash drawdown by their subrecipients to assure that subrecipients conform substantially to the same standard of timing and amounts as apply to the pass-through entity.

Interest earned on advances is required to be submitted promptly, at least quarterly, to the federal agency. Up to \$100 per year may be kept for administrative expenses.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Cause

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

Effect

The delays caused by the design of cash management system, obstruct the Section 8 program to comply with federal and local applicable laws and regulation, and the ability to meet the cash management requirement.

Recommendation

The Section 8 program should expedite the internal process preparing and sending the actual list of expenditures to be disbursed during the period and establish an effective follow up system for payment to comply with the requirement to disburse the funds within the required time period. Also, they should have the disbursements voucher ready with all authorizations and verifications before the requesting funds will be performed. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

● **Condition 06-3**

The Municipality's system of internal control over compliance with the documentation of participant files is not working effectively. During our audit of the participant files in the Section 8 programs, we noted that the Municipality does not maintain the required documents and information in each file to support participant's eligibility requirements. We tested twelve (12) participant files and noted the following exceptions:

- 1) In one file the studies' evidence of a member of a family was not observed or updated.
- 2) In one file ASUME or Child Support evidence weren't observed.
- 3) In two files HAP to owner wasn't updated.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Criteria

24 CFR Sections 882-113, 882-209, 882-214, 882-412, 882-514, 882-515, 882-518, 883-711, 883-704, 889-103, 982.4, 982.54 (d) (15), 982.158 (f) (7), 982.158 (d), 982.405 (b), and 982.404 establish that the PHA is required to accept applications for admission to the projects, determine whether the applicants are initially eligible, and on a yearly basis, reexamine family income, composition, and contribution to rent, utilities, reasonable rent and housing quality standards' inspections. In addition, the Municipality should verify that the information submitted by participants is reliable.

Cause

All of the above matters occur because the Municipality's system of internal control relating to the compliance requirements is not effectively identifying and correcting these matters through the proper review of participant files for completeness of documents, signatures and information, as well as for their accuracy. The current procedures do not effectively reduce the risk of ineligible participants receiving program benefits.

Effect

The continued failure to establish internal control over compliance with the above requirements exposes the Municipality to unauthorized user or disposition of the program's resources.

Recommendation

The Municipality should design and adopt a checklist that includes all the related documents that must be completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Questioned Cost

\$ -0-

● **Condition 06-4**

The Section 8 Program does not have an effective system of internal control to ensure the accurate preparation of federal financial reports of the Program.

The information submitted in the VMS did not match with the accounting books. The result of the sample tested was the following:

HAP Total	
\$270,343	As per VMS
<u>275,619</u>	As per books
<u>\$ 5,276</u>	<b>Difference</b>

Criteria

45 CFR Section 94.41-(b)(3) requires federal fund recipients to periodically monitor the performance of grant-supported activities to assurance those time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved by the preparation of federal financial reports. To achieve these goals, management will prepare accurate and timely federal financial reports. In addition, Common Rule, Paragraph 20-(b)(1) establishes that federal fund recipients will have a financial management system that will provide for the accurate, current and complete disclosure of the financial results of financially assisted activities. The same will be the underlying record to support the amounts included in the financial report submitted to federal grantor. Also, 45 CFR Section 74.74 states that the Federal Cash Transaction Report must be submitted no later than 45 working days following the end of each quarter.

Each recipient must report program outlays and program income on a cash or accrual basis as prescribed by the federal awarding agency. If the federal awarding agency requires accrual information and the recipients accounting

**COMMONWEALTH OF PUERTO RICO  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

records are not normally maintained on the accrual basis, the recipient is not required to convert its accounting system to an accrual basis but may develop such accrual information through analysis. The awarding agency may accept identical information from the recipient in a machine readable format, computer printout, or electronic outputs in lieu of the prescribed formats. (Certain open-ended entitlement programs require quarterly reports)

The reporting requirements for subrecipients are specified by the pass-through entity.

Cause

The condition described above results from the preparation of federal financial reports without ensured that the amounts reported agree with the underlying accounting records, and the failure of management to detect these differences during their review and approval of the federal financial reports.

Effect

The delays caused by the design accounting system, obstruct the program to comply with federal and local applicable laws and regulation, and the ability to meet the dead line for the reporting requirement. Also, the accounting process is not effective since is not reconciled with the reports submitted.

The continued failure to file accurate financial reports may result in actions by the federal grantor against the program, such as, grant payment withholding resulting from the misstatement of the financial performance of the program and possible lost of funds.

Recommendation

The Section 8 program should review the reports to ensure that the amounts reported agree with the underlying accounting records before submission to federal grantor. Also, the program should implement a reporting calendar to keep all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the program to comply with the required reporting deadlines.

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MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Questioned Costs

\$ -0-

● **Condition 06-5**

We selected a sample of two new participants in the program and one of them wasn't observed in the waiting list. In addition, they didn't comply with selection policies because they didn't follow a sequence.

Criteria

The 24 CFR section 982.204 establishes that except for special admissions, participants must be selected from the PHA waiting list. The PHA must select participants from the waiting list in accordance with admission policies in the PHA administrative plan.

The PHA must maintain information that permits the PHA to select participants from the waiting list such as:

- 1) Applicant name
- 2) Family Unit Size
- 3) Date and time of application
- 4) Qualification for any local preference
- 5) Racial or ethnic designation of the head of house hold

Cause

The Federal Program did not maintain adequate records or controls regarding to the waiting list.

Effect

This condition may result in cost disallowances because the program is increasing the risk that an ineligible participant will be selected as eligible to participate in the program activities.

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MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Recommendation

The Program should have adequate procedures to maintain a good record of the waiting list. In addition, personnel are required to monitoring and verifying the annual changes of the waiting list.

Questioned Costs

\$ -0-

● **Condition 06-6**

During the audit, we reviewed 12 participants' files. We observed that none of the files observed contains evidence of the method used by the Program to determine that the rent to the owner is reasonable in comparison to the rent for other comparable unassisted units.

Criteria

The 24 CFR sections 982.4, 982.54(d)(15), 982.158(f)(7), and 982.507 establish the program must maintain records to document the basis for the determination that rent to the owner is a reasonable rent (initially and during the term of the HAP contract). The program determinations must consider unit attributes such as location, quality, size, unit type and age of the unit, and any amenities hosing services, maintenance and utilities provided by the owner.

Cause

The federal program does not made rent comparison with other unassisted units.

Effect

The program is not in compliance with the federal regulations.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Recommendation

The Municipality had to maintain records to document the basis for the determination that rent to the owner is a reasonable rent (initially and during the term of the HAP contract).

Questioned Costs

\$ -0-

● **Condition 06-7**

During our eligibility test, we examined a sample of 12 participants' files. The followings were the exceptions found:

In four (4) cases, evidence that the repairs to be completed by the participants were not observed and the contract was not properly completed.

Criteria

The 24 CFR section 982.404 establishes that the owners must maintain the unit in accordance with HQS.

If the owner fails to maintain the dwelling unit in accordance with HQS, the PHA must take prompt and vigorous action to enforce the owners' obligations. PHA remedies for such breach of the HQS include termination, suspension or reduction of housing assistance payments and termination of the HAP contract.

The PHA must not make any housing assistance payments for a dwelling unit that fails to meet the HQS, unless the owner corrects the defect within the period specified by the PHA and the PHA verifies the correction. If a defect is life threatening, the owner must correct the defect within no more than 24 hours. For other defects, the owner must correct the defect within no more than 30 days.

**COMMONWEALTH OF PUERTO RICO  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Cause

The program failed to supervise that the deficiencies were corrected in the required period in accordance with applicable laws and regulations.

Effect

This condition may result in cost disallowances for concept of payment of rent for a property that is not in physical conditions required by law.

Recommendation

The Program should have adequate procedures to supervise that the deficiencies are corrected in the required period.

Questioned Costs

\$ -0-

**b. Section 8 - Moderate Rehabilitation and Section 8 - Lower Income Housing Assistance Program - CFDA No. 14.856**

● **Condition 06-8**

The Section 8 program internal controls relating to compliance with the cash management requirement are not effective since they are not minimizing the time elapsed between the receipt of funds and the final disbursement for payment.

Criteria

Cash management always applies to federal programs. An exception would be a federal award that operates on a cost reimbursement basis only with no cash being advanced.

When entities are funded on a reimbursement basis, program costs must be paid by entity funds before reimbursements are requested from the Federal Government. When funds are advanced, means that a Federal Program

**COMMONWEALTH OF PUERTO RICO  
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FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Agency transfers the actual amount of federal funds to a State that will be paid by the State, in a lump sum, not more than three business days prior to the day the State issues checks or initiates EFT payments and therefore recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the recipients.

When advance payments procedures are used, recipients must establish similar procedure for sub-recipients. Pass through entities must establish reasonable procedures to ensure receipt of reports on subrecipients as cash balances and cash disbursements in sufficient time to enable the pass-through entity. Pass-through entities must cash drawdown by their subrecipients to assure that subrecipients conform substantially to the same standard of timing and amounts as apply to the pass-through entity.

Interest earned on advances is required to be submitted promptly, at least quarterly, to the federal agency. Up to \$100 per year may be kept for administrative expenses.

Cause

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

Effect

The delays caused by the design of cash management system, obstruct the Section 8 program to comply with federal and local applicable laws and regulation, and the ability to meet the cash management requirement.

Recommendation

The Section 8 program should expedite the internal process preparing and sending the actual list of expenditures to be disbursed during the period and establish an effective follow up system for payment to comply with the requirement to disburse the funds within the required time period. Also, they should have the disbursements voucher ready with all authorizations and verifications before the requesting funds will be performed. Federal funds

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Questioned Cost

\$ -0-

● **Condition 06-9**

The Municipality's system of internal control over compliance with the documentation of participant files is not working effectively. During our audit of the participant files in the Section 8 programs, we noted that the Municipality was not maintaining the required documents and information in each file to support participants' eligibility requirements we tested thirteen (13) participant files and noted the following exceptions:

- 1) In one file the Treasury's Department debt certification isn't observed.
- 2) In one file the Behavior Certificates were not updated or observed.
- 3) In one file ASUME evidence isn't observed.
- 4) In one file Social Security card of a member of a family wasn't observed.
- 5) One of the new participants wasn't observed in the waiting list.
- 6) They didn't comply with selection policies because they didn't follow a sequence.

Criteria

24 CFR Sections 882-113, 882-209, 882-214, 882-412, 882-514, 882-515, 882-518, 883-711, 883-704, 889-103, 982.4, 982.54 (d) (15), 982.158 (f) (7), 982.158 (d), 982.405 (b), and 982.404 establish that the PHA is required to accept applications for admission to the projects, determine whether the applicants are initially eligible, and on a yearly basis, reexamine family income, composition, and contribution to rent, utilities, reasonable rent and housing quality standards inspections. In addition, the Municipality should verify that the information submitted by participants is reliable.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Cause

All of the above matters occur because the Municipality's system of internal control relating to the compliance requirements is not effectively identifying and correcting these matters through the proper review of participant files for completeness of documents, signatures and information, as well as for their accuracy. The current procedures do not effectively reduce the risk of ineligible participants receiving program benefits.

Effect

The continued failure to establish internal control over compliance with the above requirements exposes the Municipality to unauthorized user or disposition of the program's resources.

Recommendation

The Municipality should design and adopt a checklist that includes all the related documents that must be completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances.

Questioned Cost

\$ -0-

● **Condition 06-10**

The Federal Program Office maintains a detail of equipment with some deficiencies in relation to the acquisition date, unit acquisition cost and do not include all the equipment that the Municipality has. In addition, a physical inventory will be taken and the results reconciled with the equipment records at least once every two years.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Criteria

Based on OMB Circular A-110, 34 (f) (1), the equipment records will be maintained accurately and will include a description of the equipment, an identification number, acquisition date and cost, location and condition, and others. In addition, a physical inventory of equipment will be taken and the results reconciled with the equipment records at least once every two years.

Cause

The Federal Program Office did not prepare the detail of equipment as required.

Effect

The Municipality is exposed to the risk of possible unauthorized use and disposition of equipment due to the lack of internal controls and adequate property and equipment records. The possible misappropriation of the equipment acquired with federal funds could result in disallowed costs.

Recommendation

The Municipality should immediately perform a physical inventory of the program's property and equipment to update its property records. All missing equipment should be reported to the federal government for proper disposition, together with the counting and updating of the property, plant and equipment subsidiary ledger.

Questioned Cost

\$ -0-

● **Condition 06-11**

The program did not adjust the utility data schedule within the last 14 years. In addition, contracts rent weren't adjusted either.

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MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Criteria

The Municipality or owner must (a) establish or ensure tenant utility allowances based on utility consumption and rate data for various sized units, structure types, and fuel types, (b) make an annual review of tenant utility allowances to determine their reasonableness, and (c) adjust the allowances, when appropriate (24 CFR Section 5.603). In addition, the PHA or owner applies or ensures annual adjustments to contracts rents are applied. The HAP contract specifies the method to be used to determine rent adjustments. Adjustments must not result in material differences between rents charged for assisted units and comparable unassisted units except as those differences existed at contract execution. Special adjustments to contract rents, within the original contract term, may also be made to the extent deemed necessary by the PHA or HUD.

Cause

The program did not review or adjust the utility data and rent schedule.

Effect

The program is not in compliance with federal regulation.

Recommendation

The program should update the utility review and should be adjusted as soon as possible and review contract rent as appropriate.

Questioned Cost

\$ -0-

● **Condition 06-12**

During our eligibility test, we examined a sample of 13 participants' files. The followings were the exceptions found:

In ten (10) cases, evidence that the repairs to be completed by the participants were not observed and the contract was not properly terminated.

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Criteria

The 24 CFR section 982.404 establishes that the owners must maintain the unit in accordance with HQS.

If the owner fails to maintain the dwelling unit in accordance with HQS, the PHA must take prompt and vigorous action to enforce the owners' obligations. PHA remedies for such breach of the HQS include termination, suspension or reduction of housing assistance payments and termination of the HAP contract.

The PHA must not make any housing assistance payments for a dwelling unit that fails to meet the HQS, unless the owner corrects the defect within the period specified by the PHA and the PHA verifies the correction. If a defect is life threatening, the owner must correct the defect within no more than 24 hours. For other defects, the owner must correct the defect within no more than 30 days.

Cause

The program failed to supervise that the deficiencies were corrected in the required period in accordance with applicable laws and regulations.

Effect

This condition may result in cost disallowances for concept of payment of rent for a property that is not in physical conditions required by law.

Recommendation

The Program should have adequate procedures to supervise that the deficiencies are corrected in the required period.

Questioned Cost

\$ -0-

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
State Block Grant Program CFDA No. 14.228	<b>Condition 04-1</b>  The Municipality held high cash balances according to the bank statements. This means that federal financial assistance is sometimes requested and not used to cover immediate expenditures incurred.	The condition still prevails. <span style="float: right;">2 no</span>
State Block Grant Program CFDA No. 14.228	<b>Condition 04-2</b>  The quarterly reports were not reconciled with program books and the Municipality did not maintain evidence if there were timely submitted.	Condition was not observed. <span style="float: right;">3 no</span>
State Block Grant Program CFDA No. 14.228	<b>Condition 04-3</b>  The Municipality does not maintain an appropriate real property records as required by federal regulations.	The condition still prevails. <span style="float: right;">4 no</span>
Section 8 - Housing Choice Voucher CFDA No. 14.871	<b>Condition 04-4</b>  The Municipality does not have effective internal controls over compliance with the property management requirement.	The condition still prevails.
Section 8 - Housing Choice Voucher CFDA No. 14.871 Section 8 - Lower Income Housing Assistance CFDA No. 14.856	<b>Condition 04-5</b>  The Municipality's system of internal control over compliance with the documentation of participants' files is not working effectively.	The condition still prevails.
State Block Grant Program CFDA No. 14.228	<b>Condition 05-1</b>  The Municipality' internal control over compliance with the cash management requirements of the	Condition still prevails. <span style="float: right;">5 no</span>

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MUNICIPALITY OF VIEQUES  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
	federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.	
<b>State Block Grant Program CFDA No. 14.228</b>	<b>Condition 05-2</b>  The Municipality does not have effective internal controls to ensure the accurate preparation and timely submission of federal reports of the program. We noted that the Municipality does not submit to OCAM on time the annual report of projects performed with SBGP funds and project income related to them.	Condition was not observed. <i>h</i> <i>h</i>
<b>State Block Grant Program CFDA No. 14.228</b>	<b>Condition 05-3</b>  The Municipality does not have effective internal controls over compliance with the property management requirement. The Municipality took a physical inventory of program property, but the compilation report was not summarized nor compared to the property subsidiary ledger. In addition, there is no periodic review of the use and <u>location of program equipment to ensure that these are being used for program-related purposes.</u>	Condition still prevails. <i>h</i>
<b>State Block Grant Program CFDA No. 14.228</b>	<b>Condition 05-4</b>  The Municipality does not have effective internal controls over compliance with the requirement to ensure that all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds are paid wages not less than those established for the locality of the project (prevailing wage rates) by	Condition was not observed. <i>h</i> <i>h</i>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VIEQUES  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
<p><b>Section 8 - Housing Choice Vouchers - CFDA No. 14.871</b></p>	<p>the Department of Labor (DOL) (40 USC 276a to 276a-7). We noted that the contracts selected for testing do not have the prevailing wage rate clause updated. In addition, none of the contracts selected have the certified payrolls.</p> <p><b>Condition 05-5</b></p> <p>The Municipality does not have effective internal controls over compliance with the property management requirement. The Municipality took a physical inventory of program property, but the compilation report was not summarized nor compared to the property subsidiary ledger. In addition, there is no periodic review of the use and location of program equipment to ensure that these are being used for program-related purposes.</p>	<p>Condition still prevails.</p>
<p><b>Section 8 - Rental Voucher Program and Section 8 - Lower Income Housing Assistance Program CFDA No. 14.856</b></p>	<p><b>Condition 05-6</b></p> <p>The Municipality's system of internal control over compliance with the documentation of participant files is not working effectively. During our audit of the participant files in the Section 8 programs, we noted that the Municipality was not maintaining the required documents and information in each file to support participants' eligibility as required by Section 8 Program regulations.</p>	<p>Condition still prevails.</p>



Estado Libre Asociado de Puerto Rico  
GOBIERNO MUNICIPAL DE VIEQUES  
Oficina de Programas Federales

## CORRECTIVE ACTION PLAN

December 20, 2006

Cognizant or Oversight Agency for Audit:

Municipality of Vieques respectfully submits the following corrective action plan for the year ended June 30, 2006.

Name and address of independent public accounting firm: Ortiz, Rodríguez, Rivera & Co., Suite 152, PO Box 70250, San Juan, Puerto Rico 00936-7250

Audit period: Fiscal year ended June 30, 2006

The findings from the June 30, 2006 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

### FINDINGS - FEDERAL AWARD PROGRAM AUDITS

**Finding 06-1: Section 8 Housing Choice Vouchers – CFDA No. 14.871**

Reportable Condition: See Condition 06-1

#### Recommendation

The Municipality should reimburse the federal funds used or request a HUD Approved Form for permission of these activities.

#### Action Taken

The Municipality is in process to verify the disbursements and make the reimbursement if it corresponds. In addition, the Municipality will establish procedures in order to avoid this situation in the future.

**Finding 06-2: Section 8 Housing Choice Vouchers – CFDA No. 14.871**

Reportable Condition: See Condition 06-2

Recommendation

The Section 8 program should expedite the internal process preparing and sending the actual list of expenditures to be disbursed during the period and establish an effective follow up system for payment to comply with the requirement to disburse the funds within the required time period. Also, they should have the disbursements' voucher ready with all authorizations and verifications before the requesting funds will be performed. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Action Taken

The Municipality will establish procedures in coordination with Finance Department in order to realize the disbursements into the time required.

**Finding 06-3: Section 8 Housing Choice Vouchers – CFDA No. 14.871**

Reportable Condition: See Condition 06-3

Recommendation

The Municipality should design and adopt a checklist that includes all the related documents that must be completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances.

Action Taken

The Municipality will establish procedures of review in order to each participant file can be complete in relation to all required documents.

**Finding 06-4: Section 8 Housing Choice Vouchers – CFDA No. 14.871**

Reportable Condition: See Condition 06-4

Recommendation

The Section 8 program should review the reports to ensure that the amounts reported agree with the underlying accounting records before submission to a federal grantor.

Also, the program should implement a reporting calendar to keep all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the program to the complying of the required reporting deadlines.

Action Taken

The Municipality will establish procedures to verify the financial information prior the VMS submission in order to avoid this situation.

**Finding 06-5: Section 8 Housing Choice Vouchers – CFDA No. 14.871**

Reportable Condition: See Condition 06-5

Recommendation

The Program should have adequate procedures to maintain a good record of the waiting list. In addition, personnel are required to monitoring and verifying the annual changes of the waiting list.

Action Taken

The Municipality will establish procedures to actualize and maintain the waiting list as required by the agency requirements.

**Finding 06-6: Section 8 Housing Choice Vouchers – CFDA No. 14.871**

Reportable Condition: See Condition 06-6

Recommendation

The Municipality had to maintain records to document the basis for the determination that rent to the owner is a reasonable rent (initially and during the term of the HAP contract).

Action Taken

The Municipality will establish procedures to the reasonable rent process were realized and to the participant file have evidence of it.

**Finding 06-7: Section 8 Housing Choice Vouchers – CFDA No. 14.871**

Reportable Condition: See Condition 06-7

Recommendation

The Program should have adequate procedures to supervise that the deficiencies are corrected in the required period.

Action Taken

The Municipality will establish procedures to verify the deficiencies observed on the inspection will be corrected into the time required by the agency.

**Finding 06-8: Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation – CFDA No. 14.856**

Reportable Condition: See Condition 06-8

Recommendation

The Section 8 program should expedite the internal process preparing and sending the actual list of expenditures to be disbursed during the period and establish an effective follow up system for payment to comply with the requirement to disburse the funds within the required time period. Also, they should have the disbursements voucher ready with all authorizations and verifications before the requesting funds will be performed. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Action Taken

The Municipality will establish procedures in coordination with Finance Department in order to realize the disbursements into the time required.

**Finding 06-9: Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation – CFDA No. 14.856**

Reportable Condition: See Condition 06-9

Recommendation

The Municipality should design and adopt a checklist that includes all the related documents that must be completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness

by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances.

Action Taken

The Municipality will establish procedures of review in order to each participant file can be complete in relation to all required documents.

**Finding 06-10: Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation – CFDA No. 14.856**

Reportable Condition: See Condition 06-10

Recommendation

The Municipality should immediately perform a physical inventory of the program's property and equipment to update its property records. All missing equipment should be reported to the federal government for proper disposition, together with the counting and updating of the property, plant and equipment subsidiary ledger.

Action Taken

The Municipality will review the property records and update it's as required.

**Finding 06-11: Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation – CFDA No. 14.856**

Reportable Condition: See Condition 06-11

Recommendation

The program should update the utility review and should be adjusted as soon as possible and review contract rent as appropriate.

Action Taken

The Municipality will make an analysis of the utility data in order to verify if is necessary to review or adjust the utility data schedule, and then will be implemented.

**Finding 06-12: Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation – CFDA No. 14.856**

Reportable Condition: See Condition 06-12

Recommendation

The Program should have adequate procedures to supervise that the deficiencies are corrected in the required period.

Action Taken

The Municipality will establish procedures to verify the deficiencies observed on the inspection will be corrected into the time required by the agency.

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Modesto Aloyo, Section 8 Program Director, at (787) 741-3192.

Cordially,



Modesto Aloyo  
Section 8 Program Director  
Municipality of Vieques