

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

MUNICIPIO DE VIEQUES
AUDITORIA 2006-2007
30 DE JUNIO DE 2007

Ortiz & Rivera
COMUNIDAD DEL MUNICIPIO DE VIEQUES
2da. FEB 26 PM 1:51
CALLE DE COBARCO

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES**

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

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

PART I - FINANCIAL SECTION

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

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

TABLE OF CONTENTS

	<u>Pages</u>
PART I – FINANCIAL SECTION	
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-9
Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Assets	10
Statement of Activities	11
Fund Financial Statements-Governmental Funds	
Balance Sheet	12-13
Reconciliation of the Governmental Funds Balance Sheet to Statement of Net Assets	14
Statement of Revenues, Expenditures and Changes in Fund Balances	15
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities	16
Statement of Revenues, Expenditures and Other Financing Sources - Budget and Actual - General and Debt Service Funds	17
Notes to Basic Financial Statements	18-45

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

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

TABLE OF CONTENTS (CONTINUED)

	<u>Pages</u>
PART II – SINGLE AUDIT SECTION	
Schedule of Expenditures of Federal Awards	47
Notes to Schedule of Expenditures of Federal Awards	48
Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	49-51
Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133	52-54
Schedule of Findings and Questioned Costs	55-62
Schedule of Status of Prior Year Audit Findings and Questioned Costs	63-68

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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



ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis Rivera Zúñiga
CPA Zoraida Cruz Claudio

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

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Vieques, as of and for the year ended June 30, 2007, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

The accounting records of the Municipality of Vieques related to interfund transactions were not adequate. Accordingly, we were unable to obtain sufficient evidence to support and satisfy ourselves about the amount recorded in each major funds and the aggregate remaining funds information as due from/due to other funds, stated at \$12,557,072 in the total governmental funds column of the balance sheet.

As discussed in Note 21, to the financial statements, management has not recorded a provision for liability of closure and postclosure care costs of the landfill. Accounting principles generally accepted in the United States of America require that a provision for liability of closure and postclosure care costs be recorded to comply with applicable state and federal regulations. The amount by which this departure would affect the liabilities, net assets, and expenses of the governmental activities is not reasonable determinable.

In our opinion, except for the effects of not maintain adequate records related to interfund transaction, and for not provide a provision for liability of closure and postclosure care cost of the landfill, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Vieques as of June 30, 2007, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 26, 2007 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants, agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 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.

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

San Juan, Puerto Rico
November 26, 2007

The stamp 2286473 was affixed
to the original of this report.



Ortiz, Rivera, Rivera & Co.

**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, 2007**. 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 **\$140,044,261** and **\$125,143,954** respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to **\$137,723,694 (98 percent of total Municipality's assets)**.
- The Municipality in the same activities has reported total liabilities amounting to **\$14,900,307** in the accompanying statement of net assets, of which the most significant liabilities are bonds, notes and other long-term debt amounting to **\$7,768,943 (52 percent of total liabilities)**.
- The Municipality has reported total revenues amounting to **\$14,057,794** in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds, for the Fiscal Year Ended **June 30, 2007**. The most significant revenues amounting in this statement are property taxes and municipal licenses taxes and, licenses and permits were to **\$2,246,741 (16 percent of total revenues)** and **\$436,256 (5 percent of total revenues)**, respectively.
- The Municipality has reported a deficiency of revenues over expenditures amounting to **(\$6,670,615)** in the accompanying statement of revenues, expenditures and changes in fund balances.
- The Municipality's governmental funds reported combined ending fund balances of **(\$4,577,996)** 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 **(\$10,157,144)**.

- The Municipality has reported excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses amounting to **(\$5,630,270)** in the governmental funds. Such amount, **(\$5,630,270)**, 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 **\$5,266,388** 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, 2007** 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, 2007**. 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 government-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, 2007**). 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, **(4)** the Debt Service Fund and **(5)** Special Community Trust.

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 **\$125,143,954** at **June 30, 2007**.

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:

	<u>June 30, 2007</u>
Current assets	\$ 2,320,567
Capital assets	137,723,649
Total assets	<u>140,044,261</u>
Current liabilities	7,131,364
Non-current liabilities	7,768,943
Total liabilities	<u>14,900,307</u>
Net assets/(liabilities):	
Invested in capital assets, net of related debt	134,578,814
Restricted	5,380,265
Unrestricted	<u>(14,815,125)</u>
Total net assets	<u>\$125,143,954</u>

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:

	<u>June 30, 2007</u>
Revenues:	
Program revenues:	
Charges for services	\$ 548,105
Operating grants and contributions	1,204,352
Capital grants and contributions	3,958,678
General revenues:	
Property taxes	1,290,964
Municipal license taxes	436,256
Sales and use tax	201,111
Grants and contributions	6,235,255
Interest, fines and penalties	66,973
Miscellaneous	116,100
Total revenues	<u>\$ 14,057,794</u>
Expenses:	
General government	\$ 8,957,133
Public safety	744,485
Public works	5,988,809
Culture	2,461
Recreation	279,845
Health and welfare	1,776,803
Depreciation expense	2,647,805
Interest on long-term debt	241,953
Total expenses	<u>\$ 20,639,294</u>
Change in net assets	(6,581,500)
Net assets – at beginning of year (as restated)	<u>131,725,454</u>
Net assets – at end of year	<u>\$ 125,143,954</u>

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:

June 30, 2007

Total Assets – Major Funds	\$14,807,782
Total Assets – Nonmajor Funds	69,857
Total assets	<u>\$14,877,639</u>
Total Liabilities – Major Funds	\$19,289,816
Total Liabilities – Nonmajor Funds	165,819
Total liabilities	<u>\$19,455,635</u>
Fund Balances – Major Funds	(\$ 4,673,958)
Fund Balances – Nonmajor Funds	95,962)
Total Fund Balance	<u>(\$ 4,577,996)</u>

Condensed Statement of Operations – Governmental funds:

Total Revenues – Major Funds	\$13,830,352
Total Revenues – Nonmajor Funds	227,442
Total revenues	<u>\$14,057,794</u>
Total expenditures – Major Funds	\$20,761,668
Total expenditures – Nonmajor Funds	346,500
Total expenditures	<u>\$21,108,168</u>
Other financing sources (uses) Major	379,759
Other financing sources (uses) Nonmajor	-0-
Revenues Over Expenses – Major	(6,551,557)
Revenues Over Expenses – Nonmajor	(119,058)
Total Beginning Fund Balance, as Restated	<u>(\$2,092,619)</u>
Total Ending Deficit	<u>(\$4,577,996)</u>

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, 2007**

<u>Assets</u>	<u>Governmental Activities</u>
Cash (Notes 2 and 5)	\$ 456,886
Cash with fiscal agent (Notes 2 and 5)	1,340,988
Due from other agencies (Note 9)	515,388
Interest receivable	7,305
Capital assets, net (Note 11)	<u>137,723,694</u>
 Total assets	 <u><u>\$ 140,044,261</u></u>
 <u>Liabilities and Net Assets</u>	
Liabilities	
Accounts payable and accrued liabilities	\$ 5,910,270
Due to other agencies (Note 12)	473,934
Deferred revenues (Note 13):	
Municipal license tax	405,709
Federal government	108,650
Accrued interest	232,801
Noncurrent liabilities (Note 15):	
Due within one year	392,582
Due in more than one year	<u>7,376,361</u>
Total liabilities	<u>14,900,307</u>
 Net Assets	
Investment in capital assets, net of related debt	134,578,814
Restricted for:	
Debt service	711,254
Capital projects	4,669,011
Unrestricted	<u>(14,815,125)</u>
 Total net assets	 <u><u>\$ 125,143,954</u></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, 2007**

<u>Functions/Programs</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets</u>
<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
General government	\$ 8,957,133	\$ -	\$ -	\$ (8,409,028)
Public safety	744,485			(744,485)
Public works	5,988,809		3,958,678	(2,030,131)
Culture	2,461			(2,461)
Recreation	279,845			(279,845)
Health and welfare	1,776,803	1,204,352		(572,451)
Depreciation	2,647,805			(2,647,805)
Interest on long-term debt	241,953			(241,953)
Total primary government	<u>\$ 20,639,294</u>	<u>\$ 548,105</u>	<u>\$ 1,204,352</u>	<u>(14,928,159)</u>
General revenues:				
Property taxes				1,290,964
Municipal license tax				436,256
Sales and use tax				201,111
Grants and contributions not restricted to specific programs				6,235,255
Interest, fines and penalties				66,973
Miscellaneous				116,100
Total general revenues				<u>8,346,659</u>
Change in net assets				(6,581,500)
Net assets at beginning of year, as restated (Note 22)				131,725,454
Net assets at end of year				<u>\$ 125,143,954</u>

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, 2007

<u>Assets</u>	General	Housing and Urban Development Programs	Special Community Trust	Debt Service	Capital Project	Other Governmental Funds	Total Governmental Funds
Cash (Notes 2 and 5)	\$ 17,585	\$ 146,418	\$ 271,026	\$ -	\$ -	\$ 21,857	\$ 456,886
Cash with fiscal agent (Notes 2 and 5)	509,698			698,259	642,729		1,340,988
Due from other agencies (Note 9)				5,690			515,388
Interest receivable				7,305			7,305
Due from other funds (Note 10)	3,129,488		330,000		9,049,584	48,000	12,557,072
Total assets	<u>\$ 3,656,771</u>	<u>\$ 146,418</u>	<u>\$ 601,026</u>	<u>\$ 711,254</u>	<u>\$ 9,692,313</u>	<u>\$ 69,857</u>	<u>\$ 14,877,639</u>

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

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, 2007**

<u>Liabilities and Fund Balance (Deficit)</u>	General	Housing and Urban Development Programs	Special Community Trust	Debt Service	Capital Project	Other Governmental Funds	Total Governmental Funds
Liabilities							
Account payable and accrued liabilities	\$ 3,397,486		\$ 339,084	\$ -	\$ 2,147,302	\$ 26,398	\$ 5,910,270
Due to other funds (Note 10)	9,067,584	222,717	360,000		2,876,000	30,771	12,557,072
Due to other agencies (Note 12)	473,934						473,934
Deferred revenues: (Note 13)							
Municipal license tax	405,709						
Federal government							
Total liabilities	<u>13,344,713</u>	<u>222,717</u>	<u>699,084</u>	<u>-</u>	<u>5,023,302</u>	<u>108,650</u>	<u>405,709</u>
Commitments and Contingencies							
(Notes 19 and 20)						165,819	19,455,635
Fund Balances (Deficit)							
Reserved for:							
Encumbrances	469,202						469,202
Debt service				711,254			711,254
Capital projects					4,669,011		4,669,011
Unreserved fund balance (deficit)	(10,157,144)	(76,299)	(98,058)			(95,962)	(10,427,463)
Total fund balance (deficit)	<u>(9,687,942)</u>	<u>(76,299)</u>	<u>(98,058)</u>	<u>711,254</u>	<u>4,669,011</u>	<u>(95,962)</u>	<u>(4,577,996)</u>
Total liabilities and fund balance (deficit)	<u>\$ 3,656,771</u>	<u>\$ 146,418</u>	<u>\$ 601,026</u>	<u>\$ 711,254</u>	<u>\$ 9,692,313</u>	<u>\$ 69,857</u>	<u>\$ 14,877,639</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, 2007**

Total fund balances - governmental funds \$ (4,577,996)

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 137,723,694

- Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. (Note 4) (8,001,744)

Net assets of governmental activities \$ 125,143,954

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

-14-
ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

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

	General	Housing and Urban Development Programs	Special Community Trust	Debt Service	Capital Project	Other Governmental Funds	Total Governmental Funds
REVENUES							
Property taxes (Note 6)	\$ 894,944			\$ 386,020			\$ 1,290,964
Municipal license taxes (Note 7)	436,256						436,256
Sales and use taxes (Note 8)	201,111						201,111
Licenses and permits	515,521						519,521
Charges for service and rents	28,584						28,584
Intergovernmental revenues (Note 14)		976,910					1,204,352
Federal grants and contributions			1,569,457			227,442	10,193,933
State contributions	6,235,255				2,389,221		66,973
Interest, fines, and penalties	104,461	11,639		26,174	40,789		116,100
Other revenues	8,420,132	988,549	1,569,457	422,194	2,430,020	227,442	14,057,794
EXPENDITURES							
Current							
General government	8,880,249						8,880,249
Public safety	744,485						744,485
Public works	3,144,366	444,092					3,588,458
Culture	2,461						2,461
Recreation	279,015						279,845
Health and welfare	741,063	689,240	1,612,561		3,653,827		1,776,803
Capital outlays						346,500	5,266,388
Debt service:							
Principal retirement				243,763			243,763
Interest and other				326,716			326,716
Total expenditures	13,792,469	1,133,332	1,612,561	569,479	3,653,827	346,500	21,108,158
Excess (deficiency) of revenues over (under) expenditures	(5,372,337)	(144,733)	(63,104)	(347,285)	(1,223,807)	(119,058)	(7,050,374)
OTHER FINANCING SOURCES (USES)							
Loan issuance	89,750						89,750
Transfers in	21,484				290,000		390,680
Transfers out	(369,176)						(390,660)
Total other financing sources (uses)	(257,933)				290,000		379,759
Excess (deficiency) of revenues and other sources over expenditures and other uses	(5,630,270)	(144,783)	(63,104)	200,407	(933,807)	(119,058)	(6,670,615)
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR	(4,057,872)	68,484	(51,854)	510,847	5,602,818	23,096	2,092,619
FUND BALANCE (DEFICIT) AT END OF YEAR	\$ (9,487,942)	\$ (76,299)	\$ (58,058)	\$ 711,254	\$ 4,669,011	\$ (95,962)	\$ (4,577,996)

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, 2007**

Net change in fund balances - total governmental funds	\$(6,670,615)
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.	2,866,037
• 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.	(2,647,805)
• Governmental funds report issuance of long-term debt as other financial resources because provided current financial resources.	(379,759)
• 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.	243,763
• Change in accrued interest expense which does not require the use of current financial resources.	83,763
• 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>(76,884)</u>
Changes in net assets of governmental activities	<u><u>\$(6,581,500)</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, 2007**

	General Fund			Debt Service Fund		
	Budgeted Amounts Original	Actual	Variance with Final Budget- Positive (Negative)	Budgeted Amounts Original	Actual	Variance with Final Budget- Positive (Negative)
REVENUES						
Property taxes	\$ 808,089	\$ 947,803	\$ 139,714	\$ 164,896	\$ 390,330	\$ 225,434
Municipal license taxes	375,420	437,501	62,081			
Licenses and permits	981,000	516,537	(464,463)			
Charges for services and rent	45,000	42,584	(2,416)			
Intergovernmental revenues:						
State contributions	6,670,444	3,008,284	(3,662,160)			
Interest, fines and penalties	4,000	2,984	(1,016)			
Other revenues	616,047	90,461	(525,586)		18,869	18,869
Total revenues	9,500,000	5,046,154	(4,453,846)	164,896	409,199	244,303
EXPENDITURES						
Current:						
General government	5,082,522	6,464,997	(1,382,475)			
Public safety	800,353	731,092	69,261			
Public works	2,516,198	2,382,879	133,319			
Culture		2,461	(2,461)			
Recreation	266,468	211,146	55,322			
Health and welfare	834,459	757,698	76,761			
Debt service:						
Principal				144,481	243,763	(99,282)
Interest				69,732	325,716	(255,984)
Total expenditures	9,500,000	10,550,273	(1,050,273)	214,213	569,479	(355,266)
Excess (deficiency) of revenues over (under) expenditures	\$ -	\$ (5,504,119)	\$ (5,504,119)	\$ (49,317)	\$ (160,280)	\$ (110,963)

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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, 2007**

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, 2007**

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

- **Statement of Program Activities** - The government - wide 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, 2007**

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, 2007

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, 2007**

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.

5) Special Community Trust

This fund accounts for reserve sources for improvements and construction of housing projects for low-income people.

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).

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

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

e. Interfund Receivables and Payables

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

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, 2007**

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, 2007 amounted to \$151,126. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$219,175 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, 2007**

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	2008-09
48	Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues	2007-08
49	Accounting and Financial Reporting for Pollution Remediation Obligations	2007-08
50	Pension Disclosures - an amendment of GASB Statements No. 25 and No. 27.	2007-08
51	Accounting and Financial Reporting for Intangible Assets	2009-10

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

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

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 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 fund.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general. 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

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

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.

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, 2007 is presented below for the general fund:

	<u>General Fund</u>
Excess of expenditures over revenues - budgetary basis	(\$5,504,119)
Entity differences:	
Non-budgeted expenditures, net	(926,571)
Timing differences:	
Prior year encumbrances recorded as current year expenditures for GAAP basis	(19,591)
Current year encumbrances recorded as expenditures for budgetary basis	469,202
Basis of accounting differences:	
Net change in receivables	2,952,739
Net change in accounts payable	(<u>2,343,997</u>)
Excess of expenditures over revenues - GAAP basis	<u>(\$5,372,337)</u>

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

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.

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	\$2,549,955
Bonds payable	3,144,880
Compensated absences	1,657,680
Accrued interest payable	232,801
Due to Puerto Rico Health Insurance Administration	387,764
Due to Treasury Department	<u>28,664</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u>\$8,001,744</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).

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

The deposits at GDB of approximately \$642,000 that are restricted principally for capital projects, and the \$698,000 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its deposits in 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 taxpayer	< .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.

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

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

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

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 2006-07, 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

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

preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2007, the amount collected by CRIM from taxpayers and charges exceeded the amount advanced by CRIM for the same period by approximately \$3,000. Such amount is presented as due from CRIM in the statement of net assets. (See Note 9).

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2007. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of 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 \$406,000, corresponding to the next fiscal year municipal license.

8. SALES AND USE TAXES

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

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

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

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

9. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Puerto Rico Electric Power Authority	\$506,469
Municipal Revenues Collection Center (General Fund)	3,229
Municipal Revenues Collection Center (Debt Service Fund)	<u>5,690</u>
Total	<u>\$515,388</u>

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

10. INTERFUND TRANSACTIONS

a. Due from/to Other Funds:

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

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Capital Project	General	\$ 8,689,584
General	Capital Project	2,876,000
Capital Project	Special Community Trust	360,000
Special Community Trust	General	330,000
HUD Programs	General	222,717
Other Governmental Funds	General	48,000
General	Other Governmental Funds	<u>30,771</u>
Total		<u>\$12,557,072</u>

The balance of \$2.7 million due to the capital project fund from the general fund represents advances for working capital purposes. The \$2.9 million due to the general fund from the capital projects fund represent appropriation from the Commonwealth of Puerto Rico which were incorrectly recorded in the corresponding fund.

b. Interfund Transfers:

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

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
General	Debt Service	\$ 21,484
Debt Service	General	<u>369,176</u>
Total		<u>\$390,660</u>

The transfer from the general fund to the debt service fund of \$369,176 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, 2007**

11. CAPITAL ASSETS

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

	<u>Balance July 1, 2006 (As Restated)</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2007</u>
Capital assets, not being depreciated:				
Land	\$ 65,520,752	\$ -	\$ -	\$ 65,520,752
Construction in progress		647,500		647,500
Total capital assets, not being depreciated	<u>65,520,752</u>	<u>647,500</u>	<u>-</u>	<u>66,168,252</u>
Capital assets, being depreciated:				
Buildings and building improvements	29,286,642	1,135,612		30,422,254
Furniture and fixtures	1,919,064	160,880		2,079,944
Vehicles and equipment	1,392,296	922,045		2,314,341
Infrastructure	66,691,389			66,691,389
Total capital assets, being depreciated	<u>99,289,391</u>	<u>2,218,537</u>	<u>-</u>	<u>101,507,928</u>
Less accumulated depreciation for:				
Buildings and building improvements	8,314,215	780,076		9,094,291
Furnitures and fixtures	1,355,535	165,721		1,521,256
Vehicles and equipment	1,163,136	21,366		1,184,502
Infrastructure	16,471,795	1,680,642		18,152,437
Total accumulated depreciation	<u>27,304,681</u>	<u>2,647,805</u>	<u>-</u>	<u>29,952,486</u>
Total capital assets, being depreciated, net	<u>71,984,710</u>	<u>(429,268)</u>	<u>-</u>	<u>71,555,442</u>
Governmental activities capital assets, net	<u>\$ 137,505,462</u>	<u>\$ 218,232</u>	<u>\$ -</u>	<u>\$ 137,723,694</u>

The beginning balance of capital assets have been restated to include the infrastructure assets as required by the provisions of GASB Statement 34.

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

12. DUE TO OTHER AGENCIES

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

Puerto Rico Electric Power Authority	\$224,292
Puerto Rico Aqueduct and Sewer Authority	22,236
Internal Revenue Service	57,852
Puerto Rico Treasury Department	70,458
Puerto Rico Employee's Retirement System	97,660
Puerto Rico General Services Administration	720
Maritime Transport Authority	<u>716</u>
Total	<u>\$473,934</u>

13. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of \$405,709 in the general fund related to municipal license tax collected in fiscal year 2006-07 that will be earned in fiscal year 2007-08.

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 other governmental funds.

14. INTERGOVERNMENTAL REVENUES

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

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

15. LONG-TERM DEBTS

Bonds and notes payable and other debts outstanding at June 30, 2007 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%.	\$ 585,000
\$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%.	575,000
\$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%	61,880
\$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%.	753,000
\$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%.	355,000
\$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%.	370,000
\$260,000 series of 2005, payable in annual installments ranging from \$30,000 to \$45,000, until July 1, 2011, excluding interest of 5%.	160,000

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

\$290,000 series of 2007, payable in annual installments ranging from \$5,000 to \$25,000, until July 1, 2031, excluding interest ranging from 6.6% to 7.5% \$ 285,000

Total bonds \$3,144,880

Notes Payable

Note payable of \$2,420,304 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 \$28,664 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, 2007, are as follows:

	<i>Bonds</i>		<i>Note Payable - Law 42</i>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 202,760	\$ 92,843	\$ 55,086	\$ 149,110
2009	219,160	87,266	45,048	146,448
2010	230,760	81,375	47,878	143,617
2011	242,460	75,372	50,887	140,609
2012	88,340	69,028	54,084	137,412
2013-2017	556,500	304,712	325,867	631,606
2018-2022	780,200	214,170	441,942	515,534
2023-2027	704,700	83,590	599,360	358,114
2028-2032	120,000	2,100	800,152	144,622
	<u>\$ 3,144,880</u>	<u>\$ 1,010,456</u>	<u>\$2,420,304</u>	<u>\$ 2,367,072</u>

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

	<i>Note Payable - Law 146</i>		<i>Note Payable - LIMS</i>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 3,591	\$ 5,584	\$ 7,979	\$ 2,257
2009	3,591	5,360	8,460	1,774
2010	3,591	5,136	8,971	1,264
2011	3,591	4,914	9,513	722
2012	3,591	4,690	4,969	148
2013-2017	17,951	20,100		
2018-2022	17,951	14,516		
2023-2027	17,951	8,934		
2028-2032	17,951	3,350		
	<u>\$ 89,759</u>	<u>\$ 72,584</u>	<u>\$ 39,892</u>	<u>\$ 6,165</u>

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.

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

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additlons</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
Governmental Activities:					
Bonds payable	\$ 3,051,240	\$ 290,000	\$ 196,360	\$ 3,144,880	\$ 202,760
Note payable - Law 42	2,460,183		39,879	2,420,304	55,086
Note payable - LIMS	47,416		7,524	39,892	3,591
Note payable - Law 146		89,759		89,759	7,979
Total long-term debt	<u>5,558,839</u>	<u>379,759</u>	<u>243,763</u>	<u>5,694,835</u>	<u>269,416</u>
Due to CRIM	30,822		30,822	-	
Due to PR Health Insurance Administration	644,333		256,569	387,764	
Property tax advance - Treasury Department	35,830		7,166	28,664	7,166
Compensated absences	<u>1,286,239</u>	<u>371,441</u>		<u>1,657,680</u>	<u>116,000</u>
Total other liabilities	<u>1,997,224</u>	<u>371,441</u>	<u>294,557</u>	<u>2,074,108</u>	<u>123,166</u>
Total noncurrent liabilities	<u>\$ 7,556,063</u>	<u>\$ 751,200</u>	<u>\$ 538,320</u>	<u>\$ 7,768,943</u>	<u>\$ 392,582</u>

16. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. 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.

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.

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

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 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.

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

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, 2007 was approximately \$212,000. The Municipality's payroll for employees covered by ERS was approximately \$2.3 million. The Municipality total payroll for all employees was approximately \$5.6 million.

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

17. RISK MANAGEMENT

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

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

who is responsible for purchasing all property and casualty insurance policies of all municipalities.

18. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place and Transportation center under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2007 was \$28,584.
- 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.

19. 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, 2007

20. COMMITMENTS

The Municipality of Vieques had several outstanding or planned construction projects as of June 30, 2007. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$5.2 million.

21. 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, 2007, 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.

22. RESTATEMENTS

a. Fund Balance

The beginning fund balance of the general fund, capital projects funds and HUD Programs have been restated to correct for accounting errors as follows:

	<u>General</u>	<u>HUD Programs</u>	<u>Capital Project Fund</u>
Beginning fund balance (deficit), as previously reported	\$(1,652,363)	\$(229,270)	\$ 3,197,509
To record interfund transactions not previously reported	(2,405,309)	-	2,405,309
To adjust deferred revenue		<u>297,754</u>	
Beginning fund balance, as restated	<u><u>\$(4,057,672)</u></u>	<u><u>\$ 68,484</u></u>	<u><u>\$ 5,602,818</u></u>

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

b. Net Assets

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

Net assets at beginning of year, as previously reported:	\$ 83,787,502
Restatements:	
Inclusion of infrastructure assets as required by provisions of GASB Statement 34	47,640,198
To adjust deferred revenue	<u>297,754</u>
Net assets at beginning of year, as restated	<u>\$131,725,454</u>

23. SUBSEQUENT EVENTS

On July 29, 2007, the Legislature of the Commonwealth of Puerto Rico enacted Act No. 80 (the "Act"), in order to make mandatory in all the municipalities of Puerto Rico the imposition of a uniform municipal tax of 1.5%, from which the municipalities shall collect 1% of the sales and use tax pursuant to what is established in Sections 2410 and 6189 of Act No. 117 of July 4, 2006, known as the "Taxpayer's Justice Act of 2006", which may be levied discretionary through municipal legislation, on food and food ingredients and to provide for the collection by the Secretary of the Treasury of the remaining .5% without including food and food ingredients to be used in accordance with the purposes established in the Act; to provide for the establishment of the Municipal Development Fund, the Municipal Redemption Fund, and the Municipal Improvement Fund, as well as for matters relative to the purposes, implementation and administration of said funds and to provide for the establishment of the necessary mechanisms for the collection of the municipal tax.

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

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

purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within municipal limits.

In addition, during August 2007, the Municipality issued a \$1,135,000 bond issuance.

PART II - SINGLE AUDIT SECTION

~~46~~
ORTIZ, RIVERA, RIVERA & CO.
CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

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

<u>Federal Grantor/Program Title</u>	<u>Federal CDFA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Housing and Urban Development (HUD)			
Pass-through Office of Commissioner of Municipal Affairs			
State Block Grant Program (SBGP)	14.228		\$ 444,092
Section 8 - Housing Choice Vouchers	14.871		410,373
Section 8 - Project Based Cluster:			
Lower Income Housing Assistance Program			
Section 8 - Moderate Rehabilitation	14.856		<u>278,867</u>
Total			<u>\$1,133,332</u>

See notes to schedule of expenditures of federal awards.

-47-
ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

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

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards 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.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis Rivera Zúñiga
CPA Zoraida Cruz Claudio

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
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 have audited the 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, 2007, which collectively comprise the Municipality of Vieques' basic financial statements, and have issued our report thereon dated November 26, 2007. The report on the governmental activities was qualified because management has not recorded a liability for estimated landfill postclosing costs and, accordingly, has not recorded an expense for the current period. In addition, the balance sheet of the governmental funds was qualified because the accounting records of the Municipality related to the interfund transactions were not adequate. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material

weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality of Vieques' ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Municipality's financial statements that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting and included as items 07-A thru 07-D.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 07-A and 07-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 in a separate letter dated November 26, 2007.

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

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

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
November 26, 2007

The stamp 2286474 was affixed to the original of this report.





ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis Rivera Zúñiga
CPA Zoraida Cruz Claudio

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
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, 2007. 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 and 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.

In our opinion, 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, 2007. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings as questioned costs as item 07-1 thru 07-3.

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 the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

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

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

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

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

This report is intended solely for the information 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.

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
November 26, 2007

The stamp 2286475 was affixed to the original of this report.



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

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expressed a qualified opinion on the basic financial statements of the Municipality of Vieques.
- b. There were significant deficiencies 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 no significant deficiencies 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
 - State Block Grant Program - CFDA No. 14.228
- 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 07-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 operated by the Municipality, recording cash and other financial resources,

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

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, 2007**

b. Finding 07-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 07-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, 2007 with an unreserved fund balance deficiency in the general fund approximately \$8.2 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, 2007**

Recommendation

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

d. Finding 07-D

The Municipality realized several transfers from its special revenue fund accounts to its General Fund during prior years amounting to \$9.29 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, 2007**

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

a. SBGP - CFDA No. 14.228

● **Condition 07-1**

The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.

Criteria

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

Cause

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

Effect

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

Recommendation

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

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

Questioned Costs

\$ -0-

● **Condition 07-2**

The Municipality did not comply with the requirement of preparing and filing its federal financial reports on a timely basis. During our examination of the Federal Financial Reports, we noted that the Municipality did not send on time the quarterly report for the following period ended:

<u>Quarter Ended</u>	<u>Due Date</u>	<u>Date Submitted</u>
December 2006	02-10-07	02-15-07

Criteria

The Municipality is not in compliance with 24 CFR 85.40 (b) (1) which requires federal fund recipients to periodically monitor the performance of grant-supported activities to ensure that 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, program management should prepare accurate and timely federal financial reports. The Municipality should submit quarterly or semi-annual reports 30 days after the reporting period. The Office of Municipal Affairs granted ten days to this reporting requirement.

Cause

The above situation occurred because the Municipality did not ensure to verify and understand its reporting requirements for this program.

Effect

The continued failure to file the required reports may result in sanctions by the Federal grantor, such as grant payment withholdings.

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

Recommendation

The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially when new grants are received. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the federal government.

Questioned Costs

\$ -0-

b. Section 8 Housing Choice Vouchers - CFDA No. 14.871

• **Condition 07-3**

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

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

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

**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, 2007**

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

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

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
State Block Grant Program CFDA No. 14.228	Condition 05-1 The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.	Condition still prevails. ✓
State Block Grant Program CFDA No. 14.228	Condition 05-2 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 still prevails. ✓
State Block Grant Program CFDA No. 14.228	Condition 05-3 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.	Condition still prevails. ✓
State Block Grant Program CFDA No. 14.228	Condition 05-4 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	Condition was not observed.

**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, 2007**

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
	<p>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 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>Section 8 - Rental Voucher Program and Section 8 - Lower Income Housing Assistance Program CFDA No. 14.856</p>	<p>Condition 05-6</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 was corrected.</p>
<p>Section 8 - Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-1</p> <p>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.</p>	<p>Condition was corrected.</p>
<p>Section 8 - Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-2</p> <p>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.</p>	<p>Condition still prevails.</p>

**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, 2007**

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
<p>Section 8 - Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-3</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 does not maintain the required documents and information in each file to support participant's eligibility requirements.</p>	<p>Condition was not observed.</p>
<p>Section 8 - Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-4</p> <p>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.</p>	<p>Condition was not observed.</p>
<p>Section 8 - Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-5</p> <p>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.</p>	<p>Condition was not observed.</p>
<p>Section 8 - Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-6</p> <p>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.</p>	<p>Condition was not observed.</p>

**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, 2007**

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
<p>Section 8 - Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 06-7</p> <p>During our eligibility test, we examined a sample of 12 participants' files. The followings were the exceptions found:</p> <p>In four (4) cases, evidence that the repairs to be completed by the participants were not observed and the contract was not properly completed.</p>	<p>Condition was not observed.</p>
<p>Section 8 - Lower Income Housing Assistance Program CFDA No. 14.856</p>	<p>Condition 06-8</p> <p>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.</p>	<p>Condition still prevails.</p>
<p>Section 8 - Lower Income Housing Assistance Program CFDA No. 14.856</p>	<p>Condition 06-9</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 requirements.</p>	<p>Condition was not observed.</p>
<p>Section 8 - Lower Income Housing Assistance Program CFDA No. 14.856</p>	<p>Condition 06-10</p> <p>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.</p>	<p>Condition was corrected.</p>

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, 2007

<u>Program</u>	<u>Condition/Noncompliance</u>	<u>Status</u>
Section 8 - Lower Income Housing Assistance Program CFDA No. 14.856	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.	Condition was not observed.
Section 8 - Lower Income Housing Assistance Program CFDA No. 14.856	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.	Condition was not observed.