

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

MUNICIPIO DE VIEQUES
AUDITORIA 2009-2010
30 DE JUNIO DE 2010

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES

BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2010

(WITH INDEPENDENT AUDITOR'S REPORT THEREON)

1150492

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TORRES, HERNANDEZ & PUNTER, CPA, CSP
Certified Public Accountants

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES

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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 of the Commonwealth of Puerto Rico (the Municipality), as of and for the year ended June 30, 2010, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

Management has not recorded certain capital assets in governmental activities and, accordingly, has not recorded depreciation expenses on those assets. Accounting principles generally accepted in the United States of America require that those capital assets be capitalized and depreciated, which would increase the assets, net assets and expenses of the governmental activities. The amount by which this departure would affect the assets, net assets and expenses of the governmental activities is not reasonably determinable.

Also, as discussed in Note 2-11 to the financial statements, the Municipality has not recorded a provision for liability of closure and postclosure care costs related to the operation of the landfill. Accounting principles generally accepted in the United States of America require that a provision for liability related to closure and postclosure care costs be recorded to comply with applicable federal and state regulations. The amount by which this departure would affect the liabilities, net assets, expenses of governmental activities is not reasonable determinable.

In our opinion, except for the effects of not recording certain capital assets in governmental activities and the related depreciation expense and for the effects of not providing a provision for liability of closure and postclosure care costs related to the operation of the landfill as described in the preceding paragraphs, the financial statements referred to previously present fairly, all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality as of June 30, 2010 and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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In accordance with Government Auditing Standards, we have also issued our report dated August 17, 2011, 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, and grant 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 read in conjunction with this report in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's financial statements as a whole. The budgetary comparison schedule of the general fund and related notes on pages 43 to 44 are presented for purposes of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards and related notes on pages 45 and 46 are 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 financial statements. The budgetary comparison schedule of the general fund and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



Torres, Hernández & Punter, CPA, PSC
Certified Public Accountants

August 17, 2011

Stamp #E1532 of the
College of CPA's of
Puerto Rico is affixed
to the original.

The following discussion and analysis of the **Municipality of Vieques (Municipality)**'s financial performance provides an overview of the **Municipality**'s financial activities for the fiscal year ended June 30, 2010. Please read it in conjunction with the financial statements which follow this section.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

The government-wide financial statements report information about the **Municipality** as a whole using the economic resources measurement focus and accrual basis of accounting:

- The assets of the **Municipality**, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2010 by \$126,000,322 (net assets).
- Revenues decreased by \$529,786 (2%) and expenses increased by \$1,314,300 (5%) in comparison with year 2009, as restated.
- Net decrease in net assets amounted to \$1,923,472, a decrease of \$1,844,086 with respect to prior year (2009) net change, as restated.

Highlights for Fund Financial Statements

The fund financial statements provide detailed information about the **Municipality**'s most significant funds using the current financial resources measurement focus and modified accrual basis of accounting:

- At the close of the current fiscal year, the **Municipality**'s governmental funds reported combined ending fund balances of \$3,038,756, a decrease of (\$1,504,502) in comparison with the prior year, as restated.
- The General Fund reported an excess of expenditures and other financing uses over revenues and other financing sources of (\$245,277) and an unreserved (deficit) fund balance of (\$7,191,207).

General Financial Highlights

- The investment in net capital assets as of June 30, 2010 was \$127,249,855 (net of related debt).
- Long-term debt general and special obligation bonds decreased to \$9,637,840, approximately 2% with respect to prior year balance for the issuance of special bond for \$85,000 for purchase of equipment.
- Other long term debts increases and net reductions from payments amounted to \$1,288,237 and \$122,919, respectively.
- On a budgetary basis, actual expenditures exceeded actual revenues and transfers by (\$475,273).
- Revenues decrease was mainly in operating grants and contributions of (\$1,324,469) and capital grants and contributions of (\$291,812), although, the construction taxes increased by \$838,999.

NET ASSETS/FUND BALANCES RESTATEMENTS

Net Assets Restatements

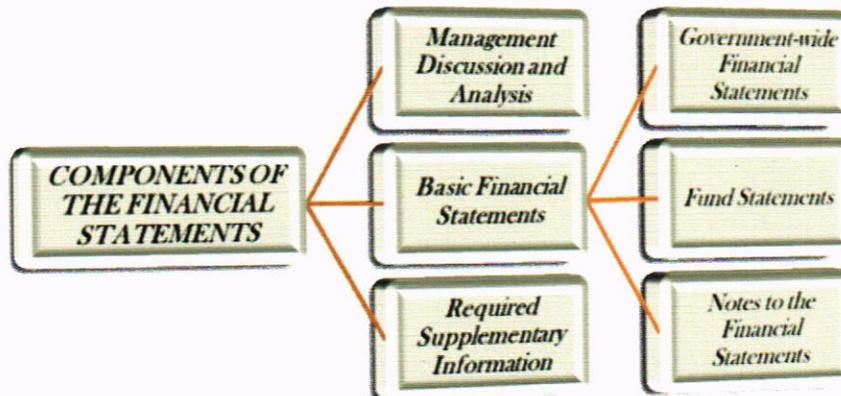
During the year, the **Municipality** adjusted the governmental net assets for unrecognized revenues and expenses. The June 30, 2009 Net Assets, as previously reported of \$116,266,922 was restated to Beginning Net Assets, July 1, 2009, for Governmental Activities to \$127,923,794. For detailed explanation of the adjustments see Note 19 of the Notes to the Financial Statements.

Fund Balances Restatements

The June 30, 2009 Fund Balances, as previously reported of (\$1,815,598) was restated to Beginning Fund Balances, July 1, 2009 for the various funds to \$4,543,258. The principal adjustment corresponded to General Fund that was restated from (\$12,271,583) to (\$6,683,529). For detailed explanation of the adjustments see Note 19 of the Notes to the Financial Statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

The **Municipality's** basic financial statements comprise three components: (1) management discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information.



The **Municipality's** basic financial statements consist of two kinds of statements, each with a different view of the **Municipality's** finances. The government-wide financial statements provide both long-term and short-term information about the **Municipality's** overall financial status. The fund financial statements focus on major aspects of the **Municipality's** operations, reporting those operations in more detail than the government-wide statements:

Basic Financial Statements

- **Government-Wide Financial Statements**

The government-wide statements report information about the **Municipality** as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the *Statement of Net Assets* – presents information on all of the **Municipality's** assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the **Municipality's** net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the **Municipality's** roads and other infrastructure may need to

be considered to assess the overall health of the **Municipality**. The second statement – the *Statement of Activities* – presents information showing how the net assets changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

- ***Fund Financial Statements***

The fund financial statements provide more detailed information about the **Municipality's** most significant funds. Funds are accounting devices that the **Municipality** uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well by bond covenants.

The **Municipality's** basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach the financial statements focus on near-term inflows and outflows of external resources, as well on balances of expendable resources available at year end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the **Municipality's** programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

The governmental fund statements focus on major funds. The **Municipality's** major funds are the general fund (which accounts for the main operating activities of the **Municipality**) and funds that complies with a minimum criterion (percentage of the assets, liabilities, revenues or expenditures). Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

- ***Notes to the Financial Statements***

Provides integral information needed to explain the basis for the numbers used within the Basic Financial Statements and provide more detailed data.

- ***Required Supplementary Information***

Provides additional information to better understand the financial position of the **Municipality** and contains the Budgetary Comparison Schedule for the General Fund.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The following table presents a summary of the Statements of Net Assets as of June 30, 2010 and 2009:

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year were maintained stable with a decrease of only 1% with respect to prior year as restated. The most significant changes were a decrease in Investment in Capital Assets, Net of Related Debt of (\$2,485,296) and a decrease of the deficit by \$476,242. The decrease in Investment in Capital Assets, Net of Related Debt is due to the construction of several capital projects, for which the related debt is of about \$3.0 million dollars.

The largest portion of the **Municipality's** net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$127,249,855 [total capital assets (\$169,910,823) less accumulated depreciation (\$37,960,180) and

less any related outstanding debt (\$4,700,788)] used to acquire those assets. The **Municipality** uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt.

Restricted net assets represent resources that are subject to external restrictions on how they may be used.

Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

As of June 30, 2010 the **Municipality** presented unrestricted (deficit) net assets of (\$7,684,975). This balance was affected by long term obligations such as compensated absences \$1,415,392, Law 42 \$2,309,297, general and special obligations for \$3,684,504 (used for operating purposes), and other debts for the amount of \$1,016,919 for which the **Municipality** did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation.

	2010	2009
Current and Non-Current Assets	\$ 9,654,548	\$ 10,348,253
Capital Assets	<u>131,950,643</u>	<u>132,033,825</u>
Total Assets	<u>141,605,191</u>	<u>142,382,078</u>
Current Liabilities	849,505	367,720
Deferred Revenues	375,916	379,160
Long-Term Liabilities	<u>14,379,448</u>	<u>13,711,404</u>
Total Liabilities	<u>15,604,869</u>	<u>14,458,284</u>
Net Assets:		
Investment in Capital Assets, Net of Related Debt	127,249,855	129,735,751
Restricted (as Restated)	6,435,442	6,479,260
Unrestricted	<u>(7,684,975)</u>	<u>(8,291,217)</u>
Total Net Assets	<u>\$ 126,000,322</u>	<u>\$ 127,923,794</u>

Changes in Net Assets

The following table summarizes the changes in net assets for the years ended June 30, 2010 and 2009:

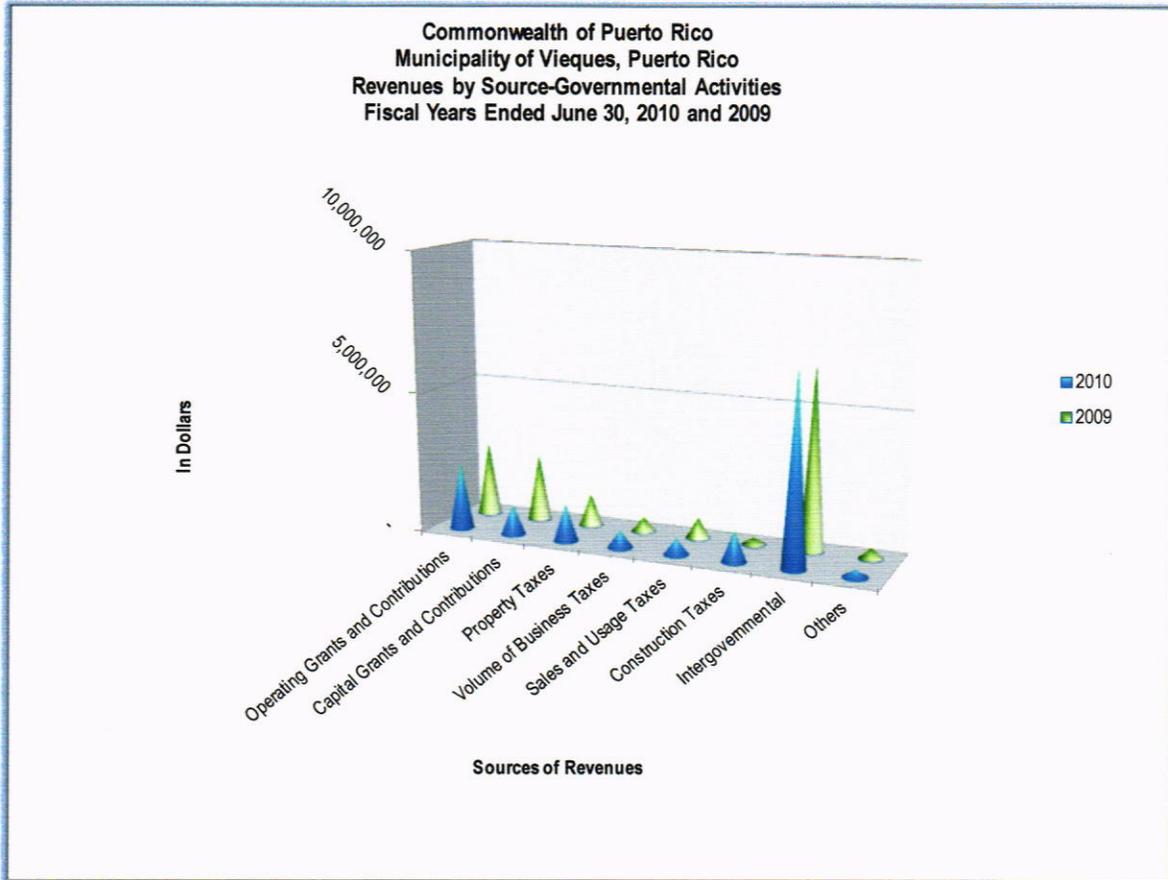
With respect to prior year, revenues decreased by approximately \$530 thousands or 2%, principally on capital grants and contributions.

Expenses increased 5% or \$1,314,300 in comparison with year 2009. Significant increases were registered on general administration due to a debt with Puerto Rico Department of Labor and an increase in compensated absence debt.

Commonwealth of Puerto Rico Municipality of Vieques, Puerto Rico		
Changes in Net Assets For Fiscal Year Ending June 30, 2010		
	2010	2009
Revenues:		
Program Revenues:		
Operating Grants and Contributions	\$ 2,372,970	\$ 2,664,782
Capital Grants and Contributions	1,081,759	2,406,228
General Revenues:		
Property Taxes	1,325,152	1,148,856
Volumen of Business Taxes	630,681	529,601
Sales and Usage Taxes	588,886	743,308
Contruction Taxes	1,101,638	262,639
Intergovernmental	6,797,412	6,556,307
Other General Revenues	262,825	379,388
Total Revenues	<u>14,161,323</u>	<u>14,691,109</u>
Expenses:		
General Administration	9,176,807	5,600,434
Public Safety	938,998	675,521
Public Works	2,231,167	3,911,964
Culture and Recreation	751,895	512,480
Health and Sanitation	651,820	756,370
Human Services and Welfare	1,634,570	1,949,983
Urban Development	230,256	770,452
Interest Costs	469,282	593,291
Total Expenses	<u>16,084,795</u>	<u>14,770,495</u>
Changes in Net Assets	(1,923,472)	(79,386)
Net Assets-Beginning, as Restated	<u>127,923,794</u>	<u>128,003,180</u>
Net Assets-Ending	<u>\$ 126,000,322</u>	<u>\$ 127,923,794</u>

Figure 1 presents revenues comparison by sources of the governmental activities during the past two years:

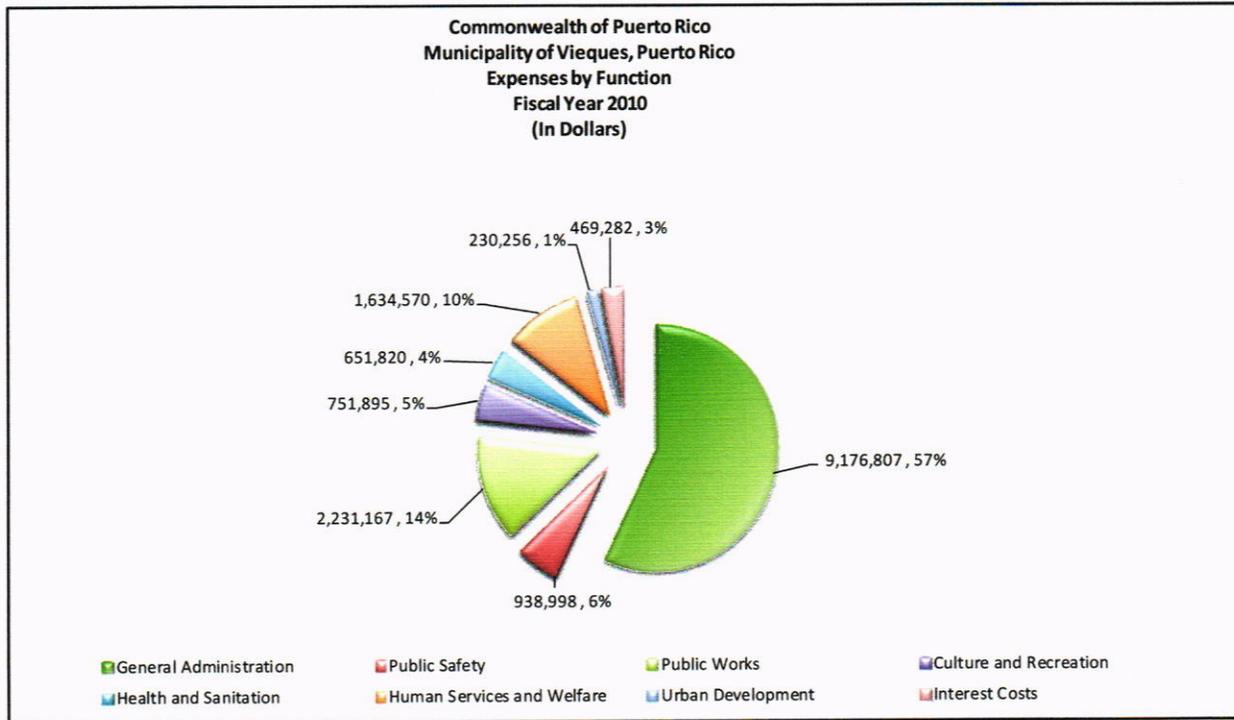
FIGURE 1



Approximately 48% of the **Municipality's** revenues came from intergovernmental, 9.4% from property taxes, 24.4% from grants and contributions, and 18.2% from other sources.

Figure 2 presents expenses by function of the governmental activities during the fiscal year 2009-2010:

FIGURE 2



The **Municipality's** expenses cover a range of services. The largest expenses are general administration with 57%, public works with 14%, human service and welfare with 10 % and public safety with 6%. Program revenues of the **Municipality** covered 21% of total expenses.

The following table focuses on the cost of each of the **Municipality's** largest functions/programs as well as each functions/programs' net cost (total cost less fees generated by the programs and program-specific intergovernmental aid):

Some of the cost of governmental activities in 2010 was paid from other governments and organizations that subsidized certain programs with grants and contributions (\$3,454,729). The \$12,630,066 net cost of services was substantially covered by other general revenues including property, volume of business, sales and usage, and construction taxes, and intergovernmental revenues.

Functions/Programs	Total Cost of Services		Net Cost of Services	
	2010	2009	2010	2009
General Administration	\$ 9,176,807	\$ 5,600,434	\$ 8,995,576	\$ 5,600,434
Public Safety	938,998	675,521	931,763	675,521
Public Works	2,231,167	3,911,964	2,231,167	2,594,679
Culture And Recreation	751,895	512,480	750,214	512,480
Health and Sanitation	651,820	756,370	636,820	756,370
Human Services and Welfare	1,634,570	1,949,983	239,849	332,226
Urban Development	230,256	770,452	(1,624,605)	(1,365,516)
Others	469,282	593,291	469,282	593,291
Total	\$ 16,084,795	\$ 14,770,495	\$ 12,630,066	\$ 9,699,485

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental Funds

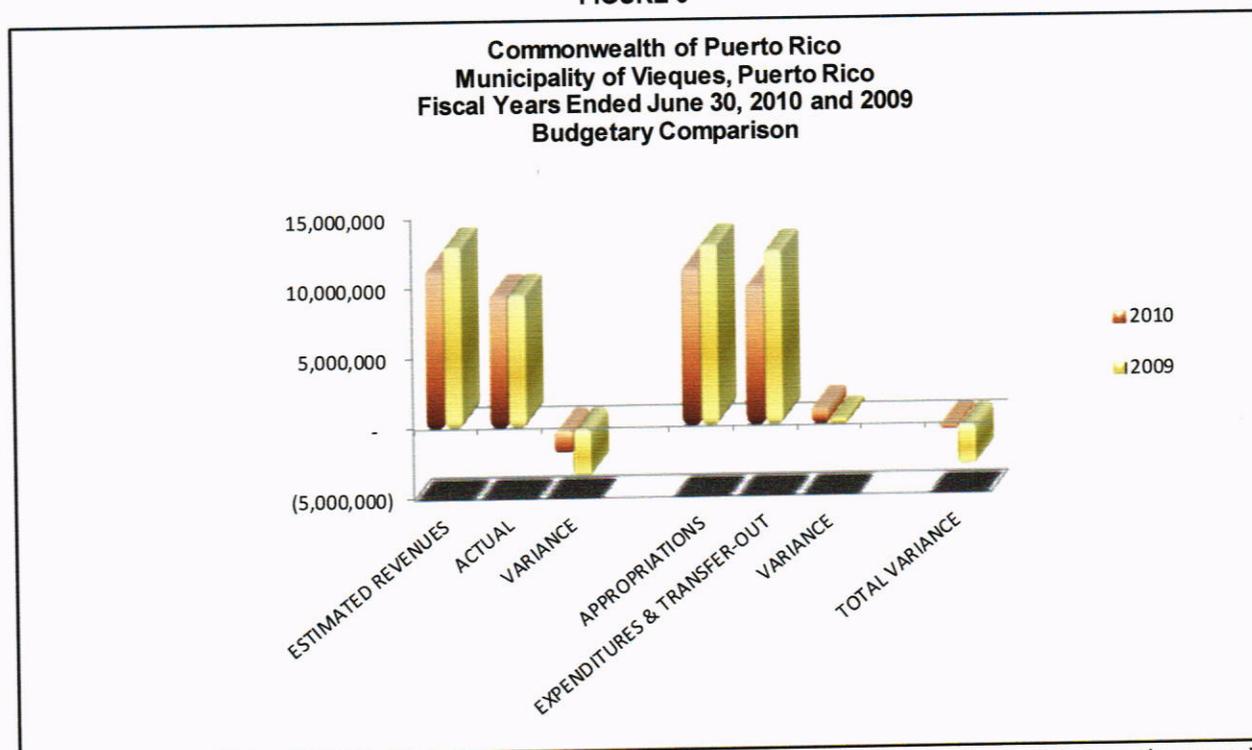
The focus of the **Municipality's** governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the **Municipality's** financing requirements. In particular, unreserved fund balance may serve as a useful measure of a **Municipality's** net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2010, the governmental funds reported combined ending fund balances of \$3,038,756, a net decrease of (\$1,504,502) in comparison with the prior year. This decrease was primarily by a net change in the Arts Center fund of (\$2,153,594), for which proceed of bond was reported on Fiscal Year 2009. Of total combined fund balances, (\$6,928,806) constitutes unreserved (deficit) fund balance of general fund, which was financed by the use of state assignments fund. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the **Municipality**. Unreserved (deficit) fund balance of the general fund represents approximately 104% of total ending general fund balance. For the year ended June 30, 2010, the fund balance (deficit) of the general fund increased by \$245,277 when compared with the prior year. The principal component of the net decreases is the transfer to debt service fund for the payment of related debts.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2009-2010 presented a decrease of 7% with respect to prior year budget. The **Municipality** did not include as an amendment to the budget the positive and negative changes on others revenues, principally in volume of business taxes (\$261,181), sales and usage taxes (\$145,472), and [(\$2,160,211)] miscellaneous.

FIGURE 3



The negative variance of (\$475,273) between revised budget and actual results was due mainly to a decrease in revenues as explained in the preceding paragraph. The **Municipality** reported less expenditures than appropriations in those functions for payments of salaries and fringe benefits, and purchase of supplies, and professional services.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of the fiscal year, the **Municipality** has invested \$131,950,643 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, infrastructure, construction in progress and equipment. This amount represents a net decrease of \$83,182 or .03% from the prior year.

The **Municipality** invested a total of \$2,190,907 of capital assets during the fiscal year 2009-2010 as follows:

- Construction in Progress - \$2,153,594
- Acquisition of Machinery and Equipment - \$37,313

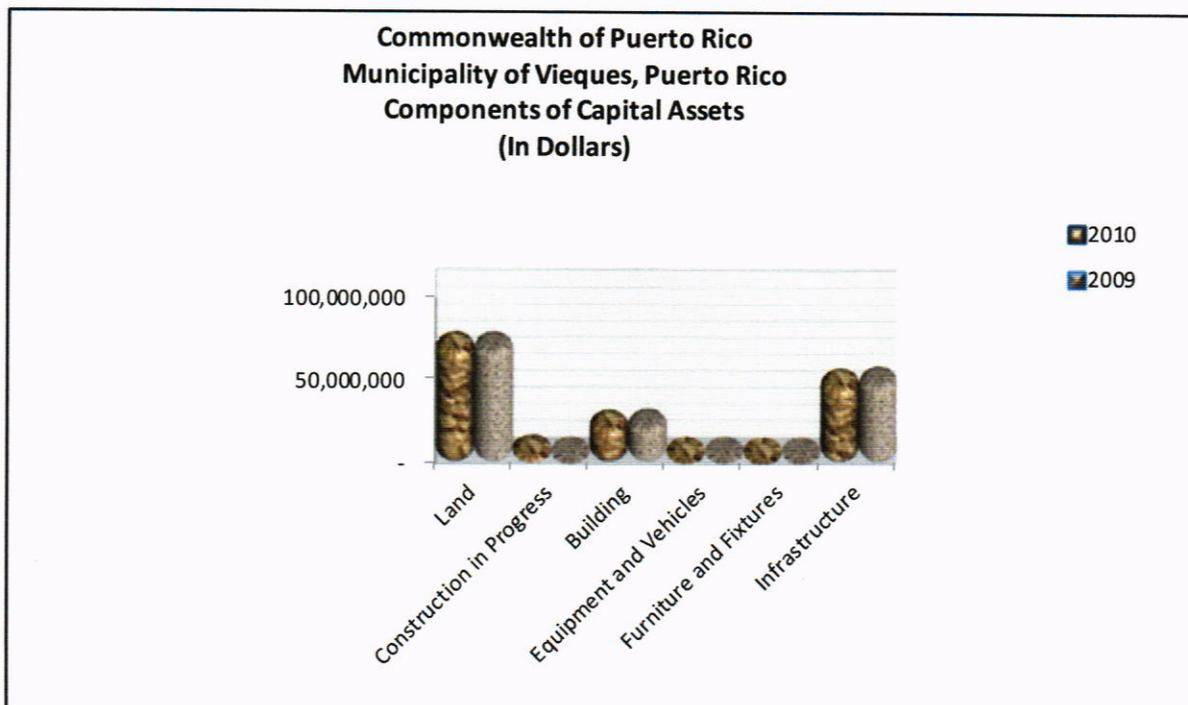
Other projects related to repair and maintenance of roads (not capitalized) was developed during the year 2010.

Construction in progress was principally for the construction of an Arts Center.

Commonwealth of Puerto Rico Municipality of Vieques, Puerto Rico Capital Assets (Net) As of June 30,		
	Governmental Activities	
	2010	2009
Non-depreciable assets:		
Land	\$ 65,520,752	\$ 65,520,752
Construction in Progress	2,801,094	647,500
Depreciable assets:		
Buildings	19,062,644	19,671,089
Equipment and Vehicles	631,254	746,971
Furniture and Fixtures	120,314	299,100
Infrastructure	43,814,585	45,148,413
Total	<u>\$ 131,950,643</u>	<u>\$ 132,033,825</u>

Figure 4 below presents the components of capital assets during the fiscal years 2010 and 2009:

FIGURE 4



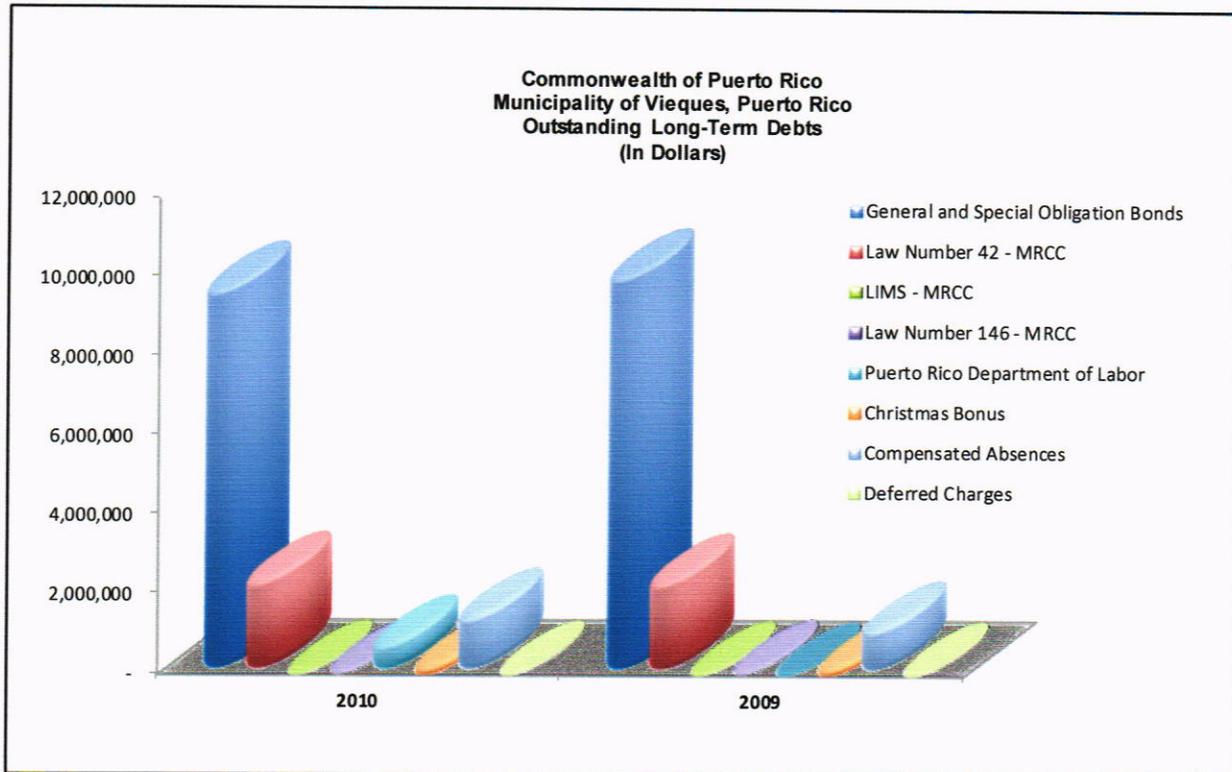
Long-Term Debt

At year-end, the **Municipality** had \$9,637,840 in general and special obligations, a decrease of 2% with respect to prior year, due to the repayment of principal of \$461,120, and the issuance of \$85,000 of special obligation. The following is a summary of the **Municipality's** outstanding debt as of June 30, 2010 and 2009:

	2010	2009
General and Special Obligation Bonds	\$ 9,637,840	\$ 10,013,960
Law Number 42 - MRCC	2,309,297	2,297,883
LIMS - MRCC	14,483	23,454
Law Number 146 - MRCC	78,988	82,578
Puerto Rico Department of Labor	728,719	-
Deferred Charges	10,188	5,094
Christmas Bonus	184,541	166,732
Compensated Absences	1,415,392	1,121,703
Total	\$ 14,379,448	\$ 13,711,404

Figure 5 presents the components of long-term debts during the fiscal years 2010 and 2009:

FIGURE 5



More detailed information about the **Municipality's** long-term liabilities is presented in Note 9 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The **Municipality's** selected and appointed officials considered many factors when setting the fiscal year 2009-2010 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The **Municipality's** unemployment rate now stands at 17.3%, which compares with the Commonwealth rate of 16.6%.

The **Municipality** applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2011 are \$10.8 million, approximately \$553,000 less than the fiscal year 2010. The **Municipality** expects a reduction of revenues due to the economic recession. Budgeted expenditures are expected to stabilize accordingly to the projected revenues. Among planned projects, this budget may be adjusted in accordance with economic injection projected when the construction project promoted by the **Municipality** and others private projects were develop during the year.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This report is designed to provide a general overview of the **Municipality's** finances and to demonstrate the accountability for the money it receives. If you have any questions about this report or need additional information, contact the **Municipality's** Finance Department at (787) 741-5000, or Carlos Lebrum Street #449, Vieques, PR 00765.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2010

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash	\$ 1,425,395
Cash with Fiscal Agent	2,853,212
Receivables (net):	
Property Taxes	38,013
Sales and Usage Taxes	26,017
Due from Governmental Units	92,271
Federal Grants	<u>5,166,208</u>
Total Currents Assets	<u>9,601,116</u>
Deferred Charges	<u>53,432</u>
Capital Assets:	
Land, Improvement and Construction in Progress	68,321,846
Other Capital Assets [Net of Depreciation]	<u>63,628,797</u>
Total Capital Assets	<u>131,950,643</u>
TOTAL ASSETS	<u>141,605,191</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses	468,377
Accrued Interest	54,865
Due to Governmental Units	326,263
Deferred Revenues	375,916
Long-Term Liabilities:	
Due Within One Year	1,721,518
Due in More than One Year	<u>12,657,930</u>
TOTAL LIABILITIES	<u>15,604,869</u>
NET ASSETS:	
Investment in Capital Assets, Net of Related Debt	127,249,855
Restricted for:	
Capital Projects	49,902
Debt Service	1,219,779
Community Development Projects	5,165,761
Unrestricted (Deficit)	<u>(7,684,975)</u>
TOTAL NET ASSETS	<u>\$ 126,000,322</u>

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenues and Changes in Net Assets
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
Mayor and Municipal Legislature	\$ 1,579,110	\$ -	\$ -	\$ -	\$ (1,579,110)
General Government	7,597,697	-	181,231	-	(7,416,466)
Public Safety	938,998	-	7,235	-	(931,763)
Public Works	2,231,167	-	-	-	(2,231,167)
Culture and Recreation	751,895	-	1,681	-	(750,214)
Health and Sanitation	651,820	-	15,000	-	(636,820)
Human Services and Welfare	1,634,570	-	1,394,721	-	(239,849)
Urban Development	230,256	-	773,102	1,081,759	1,624,605
Interest on Long-Term Debt	469,282	-	-	-	(469,282)
Total Governmental Activities	\$ 16,084,795	\$ -	\$ 2,372,970	\$ 1,081,759	(12,630,066)
General Revenues:					
Taxes:					
Property Taxes, levied for General Purposes					959,539
Property Taxes, levied for Debt Service					365,613
Volume of Business Taxes					630,681
Sales and Usage Taxes					588,886
Construction Excise Taxes					1,101,638
Intergovernmental					6,797,412
Miscellaneous					262,825
Total General Revenues					10,706,594
CHANGES IN NET ASSETS					
					(1,923,472)
Net Assets – Beginning of Year, As Restated					
					127,923,794
NET ASSETS – ENDING OF YEAR					
					\$ 126,000,322

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO

BALANCE SHEET - GOVERNMENTAL FUNDS

JUNE 30, 2010

	GENERAL FUND	ARTS CENTER FUND	SBGP FUNDS	STATE ASSIGNMENT FUND	DEBT FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
ASSETS:							
Cash	\$ 88,329	\$ -	\$ 235	\$ 34,108	\$ -	\$ 1,302,723	\$ 1,425,395
Cash with Fiscal Agent	-	453,292	-	-	1,236,631	1,163,289	2,853,212
Receivables:							
Property Taxes	-	-	-	-	38,013	-	38,013
Sales and Usage Taxes	26,017	-	-	-	-	-	26,017
Federal Grants	-	-	5,165,526	-	-	682	5,166,208
From Other Funds	-	-	-	5,980,368	-	281,933	6,262,301
Due from Governmental Units	92,271	-	-	-	-	-	92,271
Other Receivables	-	-	-	-	-	-	-
Total Assets	\$ 206,617	\$ 453,292	\$ 5,165,761	\$ 6,014,476	\$ 1,274,644	\$ 2,748,627	\$ 15,863,417
LIABILITIES AND FUND BALANCES:							
Liabilities:							
Account Payable	\$ 129,293	\$ -	\$ -	\$ -	\$ -	\$ 339,084	\$ 468,377
Bonds Payable	-	-	-	-	245,000	-	245,000
Account Interest	-	-	-	-	54,865	-	54,865
Due to Governmental Units	326,263	-	-	-	-	-	326,263
Due to Other Funds	6,212,301	-	-	-	-	50,000	6,262,301
Deferred Revenues:							
Volume of Business Taxes	375,295	-	-	-	-	-	375,295
Commonwealth of Puerto Rico	92,271	-	-	-	-	-	92,271
Federal Grants	-	-	4,999,668	-	-	621	5,000,289
Total Liabilities	7,135,423	-	4,999,668	-	299,865	389,705	12,824,661
Fund Balances:							
Reserve For:							
Encumbrances	170,130	-	-	-	-	-	170,130
Debt Service	-	-	-	-	974,779	-	974,779
Capital Projects	-	453,292	-	-	-	2,160,782	2,614,074
Special Purpose	92,271	-	166,093	6,014,476	-	198,140	6,470,980
Unreserved (Deficit)	(7,191,207)	-	-	-	-	-	(7,191,207)
Total Fund Balances	(6,928,806)	453,292	166,093	6,014,476	974,779	2,358,922	3,038,756
Total Liabilities and Fund Balances	\$ 206,617	\$ 453,292	\$ 5,165,761	\$ 6,014,476	\$ 1,274,644	\$ 2,748,627	\$ 15,863,417

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS

JUNE 30, 2010

Total Fund Balances – Government Funds (Page 16)	\$ 3,038,756
Amount reported for Governmental Activities in the Statement of Net Assets (Page 14) are different because:	
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:	
Non Depreciable Capital Assets	\$ 68,321,846
Depreciable Capital Assets	34,897,588
Infrastructure Assets	66,691,389
Accumulated Depreciation	<u>(37,960,180)</u>
Total Capital Assets	131,950,643
Other Assets used in governmental activities are not financial resources and therefore are not reported in the funds:	
Deferred Charges	53,432
Some of the Municipality's revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds:	
CDBG	4,999,668
Christmas Bonus	<u>92,271</u>
	5,091,939
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:	
General Special Obligation Bonds	(9,392,840)
PR Department of Labor	(728,719)
Christmas Bonus	(184,541)
LIMS - MRCC	(14,483)
Compensated Absences	(1,415,392)
Law Number 146 - MRCC	(78,988)
Law Number 42 - MRCC	(2,309,297)
Deferred Charges	<u>(10,188)</u>
Total Long-Term Liabilities	<u>(14,134,448)</u>
Total Net Assets of Governmental Activities (Page 14)	<u>\$ 126,000,322</u>

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUNDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	GENERAL FUND	ARTS CENTER FUND	SBGP FUNDS	STATE ASSIGNMENT FUND	DEBT FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES:							
Property Taxes	\$ 959,539	\$ -	\$ -	\$ -	\$ 365,613	\$ -	\$ 1,325,152
Volume of Business Taxes	630,681	-	-	-	-	-	630,681
Sales and Usage Taxes	299,129	-	-	-	289,757	-	588,886
Federal Assistancess	-	-	521,823	-	-	811,172	1,332,995
Intergovernmental	6,615,135	-	-	148,372	-	1,895,455	8,658,962
Construction Excise Taxes	1,101,638	-	-	-	-	-	1,101,638
Miscellaneous	262,825	-	-	-	-	-	262,825
Total Revenues	9,868,947	-	521,823	148,372	655,370	2,706,627	13,901,139
EXPENDITURES:							
Current:							
Mayor and Municipal Legislature	896,883	-	-	-	-	-	896,883
General Government	5,108,341	-	-	192,997	-	1,110,180	6,411,518
Public Safety	658,872	-	-	-	-	7,235	666,107
Public Works	1,084,198	-	-	-	-	-	1,084,198
Culture and Recreation	569,968	-	-	-	-	-	569,968
Health and Sanitation	631,041	-	-	-	-	20,779	651,820
Human Services and Welfare	616,793	-	-	-	-	722,145	1,338,938
Urban Development	6,451	-	578,447	-	-	87,360	672,258
Capital Outlay	37,313	2,153,594	-	-	-	-	2,190,907
Debt Service:							
Bond Issue Cost	-	-	-	-	-	-	-
Principal	-	-	-	-	538,762	-	538,762
Interest and Other Charges	-	-	-	-	469,282	-	469,282
Total Expenditures	9,609,860	2,153,594	578,447	192,997	1,008,044	1,947,699	15,490,641
Excess of Revenues Over (Under) Expenditures	259,087	(2,153,594)	(56,624)	(44,625)	(352,674)	758,928	(1,589,502)
OTHER FINANCING SOURCES (USES):							
Proceed of Bonds	-	-	-	-	-	85,000	85,000
Transfer – In	-	-	-	-	504,364	-	504,364
Transfer – Out	(504,364)	-	-	-	-	-	(504,364)
Total Other Financing Sources and Uses	(504,364)	-	-	-	504,364	85,000	85,000
Net Change in Fund Balance	(245,277)	(2,153,594)	(56,624)	(44,625)	151,690	843,928	(1,504,502)
Fund Balance – Beginning, As Restated	(6,683,529)	2,606,886	222,717	6,059,101	823,089	1,514,994	4,543,258
FUND BALANCE – ENDING	\$ (6,928,806)	\$ 453,292	\$ 166,093	\$ 6,014,476	\$ 974,779	\$ 2,358,922	\$ 3,038,756

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Net Change in Fund Balances – Government Funds (Page 18)	\$ (1,504,502)
Amount reported for Governmental Activities in the Statement of Activities (Page 15) 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. In the current period, these amounts are:	
Capital Assets	\$ 2,190,907
Depreciation Expense	<u>(2,274,089)</u>
Excess of Capital Assets over Depreciation Expense	(83,182)
Governmental Fund Report the effect of Bond Issuance Costs as Expenditure when Debt is first issued, and amortized in the Statement of Activities. This amounts is the effect of these differences:	
Bond Issuance Costs	(5,094)
Amortization of Deferred Charges	<u>(4,423)</u>
	(9,517)
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds:	
Christmas Bonus	8,905
Community Development Block Grant	<u>251,279</u>
Total of Revenues	260,184
Bonds proceeds provide current financial resources to governmental funds, but issuing debt increase Long-Term Liabilities in the Statement of Net Assets. In the current period, proceeds received was	
	(85,000)
Repayment of long-term principal is expenditure in the governmental funds, but issuing debt reduced Long-Term Liabilities in the Statement of Net Assets. In the current period repayments were	
	538,762
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:	
Increase in Christmas Bonus	(17,809)
Increase in Debt to PR Department of Labor	(728,719)
Increase in Compensated Absences	<u>(293,689)</u>
Total Additional Expenses	<u>(1,040,217)</u>
Change in Net Assets of Governmental Activities (Page 15)	\$ (1,923,472)

See accompanying Notes to Basic Financial Statements.

1. FINANCIAL REPORTING ENTITY

A. Organization

The Municipality of Vieques, Puerto Rico (Municipality) was founded in the year 1844, and operates as a governmental unit of the Commonwealth of Puerto Rico, under Law Number 81 of August 30, 1991, known as "Autonomous Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 12 Legislators also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services. As a government entity, the Municipality is exempt from both federal and state taxes.

B. Reporting Entity

A reporting entity is comprised of (1) the primary government, (2) component unit organizations for which the primary government is financial accountable (blended component units), and (3) other organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, and they are financially accountable to the primary government (discrete component units). The primary government consists of all funds, departments, boards and agencies that are not legally separate from the Municipality and for which the Municipality is financial accountable.

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the Municipality. In evaluating the Municipality as a reporting entity, management has addressed all the potential component units. Section 2600 of the GASB Codification of *Governmental Accounting and Financial Reporting Standards* requires the inclusion of organizations that raise and hold funds for the direct benefit of the primary government.

Section 2100 of the GASB Codification describes the criteria for determining which organizations, functions, and activities should be considered part of the Municipality for financial reporting purposes. The primary criteria include appointing a voting majority of an organization's governing body, and the Municipality's ability to impose its will on that organization or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

There are two methods of presentation of the component unit in the financial statements: blending – the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balance; and discrete – presentation of the component unit's financial data in column separate from the Municipality's balances and transactions.

The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the Municipality indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the Municipality as the reporting entity.

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2010, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Statement Presentation

The basic financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America as applicable to local governmental units (USGAAP). The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements, which provide a more detailed level of financial information. Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as governmental type.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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

Management's Discussion and Analysis

Management's discussion and analysis is required supplementary information that introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.

Government-wide Financial Statements (GWFS)

The GWFS (the *Statement of Net Assets* and the *Statement of Activities*) report information of all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely, to a significant extent, on fees and charges for support.

The focus of the *Statement of Net Assets* is designed to be similar to bottom line results for the Municipality's governmental activities and business type activities. This statement combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations. The *Statement of Net Assets* presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are restricted when constraints are placed on them that are imposed by external parties or by laws or regulations. Designations solely imposed by the Municipality's management are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, the Municipality's policy is to use the restricted resources first.

The *Statement of Activities* demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. In addition, to the extent that indirect costs are allocated to the various functions, the program expenses will include both direct and indirect costs. *Program Revenues* include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment, and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items properly excluded from program revenues are reported instead as *general revenues*.

Governmental Funds Financial Statements (GFFS)

The GFFS [the *Balance Sheet*, and the *Statement of Revenues, Expenditures and Changes in Fund Balance*] provide information about the Municipality's funds. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. Non-major funds are summarized into a single column.

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on major funds, rather than the previous financial model's fund types. This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (1) demonstrate legal and covenant compliance, (2) demonstrate the source and use of liquid resources, and (3) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the GFFS are presented in different measurement focus and basis of accounting than the GWFS, reconciliation is presented and separate explanation for each differences.

The Municipality reports its financial position (Balance Sheet) and results of operations (Statement of Revenues, Expenditures and Changes in Fund Balance) in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

Notes to the Basic Financial Statements

The notes to the financial statements provide information that is essential to a user's full understanding of the data provided in the basis financial statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information. This section includes a *Budgetary Comparison Schedule – General Fund*, which includes reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General Fund as presented in the GFFS.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The GWFS are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary funds. Subject to the additional rules and limitations detailed below, revenue (including interest on deposits and investments) is generally recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchanges-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. The accompanying GWFS include exchange-like transactions such as license fees, fines, penalties, forfeitures, permits, charges for services, and most miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received.

The Municipality groups its non-exchange transactions into the following four classes in the basic financial statements:

Derived Tax Revenues – in this revenue, which result from assessments that the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

Imposed Non-exchange Revenues – in this revenue (such as property taxes and volume of business taxes), which result from assessments made by the Municipality on non-governmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and volume of business taxes are recognized as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted.

Government Mandated Non-exchange Transactions – in this revenue (such as intergovernmental grants and contributions), receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For part of the grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Therefore, revenue is generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary Non-exchange Transactions – in this revenue (such as donations and certain grants and entitlements) receivables and revenues are generally accounted for in the same manner as government mandated non-exchange transactions discussed above.

Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues.

Governmental Funds Financial Statements

The GFFS are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For these purposes, the Municipality considers revenues to be available if they are collected within sixty (60) days after the end of the current fiscal period. Significant revenues subject to accrual include federal grants and sales and usage taxes. Revenues that the Municipality earns by incurring obligations are recognized in the same period as when the obligations are recognized. At June 30, 2010, all revenues sources met this availability criterion.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Property taxes, volume of business taxes, licenses and permits, 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. All other revenue items are considered to be measurable and available only when cash is received by the Municipality.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to Section N50 of the GASB Codification *Nonexchange Transactions*, (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For the majority of grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met.

In a manner similar to GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange, exchange-like transactions are also generally recorded when the exchange takes place while all revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded when an enforceable legal claim arises or when all eligibility requirements imposed by the provider have been met, applicable.

The Municipality generally accrues a governmental fund liability and expenditures (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. The accompanying balance sheet – governmental funds generally reflects only assets that will not be converted into cash to satisfy current liabilities. Long-Term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds. Modifications to the accrual basis of accounting include:

- a. Principal and interest on bonds payable are recorded when they matured (when payment is due), except for principal and interest of bonds due on July 1, 2010, which are recorded as governmental fund liabilities of June 30, 2010 which is the date when resources were available in the debt service fund.
- b. Obligations from compensated absences and the estimated liability for municipal solid waste landfill post-closure care costs are recorded only when they mature (when payment is due).
- c. Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (unmatured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying *Statement of Net Assets*. Such liabilities are recorded in the governmental funds when they mature.
- d. Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying *Statement of Activities*, but are not recorded in the accompanying GFFS.

The Municipality reports the following major governmental funds:

General Fund – This is the general operating fund of the Municipality. It is used to account for all financial resources, except those required to be accounted for in another fund.

Art Center Fund – This is used to account for the construction of the Art Center in Vieques, Puerto Rico.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

SBGP Fund – This is the fund used to account for all the transactions of the State Block Grant Program. The primary objectives of this program is the development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

State Assignments Fund – This is the fund used to account for all the transactions of the State Assignments by Legislature Resolutions. The primary objectives of these assignments is the development of projects on communities, not-for-profit organizations, purchase of equipment and indirect assignment to persons of low and moderate income.

Debt Service Fund – This is used to account for the accumulation of resources for, and the payment of, long-term debt principal and interests.

The non-major funds are combined in a single column in the GGFS. As a general rule the effect of interfund activity has been eliminated from the GWFS.

C. Stewardship, Compliance, and Accountability

Budgetary Information

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. Unexpended appropriations at the end of the fiscal year generally lapse. However, they may be re-appropriated for expenditures in the following fiscal year.

The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

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

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

The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the Budgetary Comparison Schedule – General Fund:

Original Budget

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance to be effective on July 1.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

Final Budget

The final budgetary data presented in the Budgetary Comparison Schedule – General Fund reflects the following changes to the original budget:

1. Certain annual appropriations are budgeted on a project basis. If such projects are not completed at the end of the fiscal year, unexpended appropriations, including encumbered funds, and unexpended grant appropriations, are carried forward to the following year. In certain circumstances, other regular annual appropriations may be carried forward after appropriate approval. Annually appropriated funds, not authorized to be carried forward, lapse at the end of the fiscal year. Appropriations carried forward from the prior year are included in the final budgetary data.
2. Appropriations may be adjusted during the year with the approval of the Mayor and the Municipal Legislature, e.g. supplemental appropriations. Additionally, the Mayor is authorized to make certain transfer of surplus within the departments. Such adjustments are reflected in the final budgetary data.

The Annual Appropriation Ordinance adopts the budget at the character level of expenditure within departments. As described above, the Mayor is authorized to make certain transfers of appropriations within departments. Accordingly, the legal level of budgetary control by the Municipal Legislature is the department Level.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. Interfund transactions of the General Fund are not included in the budgetary basis.
3. Certain accrued liabilities and other debts are not included in the budgetary basis.
4. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

The Special Revenue Fund has not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Financial Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily the same fiscal year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

D. Assets, Liabilities, and Net Assets

1) *Cash and Investment, and Cash with Fiscal Agent*

The Municipality's cash and investment are composed of demand deposits in commercial banks, demand deposits in the Governmental Development Bank of Puerto Rico (GDB), and cash equivalents in commercial banks. The Municipality has adopted the *Statement of Uniform Investment Guidelines for the Municipalities of the Government of Puerto Rico*, issued by the GDB as promulgated by Law No. 113 of August 3, 1995. The Finance Director of the Municipality, follow the guidelines, is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and interest bearing commercial bank accounts are recognized as revenue in the General Fund, Art Center Fund and in Multiuses Coliseum Fund in accordance with amount invested. Cash in the Special Revenue and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Cash with fiscal agent in the Debt Service Fund represents special additional property tax collections retained by the Government, deposit in the GDB and restricted for the payment of the Municipality's debt service, as established by law. Cash with fiscal agent in other governmental funds consists of undisbursed proceeds of certain bonds and notes issued for the acquisition and construction of major capital improvements, or grants which are maintained in a cash custodian account by the GDB. This sinking fund is maintained by the GDB, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with law.

2) 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." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statement as "interfund balances".

Advance between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables consist of all revenues earned but not collected at June 30, 2010. These account receivables are shown net of estimated allowances for uncollectible accounts, which are determined upon past collection experience, historical trends, and current economic conditions. Intergovernmental receivables in the general fund represent mostly sales and usage taxes, federal grant and contributions, property tax accounts that are levied by Municipal Revenue Collection Center (MRCC), a governmental entity created by the Government. Intergovernmental receivables in the other governmental funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded grant and contributions and state appropriations, and the amount in the debt service fund represents the distribution of property tax collected which is restricted for the debt service.

3) Inventories

The Municipality used the purchase method to account for the purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. This method records items as expenditures, in the appropriate fund, when they are acquired and, accordingly, the inventory is not recorded in the basic financial statements.

4) Deferred Charges

Deferred charges in the accompanying *Statement of Net Assets* consist of bond issuance costs, net of accumulated amortization. Deferred charges are amortized over the term of the related debt using the straight-line method. In the GFFS, bond issuance costs are recorded in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

5) Capital Assets

Capital assets, which include land, buildings and improvement, machinery and equipment, motor vehicles, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the GWFS. Capital assets, other than infrastructure assets, are defined by the government as assets with an initial, individual cost of more than \$500 (amount not rounded) and an estimated useful life in excess of two years. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. The Municipality reports infrastructure assets on a network and subsystem basis. Accordingly, the amounts spent for the construction or acquisition of infrastructure assets are capitalized and reported in the government-wide financial statements regardless of their amount.

In the case of the initial capitalization of general infrastructure assets (i.e., those reported by governmental activities) the government chose to include all such items regardless of their acquisition date or amount.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

The Municipality was able to estimate the historical cost for the initial reporting of these assets through back trending (i.e., estimating the current replacement cost of the infrastructure to be capitalized and using an appropriate price-level index to deflate the cost to the acquisition year or estimated acquisition year). As the government constructs or acquires additional capital assets each period, including infrastructure assets, they are capitalized and reported at historical cost. The reported value excludes normal maintenance and repairs which are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate. In the case of donations the government values these capital assets at the estimated fair value of the item at the date of its donation.

Capital outlay is recorded as expenditures of the General Fund and other governmental funds and as assets in the GFFS to the extent the Municipality capitalization threshold is met. Depreciation and amortization expense is recorded only in the GWFS. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. No depreciation is recorded for land and construction in progress. The estimated useful lives of major capital asset categories are:

CAPITAL ASSETS	YEARS
Infrastructure	25-50
Building and Building Improvements	20-50
Furniture and Fixtures	5-10
Vehicles and Equipment	5-20

Depreciation and amortization expense of capital assets is recorded as a direct expense of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various function/programs but reported as direct expense of the public works and urban development functions.

Impaired capital assets that will no longer be used by the Municipality, if any, are reported at the lower of carrying value or fair value. Impairment losses on capital assets with physical damages that will continue to be used by the Municipality are measured using the restoration cost approach. Impairments of capital assets that are subject to a change in the manner or duration of use, or assets affected by enactment or approval of laws or regulations or other changes in environmental factors or assets that are subject to technological changes or obsolescence, if any, are measured using the service units approach.

The Municipality is prevented legally from entering into obligations extending beyond one fiscal year, and most lease agreements entered by the Municipality contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations. The Municipality's lease agreements do not include contingent rental payments no escalation clauses. Accordingly, lease payments are recorded in the GWFS as expense when incurred.

In the accompanying GFFS, the lease payments are recorded as expenditures in the governmental fund.

6) *Deferred and Unearned Revenues*

In the GWFS, deferred revenues arise only when the Municipality receives resources before it has a legal claim to them. In the GFFS, arises when one of the following situations occur: (1) potential revenue does not meet both the measurable and available criteria for revenue recognition in the current period (unavailable revenue), and (2) the Municipality receives resources before it has a legal claim to them (unearned revenue).

7) *Long-Term Obligations, Bonds Issuance Costs, and Premium or Discount*

The liabilities reported in the GWFS include the general and special obligation bonds, long-term notes, other long-term liabilities (e.g., vacation, sick leave, claims and judgments, long-term liabilities to other governmental entities and third parties, and landfill post closure care costs). Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

In the GFFS, governmental fund types recognize bond premiums and discounts as other financing sources and uses, respectively, and bond issuance costs as debt service expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

8) *Compensated Absences*

The Municipality accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The Municipality's employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed at the current rate. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The Municipality accrued a liability for compensated absences, which meet the following criteria: (1) the Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered; (2) the obligation relates to rights that vest or accumulate; (3) payment of the compensation is probable; and (4) the amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by Section C60 of the GASB Codification *Compensated Absences*; the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees, including its share of social security and Medicare payments made on behalf of the employees in the accrual for vacation and sick leave pay. All vacation pay is accrued when incurred in the GWFS and Proprietary Fund Financial Statements. For the GWFS, the current portion is the amount estimated to be used in the following year. For the GFFS, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations.

9) *Claims and Judgments*

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund when the liability is incurred. The Long-Term Liabilities includes, when appropriate, an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

10) *Accounting for Pension Costs*

The Municipality adopted the provisions of GASBS No. 50, *Pension Disclosure*, which amended Section Pe5 of the GASB Codification *Pension Plans – Defined Benefit*, by requiring disclosure of how the contractually required contribution rate is determined by governments participating in multi-employer cost-sharing pension plans.

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

For the purpose of applying the requirements of Section Pe5 of the GASB Codification *Pension Plans – Defined Benefit*, the State Government is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multiemployer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Government and the basic financial statements of such retirement systems are part of the financial reporting entity of the Government.

11) *Landfill*

State and Federal laws and regulations require that the Municipality place a final cover on its landfill when closed and perform certain maintenance and monitoring functions at the landfill site for the next thirty years. In addition to operating expenses related to current activities of the landfill, an expense provision and related liability should be recognized based on the future closure and postclosure care costs that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and postclosure care costs is based on the amount of the landfill used during the year. The Municipality hasn't performed a study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations. Accordingly, any provision for liabilities related to closure and post-closure care costs are included in the accompanying GWFS, *Statement of Net Assets*, under the provisions of Section L10 of the GASB Codification *Landfill Closure and Post-Closure Care Costs*.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

12) Net Assets/Fund Balance

Net Assets

The GWFS and Proprietary Funds Financial Statements utilize a net assets presentation, which are categorized as follow:

- *Invested in Capital Assets, Net of Related Debt* – These consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvements of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvements of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs. In addition, the outstanding debt attributed to capital assets does not include accrued interest payable, non-capital accrued liabilities, inter-fund loans and other financial assets. Net assets invested in capital assets, net of related debt is comprised of the following:

	<u>Governmental Activities</u>
Capital Assets, Net of Accumulated Depreciation.....	\$131,950,643
Outstanding Balance on Related Debt.....	(9,637,840)
Unspent Capital Debt Proceeds.....	<u>4,937,052</u>
Total Invested in Capital Assets, Net of Related Debt.....	<u>\$127,249,855</u>

- *Restricted Net Assets* – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Assets* – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, it is the Municipality’s policy to use restricted resources first, then unrestricted resources as they are needed.

Fund Balance

The GFFS present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. Following is a brief description of the nature of certain reserves.

- *Reserve for 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.
- *Reserve for Debt Service* – The fund balance of the debt service funds is reserved for the payment of debt service in the subsequent years.
- *Reserve for Capital Projects* – Certain assets, primarily cash and investments, and cash with fiscal agent to be invested in capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- *Reserve for Special Purpose* – Certain assets, primarily cash of grants and contributions that are authorized to be carried over and expended in the ensuing year.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

E. Interfund Transactions

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation. The Municipality has the following types of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds.

Intra-Entity Transactions – Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

F. Risk Financing

The Municipality carries commercial insurance to cover property and 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. Also, principal officials of the Municipality are covered under various surety bonds. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the MRCC for the year ended June 30, 2010 amounted to approximately \$128,133. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately \$358,217 for workers compensation insurance covering all municipal employees for the same period.

G. Use of Estimates

The preparation of the basic 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 disclosures of contingent assets and liabilities at the date of the basic financial statements and the reported revenue and expenses during the reporting period. Actual result could differ from those estimates.

H. Reclassifications

Various reclassifications have been made in the accompanying basic financial statements which affect the comparability with the basic financial statements issued for previous fiscal years.

I. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) issued the following pronouncements that have effective dates after June 30, 2010:

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Statement 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010, with earlier application encouraged.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The objective of this Statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans (that is, agent employers). The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2011.

GASB Statement No. 59, *Financial Instruments Omnibus*. The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2010. Earlier application is encouraged.

3. CASH AND INVESTMENTS

Cash in Banks

The Municipality's cash and investments at June 30, 2010 are composed of: (1) demand deposits in commercial banks, and (2) demand deposits in the Government Development Bank of Puerto Rico (GDB, fiscal agent).

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Government. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Government laws.

The Municipality follows the practice of pooling cash. At June 30, 2010, the cash are maintained in commercial banks with a balance of \$1,720,017 of which \$409,328 in the General Fund, \$235 in SBGP Fund, \$62,191 in State Assignments Fund, and \$1,248,263 in Other Governmental Funds. The balance in cash account is available to meet current operating requirements and any unrestricted excess, if any, is generally invested in certificates of deposit with commercial banks. Any deficiency in the cash account is assumed by the general fund and covered through future budgetary appropriation.

Under the laws and regulations of the Government, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the Federal Deposit Insurance Corporation (FDIC) coverage. All securities pledged as collateral are held by agents designated by the Government's Secretary of the Treasury, but not in the Municipality's name.

Cash with fiscal agent in the debt service fund consists principally of property tax collections and sales and usage tax amounting to \$1,236,631 that are restricted for the payment of the Municipality's debt service, as required by law. Cash with Fiscal Agent of \$453,292 in the Arts Center Fund, and \$1,163,289 in other governmental funds consist principally of unspent proceeds of bonds that are restricted for the acquisition, construction or improvement of major capital assets. The amounts deposit in GDB is maintained in interest bearing accounts and is not collateralized.

Municipality follows the provisions of Section C20 of the GASB Codification of *Governmental Accounting and Financial Reporting Standards*, related with cash deposit and interest-earning investment contract with financial institutions. Accordingly, the following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of the Municipality at June 30, 2010:

Credit Risk

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2010, the Municipality has invested only in cash in banks of \$1.7 million which are insured by the FDIC, generally up to a maximum of \$250,000. As previously mentioned, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the FDIC coverage. No investments in debt of equity securities were made during the Fiscal Year ended June 30, 2010. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2010.

3. CASH AND INVESTMENTS (continuation)

Custodial Credit Risk

This is the risk that, in the event of the failure of a depository financial institution, the Municipality will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Government adopted by GDB, the Municipality may invest in obligations of the Government, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. At June 30, 2010, the Municipality has balances deposited in commercial banks amounting to \$1.7 million which are insured by the FDIC up to the established limit and the excess are fully collateralized as explained above. Deposits in GDB, amounting to \$2.9 million are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2010. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2010, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

Interest Rate Risk

This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2010, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less, and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. Therefore, at June 30, 2010, the interest risk associated with the Municipality's cash and cash equivalent is considered low.

Foreign Exchange Risk

This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2010.

4. DUE FROM GOVERNMENTAL UNITS

The due from governmental units for the fiscal year ended June 30, 2010 corresponds to the portion of the Christmas Bonus received from the Commonwealth for the amount of \$92,271.

5. DEFERRED AND UNEARNED REVENUES

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of *deferred revenue* and *unearned revenue* reported in the governmental funds were as follows:

	UNAVAILABLE	UNEARNED
Governmental Funds:		
Volume of Business Taxes	\$ -	\$ 375,295
Federal Government	5,000,289	-
Governmental Units	92,271	-
Total Deferred/U nearned Revenues	\$ 5,092,560	\$ 375,295

6. INTERFUND RECEIVABLE, PAYABLES AND TRANSFERS

A. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Due to/from Other Funds at June 30, 2010 are summarized as follows:

INTERFUND RECEIVABLE	INTERFUND PAYABLE	AMOUNT
State Assignments	General Fund	\$ 5,930,368
State Assignments	Other Funds	50,000
Other Funds	General Fund	<u>281,933</u>
TOTAL		<u>\$ 6,262,301</u>

B. INTERFUND TRANSFERS

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations.

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			
Sources	Transfer to	Amount	Purpose
General Fund	Other Funds	<u>\$ 504,364</u>	Debt Service Fund

7. DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2010, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

	AMOUNT
Retirement System Administration	\$ 197,006
PR Treasury Department	<u>129,257</u>
Total	<u>\$ 326,263</u>

8. CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2010 was as follows:

DESCRIPTION	BALANCE JULY 1, 2009	RECLASSIFICATION	INCREASES	DECREASES	BALANCE JUNE 30, 2010
Non-Depreciable Capital Assets:					
Land	\$ 65,520,752	\$ -	\$ -	\$ -	\$ 65,520,752
Construction in Progress	<u>647,500</u>	-	<u>2,153,594</u>	-	<u>2,801,094</u>
Total Non-Depreciable Capital Assets	<u>66,168,252</u>	-	<u>2,153,594</u>	-	<u>68,321,846</u>
Depreciable Capital Assets:					
Buildings and Buildings Improvements	30,422,254	-	-	-	30,422,254
Equipment and Vehicles	2,314,341	-	-	-	2,314,341
Furniture and Fixtures	2,123,680	-	37,313	-	2,160,993
Heavy Equipment	-	-	-	-	-
Infrastructure	<u>66,691,389</u>	-	-	-	<u>66,691,389</u>
Total Depreciable Capital Assets	<u>101,551,664</u>	-	<u>37,313</u>	-	<u>101,588,977</u>
Less Accumulated Depreciation:					
Buildings and Buildings Improvements	(10,751,165)	-	(608,445)	-	(11,359,610)
Equipment and Vehicles	(1,567,370)	-	(115,717)	-	(1,683,087)
Furniture and Fixtures	(1,824,580)	-	(216,099)	-	(2,040,679)
Heavy Equipment	-	-	-	-	-
Infrastructure	<u>(21,542,976)</u>	-	<u>(1,333,828)</u>	-	<u>(22,876,804)</u>
Total Accumulated Depreciation	<u>(35,686,091)</u>	-	<u>(2,274,089)</u>	-	<u>(37,960,180)</u>
Total Depreciable Capital Assets (Net)	<u>65,865,573</u>	-	<u>(2,236,776)</u>	-	<u>63,628,797</u>
CAPITAL ASSETS, NET	<u>\$ 132,033,825</u>	<u>\$ -</u>	<u>\$ (83,182)</u>	<u>\$ -</u>	<u>\$ 131,950,643</u>

8. CAPITAL ASSETS (continuation)

Depreciation expenses were charged to governmental functions/programs as follows:

	AMOUNT
General Government	\$ 136,445
Mayor and Municipal Legislature	682,227
Public Safety	272,891
Public Works and Transportation	568,522
Culture and Recreation	181,927
Health and Sanitation	295,632
Urban Development	<u>136,445</u>
Total Depreciation Expenses	<u>\$ 2,274,089</u>

9. GENERAL LONG-TERM DEBTS

A. General Obligations Bonds and Special Obligations Bonds

The principal long-term obligations of the Municipality are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 10).

During December 2009, the Municipality issued special obligation bonds of 2010 in the amount of \$85,000 for the operational purpose. The principal and interest at 6.00% for the first year, and 7.50% for the remaining installments are payable semi-annually ranging from \$10,000 to \$15,000 on the 1st days of July and January of each year through July 2016.

General and special obligations bonds as of June 30, 2010, are comprised of the following individual issues:

Type of Obligation and Purpose	Maturity Date	Interest Rate	Amount
General Obligation Bonds - Property Taxes:			
\$720,000, Series 1999 - Acquisition of Building	2023	4.86 to 6.50%	\$ 545,000
\$655,000, Series 2002 - Construction Purpose	2026	2.70 to 5.60%	540,000
\$595,000, Series 2005 - Purchase of Equipment	2011	4.73 to 5.00%	195,000
\$290,000, Series 2007 - Land Purchase	2031	6.60 to 7.50%	275,000
\$1,135,000, Series 2007 - Construction Purpose	2032	3.93 to 7.50%	1,100,000
\$435,000, Series 2009 - Operational Purpose	2013	4.75 to 6.50%	<u>360,000</u>
Total General Obligation Bonds			<u>3,015,000</u>
Special Obligation Bonds - General Revenues:			
\$283,000, Series 1991 - Construction Purpose	2011	3.27 to 7.81%	\$ 21,840
\$315,000, Series 2009 - Construction Purpose	2018	5.40 to 7.50%	270,000
\$3,240,000, Series 2009 - Construction Purpose	2033	2.43 to 7.00%	3,135,000
\$380,000, Series 2003 - Operational Purpose	2029	5.00 to 6.00%	325,000
\$260,000, Series 2005 - Purchase of Equipment	2011	5.00%	45,000
\$837,000, Series 2002 - Operational Purpose	2026	5.00 to 6.00%	694,000
\$2,222,000, Series 2008 - Operational Purpose	2027	3.93 to 7.50%	2,057,000
\$85,000, Series 2010 - Purchase of Equipment	2016	1.60 to 6.00%	<u>75,000</u>
Total Special Obligation Bonds			<u>6,622,840</u>
Total General and Special Obligation Bonds			<u>\$ 9,637,840</u>

According to Sections 103 and 148 through 150 of the US Internal Revenue Code and Sections 1.148

through 1.150 of the US Treasury Regulation, the Municipality's tax-exempt bonds are subject to the arbitrage rebate requirements. At June 30, 2010, the Municipality had no federal arbitrage liability on bonds since interest income earned from the investment of unspent bond proceeds were made in bank deposits that generate yields lower than the rates applicable to the debt service payments.

B. Legal Debt Limit and Legal Debt Margin

On March 9, 2009, the Commonwealth of Puerto Rico approves Law Number 7 that provides for revision of the valuation of property subject to taxation and imposes special property taxes for the Commonwealth. The Municipality debt limits are 10% of valuation of property subject to taxation, plus the balance of the special ad valorem taxes in the Debt Service Fund. In addition, before any new bonds are issued, the revenues of the Debt Service Fund should be sufficient to cover the projected debt service requirement. Additional legal debt margin was determine for the issuance of the special obligations bonds that are paid through retention made by the MRCC from monthly advance of annual property tax and subsidy send to the Municipality.

9. GENERAL LONG-TERM DEBTS (continuation)

C. Other Long-Term Debts

Borrowing from MRCC

On July 1, 2002, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the excess of property taxes advances from fiscal years up to 2001. The repayment agreement is payable in semiannual aggregate principals installments from \$49,360 plus annual interest of 6.1876%. The total amount of debt is \$2,334,223 under the enacted Law Number 42 to be paid during 22 years.

On November 28, 2001, the Municipality entered into a repayment agreement with the GDB and MRCC to pay for the proportional debt to cover the Land Information Management System (LIMS), system established by MRCC with the capacity to maintaining cadastre and photos of all real property of Puerto Rico. The original debt was \$76,312 to be paid during 10 years plus annual interest of 5.95%.

On July 1, 2007, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 146. The total amount of debt is \$89,759 to be paid during 25 years plus annual interest of 6.22%.

Department of Labor and Human Resources

On August 6, 2010, the Municipality entered into a repayment agreement with the Department of Labor and Human Resources to repay the unemployment benefit as of June 30, 2010. The repayment agreement is payable in monthly aggregate installments of principals and interest of 8.00% of \$17,079.68. The total amount of debt is \$728,719 under the agreement to be paid during 4 years.

Deferred Charges Liabilities

This amount represents the unpaid balance of the bond issue cost of the following obligation: \$3,240,000, Series 2009 and \$85,000, Series 2010 special obligation bonds.

Christmas Bonus

This amount represents the estimated accrued Christmas bonus accumulated as of June 30, 2010 and payroll related benefits, representing the benefit to employees to be paid during the first week of December 2010.

Compensated Absences

This amount represents the estimated accrued vacation benefits, accrued sick leave benefits and payroll related benefits, representing the Municipality's commitment to fund such costs from future operations.

Following are the Other Long-Term Debts:

DESCRIPTION	BALANCE	NEW	RETIREMENTS AND ADJUSTMENTS	BALANCE	AMOUNTS	AMOUNTS
	JULY 1, 2009			JUNE 30, 2010	DUE WITHIN ONE YEAR	DUE AFTER NEXT YEAR
Law Number 42 - MRCC	\$ 2,334,223	\$ -	\$ (24,926)	\$ 2,309,297	\$ 49,360	\$ 2,259,937
LIMS - MRCC	23,454	-	(8,971)	14,483	9,513	4,970
Law Number 146 - MRCC	82,578	-	(3,590)	78,988	3,590	75,398
PR Treasury Department	14,332	-	(14,332)	-	-	-
Dept of Labor and Human Resources	-	728,719	-	728,719	207,411	521,308
Deferred Charges Liabilities	-	5,094	5,094	10,188	-	10,188
Christmas Bonus	-	184,541	-	184,541	184,541	-
Compensated Absences	1,121,703	369,883	(76,194)	1,415,392	770,643	644,749
TOTAL	\$ 3,576,290	\$ 1,288,237	\$ (122,919)	\$ 4,741,608	\$ 1,225,058	\$ 3,516,550

9. GENERAL LONG-TERM DEBTS (continuation)

D. Changes in General Long-Term Debts

The following is a summary of changes in long-term debts for the year ended June 30, 2010:

DESCRIPTION	BALANCE		RETIREMENTS AND ADJUSTMENTS	BALANCE JUNE 30, 2010	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
	JULY 1, 2009	NEW ISSUES				
General	\$ 3,315,000	\$ -	\$ (300,000)	\$ 3,015,000	\$ 245,000	\$ 2,770,000
Special	6,768,960	85,000	(231,120)	6,622,840	251,460	6,371,380
Other Debts	3,576,290	1,288,237	(122,919)	4,741,608	1,225,058	3,516,550
TOTAL	\$ 13,660,250	\$ 1,373,237	\$ (654,039)	\$ 14,379,448	\$ 1,721,518	\$ 12,657,930

E. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The Municipality believes it is in compliance with all significant limitations and restrictions.

The annual requirements to amortize the general long-term debts outstanding as of June 30, 2010 are as follows:

YEAR ENDING JUNE 30, 2010	General Obligation Bonds		Special Obligation Bonds		Other Long-Term Obligations		TOTAL	
	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL	INTEREST
Governmental Funds:								
2011	\$ 245,000	\$ 107,203	\$ 251,460	\$ 292,823	\$ 1,225,058	\$ 181,383	\$ 1,721,518	\$ 581,409
2012	255,000	177,345	215,980	457,440	225,644	184,206	696,624	818,991
2013	160,000	165,086	215,700	442,074	223,980	180,537	599,680	787,697
2014	190,000	153,987	232,800	426,330	227,473	176,812	650,273	757,129
2015	85,000	145,313	256,100	409,339	94,013	139,253	435,113	693,905
2016-2020	540,000	630,841	1,419,300	1,751,470	397,444	594,753	2,356,744	2,977,064
2021-2025	710,000	421,089	1,821,800	1,197,340	532,618	453,974	3,064,418	2,072,403
2026-2030	510,000	208,147	1,474,700	523,239	715,923	265,068	2,700,623	996,454
2031-2035	320,000	35,625	735,000	105,700	444,518	42,183	1,499,518	183,508
TOTAL	\$ 3,015,000	\$ 2,044,636	\$ 6,622,840	\$ 5,605,755	\$ 4,741,608	\$ 2,218,169	\$ 14,379,448	\$ 9,868,560

10. DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality (See Note 11).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 9). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

11. PROPERTY TAXES

The Municipality is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1st of each calendar year: (1) is engaged in trade or business and is the owner of personal or real property used in trade or business, or (2) owns residential real property with a value in excess of \$15,000 (at 1957 market price).

The MRCC is responsible for the assessment of all real and personal property located within the Municipality and for the levy, administration and collection of the corresponding tax contribution.

The personal property tax is self-assessed by the taxpayer on a return, which is to be filed and paid in full by May 15 of each year with the MRCC and based on current values as of December 31 of previous year. Real property tax is assessed by the MRCC on each piece of real estate and on each building or residence. The property tax contribution is levied each year over the appraised value of the real property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957.

The MRCC is responsible for the billing of real property taxes and collections of both, personal and real property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the MRCC informs the Municipality of the estimated amount of property taxes expected to be collected for the ensuing fiscal year. Throughout the year, the MRCC advances funds to the Municipality based on the initial estimated collections. The MRCC is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the MRCC remits to the Municipality property taxes advances, which are less than the tax actually collected, a receivable from the MRCC is recorded at June 30. However, if advances exceed the amount actually collected, a borrowing from MRCC is recorded at June 30. The difference between the advances and the final settlement from MRCC for the fiscal year 2010 resulted in a receivable of \$38,013 for the Debt Service Fund.

The tax rate for fiscal year 2010 is 9.03% for real property and 7.03% for personal property of which 1.03% of both are for the redemption of public debt issued by the Commonwealth of Puerto Rico and 8.00% and 6.00%, respectively, belongs to the Municipality. The Commonwealth of Puerto Rico also contributes an annual tax rate of 0.20% of the property tax collected. The remaining percentage is distributed as follows: (a) 6.00% and 4.00%, respectively, represents the Municipality's basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. The remaining portion belonging to the Municipality of 2.00% represents the ad-valorem property taxes withheld by the MRCC and restricted for debt service, which is accounted for through the debt service fund (See Note 10). The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 has assessed valuation on residential units occupied by their owners. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. As part of Law No. 83 of August 30, 1991, as amended, the exempt amount to be paid by the Puerto Rico Treasury Department to the Municipality was frozen as of January 1, 1992.

In addition, the law grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with an annual net sales volume of less than \$150,000. The MRCC advances to the Municipality, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the MRCC from taxpayers. The MRCC periodically informs to the Municipality the amounts collected from taxpayers and applied to outstanding advances.

The Municipality records as revenue in the general fund the property tax contribution when received from monthly advances from MRCC. Due to the fact that collections of property tax are applied to the advances of property tax paid by the MRCC, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

12. VOLUME OF BUSINESS TAXES

The volume of business taxes is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due five working days after April 15 of each year. Entities with sales volume of \$3 million or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2010, the tax rates were as follows:

- a. 1.50% to financial institutions and savings and loan associations
- b. 0.5% to all other organizations

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration on or before the due date, the taxpayer is granted a 5% of discount. The volume of business tax receivable represents filed tax returns that were uncollected as of June 30, 2010. Collections of taxes during current fiscal year corresponding of the tax return based on the prior year gross sales, are applicable to the next fiscal year and recorded as deferred revenues in the General Fund.

13. SALES AND USAGE TAXES

Municipality imposes a Sales and Usage Taxes of 1.5% (1.0% collected and belong to the Municipality and 0.5% collected by the Puerto Rico Secretary of the Treasury) on the sales price of a taxable item or on the purchase price of all usage, storage or consumption of a taxable item. All merchants required to collect the Sales and Usage Taxes, are required to file a monthly Sales and Use Tax Return Form, no later than the 10th of the following month from the month being reported. The Act also provides for restrictions on the use of the resources (including the 0.5% collected by the Puerto Rico Secretary of Treasury) to be invested in solid waste and recycling programs, capital improvements and health and public safety costs.

The amount collected by the Puerto Rico Secretary of Treasury will be deposited in accounts or special funds in GDB, subject to restrictions imposed and distributed as follows:

- a. 0.2% will be deposited in a "Municipal Development Fund" to finance costs as restricted by the Act;
- b. 0.2% will be deposited in a "Municipal Redemption Fund" to finance loans to municipalities subject to restrictions imposed by the Act; and
- c. 0.1% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects. These funds will be distributed based on legislation from the Commonwealth's Legislature.

Sales tax receivable represents filed sales tax returns that were collected subsequent to June 30, 2010, but pertaining to the current year period.

14. CONSTRUCTION EXCISE TAXES

Municipality imposes and collects municipal construction excise taxes to most natural and legal persons and any governmental instrumentality that carry out activities related to construction, expansion, major repairs, relocations, alterations and other types of permanent improvements to residential, commercial and industrial buildings, and any structures within the territorial area of the Municipality. The tax is also applicable to infrastructure projects, the installation of machinery, equipment, cable TV, commercial antennas and fixtures, and other types of construction-related activities.

The construction excise tax generally is a self-assessed tax imposed over the cost of the project, net of certain exemptions such as the costs associated with the acquisition of land, existing buildings and improvements, project design and other engineering fees, licenses and permits, consulting and legal fees. The tax is paid by the taxpayer before the beginning of the construction project. The activities covers by this tax and the exemption granted are as follows:

- a. Total exemption are granted to projects self-administering by federal government, state government (including public corporation), and the municipalities of Puerto Rico.
- b. Low income resident of Vieques that received federal, state or municipal funds for construction or improvement of their home, a total exemption is granted.

14. CONSTRUCTION EXCISE TAXES (continuation)

- c. Civic, religions and communities non-for-profit organization should have an exemption for the first \$15,000 of the total cost of the projects. In excess of \$15,000, a 3.50% of construction excise taxes should be paid.
- d. Resident of Vieques should paid construction excise taxes in accordance with the following scale:

TOTAL COST	CONSTRUCTION EXCISE TAX
From \$1,000 to \$10,000	2.00% of Total Cost
From \$10,001 to \$15,000	2.50% of Total Cost
From \$15,001 to \$20,000	2.75% of Total Cost
From \$20,001 to \$25,000	3.00% of Total Cost
From \$25,001 to \$30,000	4.00% of Total Cost
In excess of \$30,000	5.00% of Total Cost

- e. All other projects should paid 5.00% of total cost.

15. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consist primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the Quasi-public Corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

16. PENSION PLAN

Description of the Plan

Employees of the Municipality participate in the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). The ERS is cost-sharing multiple-employer defined benefit pension plan sponsored by the Government under the Act No. 447, approved on May 15, 1951, as amended. ERS covers all regular employees of the Government and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of the Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees. ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service or members who have attained at least 58 years of age and have completed at least 10 years of creditable service are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average salary, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average salary, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive up to a maximum of 65% of the average salary, as defined, or if they have attained 55 years of age will receive up to a maximum of 75% of the average salary, as defined. Disability retirement benefits are available to members for occupational disability up to a maximum benefit of 50% of the average salary, as defined. However, for non-occupational disability, a member must have at least 10 years of creditable services.

The contribution requirements for both employees and employers are established by law and are not actuarially determined. Employees are required to contribute 5.775% for the first \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of their monthly gross salary. The Municipality is required by Act No. 447 to contribute 9.275% of its employees' gross salaries.

16. PENSION PLAN (continuation)

Act No. 1 of 1990 made certain amendments applicable to new participants joining the ERS effective April 1, 1990. These changes consist principally of the establishment of contributions at 8.275% of their monthly gross salary, an increase in the retirement age to 65, a decrease in the annuity benefit to 1.5% of the average salary, as defined, for all years of creditable services, a decrease in the maximum disability, and death benefits annuities from 50% to 40% of average salary, as defined, and the elimination of the Merit Annuity for participants who have completed 30 years of creditable services.

Law Number 305 was enacted on September 24, 1999, amended the Act Number 447 for the purpose of establishing a new program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system (ERS) as of December 31, 1999, may elect either to stay in the defined-benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

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 the System, together with those of the current defined-benefit plan. Benefits at retirement age will not be guaranteed by the Government. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% up to a maximum of 10%) of their monthly salary, and will be invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employers' contributions (9.275% of the employees' salary) will be used to fund the current plan.

If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

Funding Policy

The authority under which the funding policy and the obligations to contribute to the ERS and System 2000 by the plans' members, employers and other contributing entities (state of municipal contributions), are established or may be amended by law.

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600
Hired on or after April 1, 1990	8.275% of gross salary over \$6,600
	8.275% of gross salary

Annual Contribution

Total employee contributions to the above-mentioned plans during the year ended June 30, 2010 amounted to \$318,936. The Municipality's contributions during those years are recognized as total pension expenditures/expenses in the category of administration as follow:

FISCAL YEAR	LAW NO. 447	SYSTEM 2000
2010	\$ 184,913	\$ 182,854

These amounts represented the 100% of the required contribution for the corresponding year. Additionally, changes made in the types and amounts of benefits offered by special laws and costs of living adjustments, led to a one-time recommended contribution to fund the retroactive adjustment related to the changes.

The Employee's Retirement System of the Government of Puerto Rico provides additional information of the ERS and System 2000. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Government. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.

17. CONTINGENCIES

A. CLAIMS AND JUDGMENTS

The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. The legal counsel of the Municipality has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available cannot determine the final outcome of these claims. Accordingly, the financial statements do not include adjustment, if any, that could result from the resolution of this legal proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claimed amounts.

B. FEDERAL GRANTS

In the normal course of operations, the Municipality receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

18. COMMITMENTS

A. Construction

The Municipality had commitments at June 30, 2010 of approximately \$9.9 million for the construction, improvements, or renovation of several municipal facilities.

B. Other Commitments

At June 30, 2010, the general fund had a deficit of \$6,928,806 which will be covered with future budgetary appropriations of the general fund.

19. NET ASSETS/FUND BALANCES RESTATEMENTS

A. Net Assets Restatements

During the year, the Municipality adjusted the governmental net assets for unrecognized revenues and expenses. The following schedule reconciles the June 30, 2009 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2009, for Governmental Activities.

	NET ASSETS
Net Assets, as Previously Reported, At June 30, 2009	\$ 116,266,922
Adjustment to Account Payables	2,085,989
Adjustment to Cash Accounts	555,209
Adjustment to Due From Government Unit	(411,143)
Adjustment to Bank Overdraft	2,673,400
Adjustment to Due to Government Unit	1,657,775
Adjustment to Interest Expenditures	(84,055)
Adjustment to Expenditures not Recognized	(34,729)
To Eliminate Deficit in the SBGP Fund	165,658
Adjustment to Revenues not Recognized	39,092
Adjustment to Debt that does not proceed	14,332
Adjustment to Principal of Debt from Law 42	(21,515)
Adjustment to Principal of Debt from Bond \$315,000	20,000
Adjustment to Principal of Debt from Bond \$3,240,000	50,000
Adjustment to recognize Christmas Bonus Revenue	83,366
Adjustment to recognize Christmas Bonus Liability	(166,732)
Adjustment to Accrued Interest	291,055
Adjustment to Debt not recognized	(61,980)
Adjustment to SBGP Fund not recognized	4,748,389
Adjustment to Deferred Charges not recognized	52,761
Beginning Net Assets, as Restated, At July 1, 2009	<u>\$ 127,923,794</u>

19. NET ASSETS/FUND BALANCES RESTATEMENTS (continuation)

B. Fund Balances Restatements

The following reconciles the June 30, 2009 Fund Balance, as previously reported to Beginning Fund Balance, as restated, July 1, 2009 for the various funds:

	GENERAL FUND	HUD PROGRAMS	SPECIAL COMMUNITY TRUST	DEBT SERVICE FUND	CAPITAL PROJECTS FUND	SBGP FUND	STATE ASSIGNMENT FUND	ARTS CENTER FUND	OTHER GOVERNMENTAL FUND	TOTAL GOVERNMENTAL FUNDS
Fund Balance (Deficit), as Previously Reported, At June 30, 2009	\$ (12,271,583)	\$ (147,655)	\$ (29,081)	\$ 628,650	\$ 9,927,117	\$ -	\$ -	\$ -	\$ 76,954	\$ (1,815,598)
To Reclassified Major Funds Balance	(25,498)	147,655	29,081	-	(9,927,117)	(165,658)	6,799,567	1,680,706	1,461,264	-
Adjustment to Account Payables	1,159,809	-	-	-	-	-	926,180	-	-	2,085,989
Adjustment to Cash Accounts	-	-	-	524,874	-	-	18,830	-	11,505	555,209
Adjustment to Due From Government Unit	(453,103)	-	-	41,960	-	-	-	-	-	(411,143)
Adjustment to Bank Overdraft	2,673,400	-	-	-	-	-	-	-	-	2,673,400
Adjustment to Due to Government Unit	1,657,775	-	-	(372,395)	-	-	-	-	-	1,657,775
Adjustment to Principal and Interest Expenditures	-	-	-	-	-	-	-	-	-	(372,395)
Adjustment to Due From(To) Other Funds	536,579	-	-	-	-	222,717	(1,685,476)	926,180	(34,729)	(34,729)
Adjustment to Expenditures not Recognized	-	-	-	-	-	-	-	-	-	-
To Eliminate Deficit in the SBGP Fund	-	-	-	-	-	165,658	-	-	-	165,658
Adjustment to Revenues not Recognized	39,092	-	-	-	-	-	-	-	-	39,092
Beginning Fund Balance (Deficit), As Restated, At July 1, 2009	\$ (6,683,529)	\$ -	\$ -	\$ 823,089	\$ -	\$ 222,717	\$ 6,059,101	\$ 2,506,886	\$ 1,514,994	\$ 4,543,258

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget
	Original	Final		
BUDGETARY FUND BALANCE (DEFICIT), JULY 1, 2009	\$ (7,158,930)	\$ (7,158,930)	\$ (7,158,930)	\$ -
Resources (Inflows):				
Property Taxes	959,540	959,540	959,539	(1)
Volume of Business Taxes	369,500	369,500	630,681	261,181
Intergovernmental Revenues	6,469,663	6,469,663	6,615,135	145,472
Licenses and Permits	1,108,001	1,108,001	1,101,638	(6,363)
Miscellaneous	2,390,727	2,390,727	230,516	(2,160,211)
Rent	32,000	32,000	32,309	309
Total Resources (Inflows)	11,329,431	11,329,431	9,569,818	(1,759,613)
Amounts Available for Appropriation	4,170,501	4,170,501	2,410,888	(1,759,613)
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature	1,023,956	1,130,957	911,931	219,026
General Government	4,349,766	5,208,225	4,923,984	284,241
Public Safety	1,089,183	806,475	662,169	144,306
Public Works	1,732,081	1,582,227	1,158,504	423,723
Culture and Recreation	691,293	637,086	575,927	61,159
Health and Sanitation	872,429	630,626	631,041	(415)
Human Services and Welfare	869,131	731,717	618,417	113,300
Urban Development	100,000	6,451	6,451	-
Capital Outlays	227,500	91,303	52,303	39,000
Transfer to Other Funds	374,092	504,364	504,364	-
Total Charges to Appropriations	11,329,431	11,329,431	10,045,091	1,284,340
BUDGETARY FUND BALANCE (DEFICIT), JUNE 30, 2010	\$ (7,158,930)	\$ (7,158,930)	\$ (7,634,203)	\$ (475,273)

See accompanying Notes to Required Supplementary Information.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

NOTE A Explanation of Differences Between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

	<u>General Fund</u>
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 43)	\$ 2,410,888
Difference – Budget to GAAP:	
The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes	7,158,930
Sales and Usage Taxes are revenues for financial reporting purposes but are not inflows for budgetary presentation purposes	<u>299,129</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 18)	<u>\$ 9,868,947</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 43)	\$ 10,045,091
Difference – Budget to GAAP:	
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes	(170,130)
Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes	239,263
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	<u>(504,364)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 18)	<u>\$ 9,609,860</u>

NOTE B Explanation of Differences Between Budgetary Fund Balance and GAAP Fund Balance

Budgetary Fund Balance (Deficit), June 30, 2010	\$ (7,634,203)
Timing Differences:	
Encumbrances	170,130
Cancelation of Prior Year Encumbrances	236,138
Revenues that are not Budgetary Resources	<u>299,129</u>
Fund Balance (Deficit), June 30, 2010	<u>\$ (6,928,806)</u>

See accompanying Notes to Required Supplementary Information.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Housing and Urban Development:			
Direct Program:			
Section 8 Housing Choice Voucher.....	14.871		\$ 319,537
Section 8 Moderated Rehabilitation Single Room Occupancy	14.249		336,521
Pass-Through State – Office of the Commissioner of Municipal Affairs:			
Community Development Block Grant/States Program (SBGP) and Non Entitlements Grants in Hawaii (Stated Administered Small Cities Program)	14.228	09-FC-65-001	578,447
Homeless Prevention and Rapid Rehousing Program.....	14.257	N/AV	<u>14,046</u>
Total U.S. Department of Housing and Urban Development.....			<u>1,248,551</u>
U. S. Department of Homeland Security:			
Pass-Through Office of the Public Security Affairs:			
Homeland Security Grant Program.....	97.067	2007-GE-T7-0043	<u>7,235</u>
Total U.S. Department of Homeland Security			<u>7,235</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS.....			<u>\$1,255,786</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activities of the **Municipality of Vieques, Puerto Rico (Municipality)**. The information in this Schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of **Municipality**, it is not intended to and does not present the financial position, or change in net assets of the **Municipality**.

Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. The **Municipality** reporting entity is defined in Note (1) (A) to the basic financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed-through other government agencies are included on the Schedule.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State and Local Government*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.
- B. Negative amounts, if any, shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.
- C. Pass-through entity identifying numbers are presented where available.

3. FEDERAL CFDA NUMBER

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

4. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Expenditures of federal awards are reported in the **Municipality's** Statement of Revenues, Expenditures and Changes in Fund Balances- Governmental Fund as follows: SBGP Funds – \$578,447 and Other Governmental Funds \$677,339.



TORRES, HERNANDEZ & PUNTER, CPA, CSP
Certified Public Accountants

**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

We have audited the financial statements of the Municipality of Vieques of the Commonwealth of Puerto Rico (from now on the Municipality) as of and for the fiscal year ended June 30, 2010, and have issued our report thereon dated August 17, 2011. 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 the Municipality's internal control over financial reporting as 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 was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Municipality's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs, as items #10-01 through #10-17, to be material weaknesses.

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs, as items #10-01 through #10-17, to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and

Compliance and Other Matters - Continued

accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the accompanying schedule of findings and questioned costs, as items #10-01 through #10-17.

Municipality's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs, on pages 51 to 74 and in their corrective action plan. We did not audit the Municipality's responses and, accordingly, we express no opinion on those responses.

This report is intended solely for the information and use of Municipality's management, the U.S. Department of Housing and Urban Development and other regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.


Torres, Hernández & Punter, CPA, PSC
Certified Public Accountants

August 17, 2011

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TORRES, HERNANDEZ & PUNTER, CPA, CSP
Certified Public Accountants

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT HAVE A DIRECT AND MATERIAL EFFECT ON 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

Compliance

We have audited the Municipality of Vieques of the Commonwealth of Puerto Rico (from now on the Municipality) compliance of with the types of compliance requirements described in OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of the Municipality's major federal programs for the year ended June 30, 2010. Municipality's major federal programs are identified in the summary of auditor's 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's management. Our responsibility is to express an opinion on Municipality's compliance based on our audit.

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

As described in the accompanying schedule of findings and questioned costs as items #10-10, #10-11, #10-12, #10-13, #10-14 #10-15, #10-16 and #10-17, the Municipality did not comply with requirements regarding Cash Management, Davis-Bacon Act, Equipment and Real Property Management and Reporting that are applicable to the Community Development Block Grant/States Program (SBGP), and the Municipality did not comply with requirements regarding Cash Management, Eligibility and Equipment and Real Property Management that are applicable to Section 8 Housing Choice Voucher Program and Section 8 Moderated Rehabilitation Single Room Occupancy Programs. Compliance with such requirements are necessary, in our opinion, for the Municipality to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items #10-09, and #10-17.

Internal Control Over Compliance

Management of Municipality 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 the Municipality's 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 in accordance with OMB Circular A-133, 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.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items #10-10 through #10-17 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items #10-09 through #10-17 to be significant deficiencies.

Municipality's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs, on pages 51 to 74 and in their corrective action plan. We did not audit the Municipality's responses and, accordingly, we express no opinion on those responses.

This report is intended solely for the information and use of Municipality's management, the U.S. Department of Housing and Urban Development and other regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.


Torres, Hernández & Punter, CPA, PSC
Certified Public Accountants

August 17, 2011

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2010

Part I - Summary of Audit Results:

Financial Statements

The independent auditor's report on the basic financial statements expressed a qualified opinion.

Internal Control Over Financial Reporting:

Material weaknesses identified?	<u> X </u> yes	_____ no
Significant deficiencies identified?	<u> X </u> yes	_____ none reported
Noncompliance material to the Statement noted?	<u> X </u> yes	_____ no

Federal Awards

Internal control over major programs:

Material weaknesses identified?	<u> X </u> yes	_____ no
Significant deficiencies identified?	<u> X </u> yes	_____ none reported

The independent auditor's report on compliance with requirements applicable to major federal awards program expressed a qualified opinion.

The audit disclosed findings to be reported in accordance with OMB Circular A-133, Section 510(a).

<u> X </u> yes	_____ no
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Municipality's major awards during the year ended June 30, 2010 were:

- CFDA #14.228 - Community Development Block Grant/States Program (SBGP),
- CFDA #14.871 - Section 8 Housing Choice Voucher Program
- CFDA #14.249 - Section 8 Moderated Rehabilitation Single Room Occupancy Program

A threshold of \$300,000 was used to distinguish between type A and type B programs, as those terms are defined in OMB Circular A-133, Section 520 (a).

Municipality qualify as a low risk auditee?	_____ yes	<u> X </u> no
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-01: REQUIRED CLAUSES NOT INCLUDED ON CONTRACTS

CONDITION: We selected twelve (12) contracts for examination. We noted the following required clauses were not included, stating the following:

1. That the contracted party, prior to contract date:
 - ✓ Has submitted tax returns for the last five (5) years and that no amounts are due to the Commonwealth of Puerto Rico (CPR) for taxes or is under a payment plan,
 - ✓ Has no debt outstanding with the Municipal Revenue Collection Center (CRIM) for real property taxes and other debt concepts or is under a payment plan, and
 - ✓ Has no debt outstanding with the Department of Labor and Human Resources (DLHR) for unemployment, disability and driver's social security.

(4 Contracts),

2. That the contracted party will not enter in contractual relationships or acts that represents a conflict of interest with the Municipality (1 Contract),
3. That the contracted party has no knowledge of any Municipality's official or public employee having direct or indirect interest in the contract, (1 Contract),
4. That the contracted party is not required to satisfy an alimony requirement, and if it is required, contracted party is complying with alimony payments (1 Contract),
5. That the Municipality may cancel the contract immediately in case of negligence, abandonment of duty or noncompliance from contracted party (2 Contracts),
6. That the contracted party does not receive compensation for services rendered under regular appointment from another public entity, except as authorized by law (2 Contracts),
7. That the required 7% retention for professional services (or the one applicable) will be made, unless a waiver from the Treasury Department of the Commonwealth of Puerto Rico (TD) is presented (1 Contract),
8. A warning that services cannot be requested unless contract has been presented for registration at the Comptroller's Office of Puerto Rico (OCPR) (2 Contracts),

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-01: REQUIRED CLAUSES NOT INCLUDED ON CONTRACTS (CONTINUED)

9. That the contracted party has not been convicted of crimes against public integrity, as defined in the penal code, or from mishandling of public funds and that has not been declared guilty of those crimes by a court of the CPR, a federal court or any other court under the United States jurisdiction (2 Contracts), and
10. For construction and public improvements contracts, that the contracted party certifies that is in compliance with the permits required to work as a contractor (3 Contracts).

CRITERIA: Sound government management requires disclosure of such information when a contract is prepared in order to safeguard municipal interest. Also, to comply with the following applicable laws and regulations related to contracts as detailed for each instance above as follows:

Instance 1 -

Article 5, A, Law No. 237 of August 31, 2004, to establish guides for agencies and governmental entities during the process of preparing contracts for professional and consulting services,
Article 14, Law No. 164 of July 23, 1974, as amended,
Article 9(j) Law No. 230 of July 23, 1974, "Puerto Rico Accounting Law", as amended,
Article 6(c) of OCPR Ruling No. 33, as amended, related to contracts and documents and submission of copies to OCPR,
Administrative Bulletin No. OE-1991-24, as amended by Administrative Bulletin OE-1992-52,
Circular Letter No. 1300-1-06 of TD, dated July 20, 2005,
Memorandum No. 92-31 from the Office of the Commissioner of Municipal Affairs (OCAM),
Circular Letter No. OC-06-15 of OCPR, and
Chapter 9, Section 2, of OCAM Ruling for Municipal Administration.

Instance 2 -

Article 5, G, Law No. 237 of August 31, 2004,
Article 5, sections (g) and (m), Law No. 84 of June 18, 2002,
Article 3.3 Law No. 12 of July 24, 1985, as amended,
Administrative Bulletin No. OE-1994-11,
Memorandums No. 07-93 and No. 93-04 from the Office of the Governor of Puerto Rico, and
Circular Letters No. 95-05 and 94-01 of the Governmental Ethics Office.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-01: REQUIRED CLAUSES NOT INCLUDED ON CONTRACTS (CONTINUED)

Instance 3 -

Article 5, sections C and F Law No. 237 of August 31, 2004,
Article 5, sections (e), (k) and (n), Law No. 84 of June 18, 2002,
Article 3.3 Law No. 12 of July 24, 1985, as amended, and
Circular Letters No. 2002-05 and 95-05 of the Governmental Ethics Office.

Instance 4 -

Article 5, K, Law No. 237 of August 31, 2004, and
Section VII, Article 30, Law No. 5 of December 30, 1986, as amended.

Instance 5 -

Article 5, M, Law No. 237 of August 31, 2004, and
Memorandum No. 07-93 from the Office of the Governor of Puerto Rico.

Instance 6 -

Article 5, sections E, N and O, Law No. 237 of August 31, 2004,
Article 3.3(e) Law No. 12 of July 24, 1985, as amended,
Ruling for Requesting and Managing Waivers before State Department of CPR, following Article 3.3, Sections (d) and
(e) of the Governmental Ethics Office,
Administrative Bulletin No. OE-1998-06, as amended by Administrative Bulletin No. OE-1998-14 ,
Memorandum No. 07-93 from the Office of the Governor of Puerto Rico,
Memorandum No. 2004-05 from OCAM, and
Articles 3.2, 3.3 and 3.7 Law No. 12 of July 24, 1985, as amended.

Instance 7 -

Article 5, I, Law No. 237 of August 31, 2004,
Memorandum No. 07-93 from the Office of the Governor of Puerto Rico, and
Circular Letters No. 1300-19-05 and No. 1300-03-95 from TD.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-01: REQUIRED CLAUSES NOT INCLUDED ON CONTRACTS (CONTINUED)

Instance 8 -

Article 1(e) Law No. 18 of October 20, 1975 as amended by Law No. 127 of May 31, 2004, and Memorandum No. 2004-11 from OCAM.

Instance 9 -

Article 5, Ñ, Law No. 237 of August 31, 2004,
Article 5(p) Law No. 84 of June 18, 2002,
Law No. 458 of December 29, 2000, as amended, and
Memorandum No. 99-11 from OCAM.

Instance 10 -

Chapter 9, Section 6, OCAM Ruling for Municipal Administration.

CAUSE: Internal control procedures to assure that contracts include all clauses required by laws and regulations were not effective enough during this fiscal year. Contracts were not properly verified by the officials preparing them to assure this information was contained in contracts before signature.

EFFECT: The Municipality is not properly safeguarded.

RECOMMENDATION: To strengthen present control procedures to assure all contracts prepared contains all the necessary clauses and information, as required by present laws and regulations, and by state and federal agencies. One employee should be designated to verify contracts before signature to ensure they are complete in terms of required clauses before signature. We also recommend that an employee be designated as preintervention officer to verify all contracts prepared.

MANAGEMENT RESPONSE: See corrective action plan.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-02: DOCUMENTS NOT AVAILABLE ON MUNICIPAL EMPLOYEE FILES

CONDITION: One (1) of twenty five (25) employee files examined did not include the following documents:

1. Form I-9 "Employment Eligibility Verification" from the Department of Homeland Security, U.S. Citizenship and Immigration Services,
2. TD 499 R-4.1 "Withholding Exemption Certificate" form signed by employee, and
3. Good Conduct Certificate.

CRITERIA: To comply with municipal internal controls related to required documents to be included on employee files and with applicable laws and regulations.

For Form I-9 employers must complete it for all newly hired employees to verify their identity and authorization to work in the United States, including a list of approved documents that employees can present to verify their identity and employment authorization.

For form 499 R-4.1 "Withholding Exemption Certificate" the employee must complete this form and submit it to the employer. Otherwise, the employer is required to withhold income taxes without taking into consideration the employees personal exemption, exemption for dependents and allowance based on deductions, pursuant to the Internal Revenue Code of Puerto Rico (Code).

CAUSE: The Municipality does not have in operation an appropriate internal control procedure to assure that all these forms are properly completed and included in employee files, and updated periodically.

EFFECT: For form 499 R-4.1 "Withholding Exemption Certificate TD could impose penalties for each employee for which withholdings are being made and for whom the form was not prepared and included in their file. For Form I-9 the U.S. Citizenship and Immigration Services could perform random inspections and fine from \$100 to \$1,100 per missing I-9 forms and, if the problem is persistent, the fine could increase up to \$11,000 per employee.

RECOMMENDATION: The implementation of an internal control procedure requiring a checklist to be reviewed each time an employee is hired, and when an employee file is updated, to assure all required documents are available. Also, to schedule reviews of employee files for updating purposes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-02: DOCUMENTS NOT AVAILABLE ON MUNICIPAL EMPLOYEE FILES (CONTINUED)

MANAGEMENT RESPONSE: See corrective action plan.

FINDING NUMBER 10-03: MUNICIPALITY DOES NOT RECONCILIATE SALARIES REPORTED ON QUARTERLY TAX RETURNS (941 PR SOCIAL SECURITY) WITH ACCOUNTING RECORDS

CONDITION: Salaries reported on Social Security Tax Return (Form 941 PR) do not reflect balances recorded on general ledger, and such differences are not reconciled in another document. There is no internal control procedure implemented to assure that all salaries paid to employees are included on payroll tax returns prepared, and the amount recorded on general ledger for salaries paid is the same as the amount included on payroll tax returns prepared.

CRITERIA: As an appropriate internal control procedure each document prepared should be conciliated with its supporting records. The accounting record is the source document for the preparation of the social security tax return.

CAUSE: There is no integration between Payroll and Finance Department to assure data is consistent on 941 PR Tax returns and accounting records. The Municipality should establish procedures in order to conciliate each time a 941 PR return is prepared, to assure all salaries are properly included and traced to accounting records.

EFFECT: If salaries are not conciliated with tax return, there could be an overpayment of payroll taxes. This could result in overpayment to the IRS or payment of interests and penalties for underpayment of taxes. Also, this represents a noncompliance with section 6651 of the Internal Revenue Code of the United States, which imposes, among other things, penalties to be added to the amount required to be shown as tax on the returns of 5% of the amount of such tax if the failure is for not more than one month, with an additional 5% for each additional month or fraction thereof during which such failure continues, not exceeding 25% in the aggregate.

RECOMMENDATION: We recommend to finance department to conciliate the tax return form 941-PR with the general ledger on a quarterly basis, and to adjust any differences.

MANAGEMENT RESPONSE: See corrective action plan.

FINDING NUMBER 10-04: ASSISTANCE SHEET NOT SIGNED BY THE SUPERVISOR OR EMPLOYEE

CONDITION: Of twenty five (25) assistance sheets examined, six (6) were not signed by the municipal supervisor and three (3) were not signed by the municipal employee.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-04: ASSISTANCE SHEET NOT SIGNED BY THE SUPERVISOR OR EMPLOYEE (CONTINUED)

CRITERIA: A sound internal control policy requires that assistance sheets should be reviewed and signed by the municipal employee and supervisor to eliminate the possibility of payment for hours not worked. Also, to comply with general requirements of:

1. OCAM Ruling for Municipal Administration,
2. Law No. 81 "Autonomous Municipalities of the CPR", and
3. Law No. 230 of July 23, 1974 "Puerto Rico Accounting Law", as amended.

CAUSE: The Municipality does not have in operation an appropriate internal control procedure to assure that all assistance sheets are reviewed and approved before preparing the payroll.

EFFECT: That could result in salaries paid for which the employee does not work or for hours not approved by the supervisor.

RECOMMENDATION: One employee should be designated to verify each assistance sheet to be approved by the supervisor and signed by the employee before preparing the payroll.

MANAGEMENT RESPONSE: See corrective action plan.

FINDING NUMBER 10-05: SUPPORTING DOCUMENTS OF DISBURSEMENT TRANSACTIONS NOT IDENTIFIED AS PREINTERVENTED

CONDITION: Two (2) disbursement orders out of a sample of twenty-five (25) examined were not stamped as preintervented, and there is no signature of the preintervention officer nor any documentation of the preintervention process to this documents.

CRITERIA: To comply with chapter 4, sections 7 and 8 of the OCAM Ruling for Municipal Administration. Sound management requires that disbursements be verified, first when purchase order is prepared, and later before disbursement is made, to assure it complies with applicable state and federal laws and regulations. As an appropriate internal control procedure, an independent review of all supporting documents prepared should be made to assure that they are correct, complete and in compliance with all laws requirements prior to disbursement. This review should be documented by a stamp identifying the documents as preintervented.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-05: SUPPORTING DOCUMENTS OF DISBURSEMENT TRANSACTIONS NOT IDENTIFIED AS PREINTERVENTED (CONTINUED)

CAUSE: The internal control procedure to assure that all supporting documents of a transaction are properly preinterveneted before disbursement is made was not effective enough during fiscal year 2009-2010.

EFFECT: Purchases and disbursements could be made not in compliance with applicable laws and regulations, and not be detected in a timely manner. This could lead to findings and questioned costs by state agencies, which could be avoided if the preintervention process is properly performed. Also, disbursements can be made for goods and services not received or improperly invoiced, and no documentation is available on supporting documents certifying that they were verified.

RECOMMENDATION: The Municipality should strengthen verification and monitoring procedures related to purchases and disbursements, to assure they are properly verified and preinterveneted, including it's supporting documents.

MANAGEMENT RESPONSE: See corrective action plan.

FINDING NUMBER 10-06: PURCHASE ORDER PREPARED AND DATED AFTER INVOICE DATE

CONDITION: Three (3) purchase orders out of a sample of twenty-five (25) examined were prepared after invoice was received.

CRITERIA: To comply with chapter 4, sections 7 and 8 of the OCAM Ruling for Municipal Administration, which states that a purchase order should be dated before invoice date. Also, as an appropriate internal control procedure, all disbursements should be properly supported and reviewed before a disbursement is authorized.

CAUSE: The internal control procedure to assure that all supporting documents of a transaction are properly documented before disbursement is authorized and finally made was not effective enough during fiscal year 2009-2010.

EFFECT: Purchases can be made for goods and services not received or improperly invoiced, and no documentation is available on supporting documents certifying that they were verified.

RECOMMENDATION: To strengthen internal control procedures to assure that all purchase orders are prepared and dated before the actual invoice is send by the supplier, and that after invoice is received and all required supporting documents of disbursement transactions are available and verified for compliance, disbursement is authorized.

MANAGEMENT RESPONSE: See corrective action plan.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER 10-07: BIDS FILES INCOMPLETE

CONDITION: For three (3) bids examined, their related files were incomplete in terms of the following:

Conditions	Instances
1. Bidder did not provide evidence of insurance policies, specifically public responsibility and State Insurance Fund,	2
2. Bidder did not provide evidence of: <ul style="list-style-type: none"> ✓ Good standing certificate issued by the State Department, ✓ Certifications from TD stating that no tax debt is outstanding, or is under a payment plan, ✓ Certifications from CRIM stating that no debt is outstanding for real property taxes and other debt concepts or is under a payment plan, and ✓ Certifications from DLHR for unemployment, disability and driver's social security. 	2

CRITERIA: To comply with chapter 8, part 1, section 4 of the OCAM Ruling for Municipal Administration.

CAUSE: The Municipality has not implemented a strict policy of verifying all bid files prepared for every bid celebrated, to assure that all documentation required under internal control policies and applicable laws and regulations is available, before filing them. Although files are prepared for each bid celebrated, the procurement office does not perform a detailed verification of the documentation prepared and obtained from the bid, following a checklist or other verification method.

EFFECT: Bids are not properly documented, and municipal interests are not adequately protected. Also, without documentation that the bidder awarded or contractor obtained was properly insured, we were unable to verify that the municipality was adequately covered.

RECOMMENDATION: To implement review procedures to assure that all the bid files includes all documents required by applicable laws and regulations. An employee independent of the Finance Department and the Bid Board should be designated to oversee this procedure.

MANAGEMENT RESPONSE: See corrective action plan.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part II - Findings Related to the Financial Statements:

FINDING NUMBER: 10-08: LANDFILL CLOSURE AND POST-CLOSURE CARE COSTS NOT ACCUMULATED

CONDITION: The Municipality has not recorded an expense provision and related liability based on the future closure and post-closure care costs that will be incurred near or after the date the landfill no longer accepts waste. This expense provision and related liability must be determined based on a study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations, and on the amount of the landfill used during the year.

CRITERIA: To comply with the provisions of Section L10 of the Governmental Accounting Standards Board (GASB) Codification related to Landfill Closure and Post-Closure Care Costs.

CAUSE: The Municipality has not scheduled or considered contracting the study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations.

EFFECT: The Statement of Net Assets is understated because the required debt related to closure and post-closure care costs has not being recognized in the financial statements.

RECOMMENDATION: To consider the feasibility of including on next budget an amount for contracting the study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations.

MANAGEMENT RESPONSE: See corrective action plan.

Part III - Findings and Questioned Costs Related to Federal Awards:

Presentation follows compliance requirements included in the Compliance Supplement of the Office of Management and Budget (OMB) Circular A-133 "Audits of States, Local Governments, and Non-profit Organizations".

A - Activities Allowed or Unallowed

FINDING NUMBER 10-09: SUPPORTING DOCUMENTS OF DISBURSEMENT TRANSACTIONS WERE NOT STAMPED AS CANCELLED PAID

FEDERAL PROGRAMS: CFDA #14.228 - Community Development Block Grant/States Program (SBGP), CFDA #14.871 - Section 8 Housing Choice Voucher Program, CFDA #14.249 - Section 8 Moderated Rehabilitation Single Room Occupancy Program

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

A - Activities Allowed or Unallowed

FINDING NUMBER 10-09: SUPPORTING DOCUMENTS OF DISBURSEMENT TRANSACTIONS WERE NOT STAMPED AS CANCELLED PAID (CONTINUED)

CONDITION: For all nineteen (19) disbursements selected for testing of federal awards none were identified as cancelled paid.

CRITERIA: Sound Government management requires that supporting documents of disbursement transactions be identified as paid, to avoid duplication of payment in the future. Also, OMB Circular A-87 states general requirements for the allowability of costs charged to a federal award. As stated in that circular, disbursements should be identified as "cancelled paid", to eliminate the possibility of duplicating disbursements.

CRITERIA:

Also, to comply with general requirements of:

1. OCAM Ruling for Municipal Administration,
2. Law No. 81 "Autonomous Municipalities of the CPR", and
3. Law No. 230 of July 23, 1974 "Puerto Rico Accounting Law", as amended.

CONTEXT: We select nineteen (19) disbursements made during fiscal year 2009-2010 and verified their related supporting documents available. Condition represents one hundred (100)% of the sample selected.

CAUSE: The internal control procedures of the Federal Awards Department of the Municipality to assure that all disbursements prepared through federal awards were identified as cancelled paid was not effective enough during this fiscal year.

EFFECT: If invoices and other supporting documents of the disbursements are not stamped as cancelled paid, payment of invoices already paid could be made.

RECOMMENDATION: The Federal Awards Department of the Municipality should strengthen control procedures to ascertain that all disbursement vouchers and its supporting documents are properly identified as "cancelled paid", to avoid the possibility of paying twice.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

B - Allowable Costs/Costs Principles

None.

C - Cash Management

FINDING NUMBER: 10-10 : FEDERAL ASSISTANCE NOT USED TO COVER IMMEDIATE EXPENDITURES

FEDERAL PROGRAMS: CFDA #14.228 - Community Development Block Grant/States Program (SBGP), CFDA #14.871 - Section 8 Housing Choice Voucher Program, CFDA #14.249 - Section 8 Moderated Rehabilitation Single Room Occupancy Program

CONDITION: Municipality requested federal financial assistance and was not used to cover immediate expenditures incurred. On average, the Municipality required approximately from twenty (20) to twenty-seven (27) labors days to disburse the amounts requested.

Federal Awards Receipt Date	Date Awards were used	Lapse of Time Between Receipt and Use of Awards	Deposit Amount
Program: SBGP			
8/13/2009	9/9/2009	27	\$351,848
12/23/2009	1/19/2010	27	5,320
6/22/2010	6/29/2010	7	6,874
Program: Section 8			
8/3/2009	8/11/2009	8	23,768
11/2/2009	12/16/2009	44	23,767
2/1/2010	3/3/2010	30	25,343
6/1/2010	6/30/2010	29	28,724

CRITERIA: As stated on U.S. Treasury Department Circular 1075, Code of Federal Regulations, 45 CFR, Part 74, Subpart C, Section 74.21(b)(5) "Standards for financial management systems" and CFR 74.22(a) "Payments", written procedures must be implemented to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury Department and the issuance or redemption of checks, warrants or payments by other means for program purposes by the recipient.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

C - Cash Management

FINDING NUMBER: 10-10 : FEDERAL ASSISTANCE NOT USED TO COVER IMMEDIATE EXPENDITURES
(CONTINUED)

CONTEXT: We selected eight (8) deposits of federal assistance received by the Municipality during the fiscal year. Then we verified the checks disbursed beginning the same date of the amount deposited. We verified the time frame used by the Municipality to disburse all the amount deposited and determine if the Municipality is in compliance with the cash management requirement. Also, we verified federal awards bank accounts in order to determine if the amount is reasonable or if excessive balances are maintained for extended periods of time.

CAUSE: Municipality submits a request of federal funds to federal agency and takes more than 3 (three) days to expend the funds. Therefore, the Municipality's internal control procedures to comply with this requirement were not effective enough during fiscal year 2009-10.

EFFECT: The federal programs department is requesting funds in excess of the immediate expenditures incurred or their immediate program needs, not complying with CFR 45 CFR, Part 74, Subpart C, Section 74.21 and 74.22, mentioned above.

RECOMMENDATION: To strengthen the system for requesting federal funds to be adequate enough to satisfy immediate expenditures incurred by each federal programs, and to avoid maintaining excessive cash balances in bank accounts. Also to assure that each disbursement is identified to specific needs detailed on funds request.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

D - Davis - Bacon Act

FINDING NUMBER 10-11: CONTRACTOR'S PAYROLLS NOT AVAILABLE FOR VERIFICATION

FEDERAL PROGRAM: CFDA #14.228 - Community Development Block Grant/States Program (SBGP)

CONDITION: For two (2) construction contracts selected in excess of \$2,000, the Federal Awards Department of the Municipality did not required the contractors to deliver payroll sheets, to ascertain that laborers and mechanics were paid the prevailing wages rates established by the Department of Labor. Therefore, construction project payroll reviews are not being performed as required by the Davis-Bacon Act, to assure labor classifications are correct and prevailing wages were paid.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

D - Davis - Bacon Act

FINDING NUMBER 10-11: CONTRACTOR'S PAYROLLS NOT AVAILABLE FOR VERIFICATION (CONTINUED)

CRITERIA: The United States Code (USC) Title 40, Sections 276 a to 276 a-7, states that "for every contract in excess of \$ 2,000, for construction, alteration, and/or repair, including painting and decorating, of public buildings, and which requires or involves the employment of mechanics and/or laborers, the contractor shall pay all mechanics and laborers employed directly upon the site of the work, the full amounts accrued at time of payment, computed at wage rates not less than those stated in the advertised specifications, regardless of any contractual relationship which may be alleged to exist between the contractor or subcontractor and such laborers and mechanics". Therefore, the municipality is responsible to ensure that contractors and subcontractors comply with these requirements.

CONTEXT: We requested two (2) contractor's payroll in order to verify the wage rates paid by the contractor and if laborers and mechanics were paid full amounts accrued at time of payment, computed at wage rates not less than those stated in the advertised specifications. For both contracts (and in overall, for none of the construction contracts in excess of \$2,000 made through SBGP funds) the Federal Awards Department of the Municipality is not performing the procedure. Therefore, this condition applies to 100% of the construction contracts in excess of \$2,000 made through SBGP funds.

CAUSE: The Federal Awards Department of the Municipality has not implemented the procedures required by Davis-Bacon Act and there is no employee designated to oversee this compliance.

EFFECT: The municipality is not in compliance with The United States Code (USC) Title 40, Sections 276 a to 276 a-7, and in the event that any laborer or mechanic employed by the contractor or subcontractor directly on the site of the work covered by the contract has been paid or is being paid a rate of wages less than the rate of wages required by the contract to be paid as aforesaid, the government may, by written notice to the contractor or subcontractor, terminate his right to proceed with the work or such part of the work as to which there has been a failure to pay said required wages and to prosecute the work to completion by contract or otherwise.

RECOMMENDATION: Municipality should implement a control procedures to ascertain that contractors paid with federal funds submit payrolls for all employees of contractors and/or subcontractors working at project sites, to ensure prevailing wages are paid throughout the contract. Also to instruct Federal Awards Department personnel to monitor payment of prevailing wage rates in those contracts. This includes requiring contractors and/or subcontractors to submit payroll reports and rates paid to employees by their job classifications, to permit verification of compliance.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

E - Eligibility

FINDING NUMBER 10-12: TENANTS'S FILES INCOMPLETE

FEDERAL PROGRAMS: CFDA #14.871 - Section 8 Housing Choice Voucher Program, CFDA #14.249 - Section 8 Moderated Rehabilitation Single Room Occupancy Program

CONDITION: For twelve (12) tenants files examined, the following documents necessary for eligibility evaluation were not available:

1. Privacy authorization form signed by all household members eighteen (18) years old and over - 2 instances, representing 17% of sample,
2. Photo Identification for all family members eighteen (18) years old and over - 1 instance, representing 8% of sample,
3. Birth Certificates for all family members - 2 instances, representing 17% of sample,
4. Social Security card for all family members six (6) years old and over - 3 instances, representing 25% of sample,
5. Memorandum of Family Obligations signed by all family members eighteen (18) years old and over - 1 instance, representing 8% of sample,
6. Completed Form HUD-50058 "Family Report" and Worksheet in file - 1 instance, representing 8% of sample,
7. Criminal Background Checks for all family members eighteen (18) years old and over - 2 instances, representing 17% of sample, and
8. HAP Rent notification, sent thirty (30) days before effective date, not included - 3 instances, representing 25% of sample.

CRITERIA: Title 24 Housing and Urban Development, Volume 1, Code of Federal Regulations, Sections 5.230 and 5.617 requires tenants and other family members, as a condition of admission or continued occupancy, to provide the necessary information, documentation, and releases for the Public Housing Administration to verify income eligibility. This is necessary to document proper verification and determination of eligibility of tenants. Regarding tenant's applications, the Public and Indian Housing Compliance Supplement for Annual Audits of Public Housing Agencies and Indian Housing Authorities (Sections B183 to B184 Chapter 6-Occupancy), requires the housing administrator to keep tenant's applications in files.

In addition, data collected on Form HUD-50058 provides the Municipality and the Department of Housing and Urban Development (HUD) with a picture of the people who participate in subsidized housing programs.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

E - Eligibility

FINDING NUMBER 10-12: TENANTS'S FILES INCOMPLETE (CONTINUED)

CONTEXT: We selected twelve (12) tenant's files for section 8 programs and verify the documents available on files. Percentage relation of conditions to findings are included above in the condition section.

CAUSE: The Federal Awards Department of the Municipality has available a checklist with all the necessary forms required to document eligibility verification on tenant's files, nevertheless, due care is not exercised to assure that this checklist is properly completed and that all documentation is available and provided by tenants.

EFFECT: Public Housing Administration may be qualifying tenants that do not provide the necessary documentation for occupancy, and there is no complete documentation of the Public Housing Administration verification of eligibility, since documents are not available on files.

RECOMMENDATION: The Municipality should strengthen eligibility verification procedures to assure they include all the necessary documents required to document eligibility verification to tenants.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

FINDING NUMBER 10-13: SECTION 8 PROGRAMS USING DIFFERENT INCOMPLETE WAITING LISTS

FEDERAL PROGRAMS: CFDA #14.871 - Section 8 Housing Choice Voucher Program and CFDA #14.249 - Section 8 Moderated Rehabilitation Single Room Occupancy Program

CONDITION: The Federal Awards Department of the Municipality maintain different waiting lists for each fiscal years and the waiting list provided to us for examination does not provide the following information:

1. Applicant income level,
2. Move-in date if applicant was accepted, and
3. The need for accessible units.

CRITERIA: As required by HUD Occupancy Handbook Chapter 4 Waiting List and Tenant Selection, states that In order to assure that all applicants are treated fairly, the Federal Awards Department of the Municipality must maintain an up-to-date and complete waiting list.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

E - Eligibility

FINDING NUMBER 10-13: SECTION 8 PROGRAMS USING DIFFERENT INCOMPLETE WAITING LISTS
(CONTINUED)

CONTEXT: We selected twelve (12) tenants files and requested the waiting list in order to verify if move-in tenants were selected from such waiting list and how.

CAUSE: Section 8 Director maintains various incomplete waiting lists which are not updated.

EFFECT: Maintaining various incomplete waiting lists will increase the possibility of administrative resources expended on processing information regarding applicants who are ineligible or no longer have an interest in reside the property.

RECOMMENDATION: To update and maintain one waiting list and include all basic information required in the HUD Occupancy Handbook.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

F - Equipment and Real Property Management

FINDING NUMBER 10-14: PROPERTY RECORDS OF ALL FEDERAL AWARDS (Finding Also Applies to the Financial Statements)

FEDERAL PROGRAMS: CFDA #14.228 - Community Development Block Grant/States Program (SBGP), CFDA #14.871 - Section 8 Housing Choice Voucher Program, CFDA #14.249 - Section 8 Moderated Rehabilitation Single Room Occupancy Program

CONDITION: According to Code of Federal Regulations (CFR), Title 24, Housing and Urban Development, Part 85, Subpart C, Section 85.32, (d)(1); (2):

1. Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, and cost of the property, percentage of federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property, and

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

F - Equipment and Real Property Management

FINDING NUMBER 10-14: PROPERTY RECORDS OF ALL FEDERAL AWARDS (Finding Also Applies to the Financial Statements) (CONTINUED)

2. A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.

As indicated on auditors' reports of prior fiscal years, the Municipality do not have available complete property records, based on a physical inventory counts. At present, records are maintained by the property office, by dependency, with a description of the property items, amount of items, property number assigned, cost, the property items acquired during the year, items retired from property records, and final balance. The records do not provide information as to acquisition dates, disbursement order number, property transfer, and if property was acquired with state or federal funds. Also, property records lack information on Municipal building and facilities, land lots acquired, and the amount of construction in progress for the buildings and facilities in construction stages is not accurately maintained as of June 30, 2010. Therefore, there is no reasonable assurance that property records includes all property physically in existence and owned by the Municipality, and excludes all property not in existence or damaged, as of June 30, 2010.

CRITERIA: As an appropriate internal control procedure, and to comply with CFR 24, Title 85, Subpart C, Section 85.32, which states that a complete set of records should be maintained in order to assure all balances are correct and properly recorded.

CAUSE OF CONDITION: There is no uniform control procedure requiring a standard and complete set of property records, as required by Common Rule.

EFFECT: Accurate and complete financial information of property is not available.

RECOMMENDATION: The Municipality should perform a physical inventory and reconcile it with the present accounting records, adjust any differences found and identify if property items are acquired with state or federal awards. Also, to implement a procedure that includes the recording of every property items purchased or constructed in the subsidiary records before use it.

QUESTIONED COSTS: None

MANAGEMENT RESPONSE: See corrective action plan.

G - Matching, Level of Effort and Earmarking

No Conditions Detected.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

H - Period of Availability of Federal Funds

No Conditions Detected.

I - Procurement and Suspension and Debarment

No Conditions Detected.

J - Program Income

No Conditions Detected.

K - Real Property Acquisition and Relocation Assistance

No Conditions Detected.

L - Reporting

FINDING NUMBER 10-15: LATE SUBMISSION OF SINGLE AUDIT REPORT PACKAGE

FEDERAL PROGRAMS: CFDA #14.228 - Community Development Block Grant/States Program (SBGP), CFDA #14.871 - Section 8 Housing Choice Voucher Program, CFDA #14.249 - Section 8 Moderated Rehabilitation Single Room Occupancy Program

CONDITION: The Municipality did not submitted the single audit reports and reporting package for the year ended June 30, 2010, to the Federal Clearinghouse during the required period. This condition has been noted and reported in audits of previous years.

CRITERIA: OMB Circular A-133, Subpart C "Auditees", Section 320 (a), (c) " Report Submission", states that the audit shall be completed and the Data Collection Form and reporting package shall be submitted to the Federal Clearinghouse designated by OMB within the earlier of 30 days after receipt of the auditor's reports, or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

CONTEXT: We verified the reporting date of last year financial statements and reporting package, and reporting date of current year financial statements to determine compliance with OMB Circular A-133 report submission requirements. Also, we verified last year reporting package date and was not in compliance with the requirement of submission within 30 days after receipt of the auditor's report or nine months after the end of the audit period.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

L - Reporting

FINDING NUMBER 10-15: LATE SUBMISSION OF SINGLE AUDIT REPORT PACKAGE (CONTINUED)

CAUSE: The Municipality do not have in place a strict policy to formalize auditor contract before the fiscal year end so management can coordinate with auditors to commence audit procedures to allow the necessary time to complete the audit during the required period.

EFFECT: The Municipality may be subject to sanctions, as described in OMB Circular A-133. According to OMB Circular A-133, section 225 named "Sanctions", in cases of continued inability to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

1. Withholding a percentage of federal awards until the audit is completed satisfactorily,
2. Withholding or disallowing overhead costs,
3. Suspending federal awards until the audit is conducted, or
4. Terminating the federal award.

RECOMMENDATION: As recommended in prior years audits, we recommend management to formalize independent external auditor's single audit contract before the fiscal year end and to coordinate with auditors to commence audit procedures to allow the necessary time to complete the audit during the required period.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

FINDING NUMBER: 10-16: SUBMISSION OF SBGP FINANCIAL REPORTS TO OCAM

FEDERAL PROGRAM: #14.228 - Community Development Block Grant/States Program (SBGP)

CONDITION: During fiscal year 2009-10 the Federal Awards Department of the Municipality is not delivering, within the required time limits, the financial reports related to the administration of the federal awards to the awarding agency nor the Commissioner's Office for Municipal Affairs (OCAM).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

L - Reporting

FINDING NUMBER: 10-16: SUBMISSION OF SBGP FINANCIAL REPORTS TO OCAM (CONTINUED)

CRITERIA: As required by federal regulations, recipients of federal awards should use the standard financial reporting forms or such other forms as may be authorized by OMB. These other forms may include financial, performance, and special reporting. Each recipient must report program outlays and program income on a cash or accrual basis, as prescribed by the Federal awarding agency.

CONTEXT: We select two (2) quarterly reports for the SBGP programs and reviewed the reports in terms of completeness and submission date. The quarterly reports of September 2009 and June 2010 were not submitted on time, representing this condition 50% of the reports submitted during the fiscal year.

CAUSE: The Municipality's internal control procedure to assure that reports related to the administration of the federal awards are prepared and send to the respective agencies within time limits required was not effective enough during fiscal year 2009-2010.

EFFECT: The Federal Programs Department of the municipality is not in compliance with federal regulations regarding financial reporting.

RECOMMENDATION: The Federal Awards Department should strengthen control procedures to assure that financial reports of the federal awards are prepared and send to awarding agencies. Once reports are prepared, the Federal Awards Department should trace the amounts reported to accounting records that support the schedule of expenditures of Federal awards and verify agreement, accuracy and completeness of the reports and that they agree with the accounting records.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

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MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

FINDING NUMBER: 10-17: SUBMISSION OF SECTION 8 FINANCIAL REPORTS TO THE REAL ESTATE ASSESSMENT CENTER'S (REAC)

FEDERAL PROGRAM: #14.871 - Section 8 Housing Choice Voucher Program

CONDITION: The financial report for the fiscal year 2009-10 has not been transmitted to the REAC System as required by The Public Housing Agency 8.2.1.0 User Guide for Submissions on or Before Fiscal Year End March 31, 2008, Chapter 6 Submitting Financial Data.

CRITERIA: As required by The U.S. Department of Housing and Urban Development (HUD) created the Real Estate Assessment Center (PIH-REAC) to centralize and standardize the way HUD monitors and evaluates HUD developments and programs. Each Public Housing Agencies is responsible for submitting financial information to PIH-REAC/HUD for analysis.

CONTEXT: We request the financial report submitted to the REAC System and the report has not been submitted at the date of the audit report.

CAUSE: The Municipality's internal control procedure to assure that reports related to the administration of the federal awards are prepared and send to the respective agencies within time limits required was not effective enough during fiscal year 2009-2010.

EFFECT: The Federal Programs Department of the municipality is not in compliance with federal regulations regarding financial reporting.

RECOMMENDATION: The Federal Awards Department should strengthen control procedures to assure that financial reports of the federal awards are prepared and send to awarding agencies. Once reports are prepared, the Federal Awards Department should trace the amounts reported to accounting records that support the schedule of expenditures of Federal awards and verify agreement, accuracy and completeness of the reports and that they agree with the accounting records.

QUESTIONED COSTS: None.

MANAGEMENT RESPONSE: See corrective action plan.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

Part III - Findings and Questioned Costs Related to Federal Awards:

N - Subrecipient Monitoring

Not Applicable. During the year ended June 30, 2010 the Municipality did not pass-through any federal funds to other entities.

O - Special Test and Provisions

No Conditions Detected.

(1) Audit Findings that have been Fully Corrected:

NONE

(2) Audit Findings not Corrected or Partially Corrected:

FISCAL YEAR 2009

Finding Number 09-1 **Davis Bacon Act**
Deficiencies in the documentation supporting compliance with Davis Bacon Act.

CFDA Number 14.228

Questioned Cost None

Auditee Comments Pending of final determination of the US Department of Housing and Urban Development.

Finding Number 09-2 **Reporting**
Quarterly reports were not submitted on a timely basis.

CFDA Number 14.228

Questioned Cost None

Auditee Comments Pending of final determination of the US Department of Housing and Urban Development.

Finding Number 09-3 **Eligibility**
Missing documentation in participants' files.

CFDA Number 14.871

Questioned Cost None

Auditee Comments Pending of final determination of the US Department of Housing and Urban Development.

FISCAL YEAR 2008

Finding Number 08-1 **Davis Bacon Act**
Deficiencies in the documentation supporting compliance with Davis Bacon Act.

CFDA Number 14.228

Questioned Cost None

Auditee Comments Pending of final determination of the US Department of Housing and Urban Development.

(3) Audit Findings not Corrected or Partially Corrected (cont.):

Finding Number	08-2	Reporting Quarterly reports were not submitted on a timely basis.
CFDA Number	14.228	
Questioned Cost	None	
Auditee Comments	Pending of final determination of the US Department of Housing and Urban Development.	
Finding Number	08-3	Allowable Cost/Cost Principles Missing documentation on disbursement vouchers.
CFDA Number	14.228	
Questioned Cost	None	
Auditee Comments	Pending of final determination of the US Department of Housing and Urban Development.	
Finding Number	08-4	Eligibility Missing documentation in participants' files.
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments	Pending of final determination of the US Department of Housing and Urban Development.	
FISCAL YEAR 2007		
Finding Number	07-2	Davis Bacon Act Quarterly reports were not submitted on a timely basis.
CFDA Number	14.228	
Questioned Cost	None	
Auditee Comments	Pending of final determination of the US Department of Housing and Urban Development.	
FISCAL YEAR 2006		
Finding Number	06-7	Eligibility Missing documentation in participants' files.
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments	Pending of final determination of the US Department of Housing and Urban Development.	

(4) Audit Findings not Corrected or Partially Corrected (cont.):

Finding Number	06-9	Eligibility Missing documentation in participants' files.
CFDA Number	14.856	
Questioned Cost	None	
Auditee Comments	Pending of final determination of the US Department of Housing and Urban Development.	

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

NONE



TORRES, HERNANDEZ & PUNTER, CPA, CSP
Certified Public Accountants

To the clients and users of the financial statements
reported upon by Torres, Hernández & Punter CPA, PSC
Certified Public Accountants

The partners and staff of Torres, Hernández & Punter CPA, CSP are pleased to announce the successful completion of an independent peer review of our accounting and auditing practice. This review was undertaken as a condition of membership in the American Institute of Certified Public Accountants (AICPA), the national organization of CPA's in public practice, industry, government and education. Our participation in the Peer Review Program demonstrates our firm's commitment and desire of maintaining and improving the quality of our practice.

After thorough study of our policies and procedures, the team conducting the review concluded our firm complies with the quality control standards established by the AICPA and the Puerto Rico Society of CPA's (PRSCPA). Our firm is committed to periodic peer review to foster quality performance.

Bankers, bonding agents, investors, suppliers, legal advisors and others use the financial statements our firm audits, reviews, or compiles. We think those people, our clients, and our own staff deserve independent quality assurance that our firm provides quality services. We are proud of our peer review results and would be happy to answer any questions you might have.

Sincerely,

Torres, Hernández & Punter, CPA, PSC
Torres, Hernández & Punter, CPA, CSP

Added Value Services, Provided by Leading Professionals, Obtaining a Reasonable Return on Investment

PO Box 4846, Carolina, PR 00984-4846
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System Review Report

To the Partners of
Torres, Hernandez & Punter, CPA, PSC
And the Colegio de Contadores Publicos Autorizados
de Puerto Rico

We have reviewed the system of quality control for the accounting and auditing practice of Torres, Hernandez & Punter, CPA, PSC (the firm) in effect for the year ended October 31, 2009. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included engagements performed under Governmental Auditing Standards and an audit of Employee Benefit Plan.

In our opinion, the system of quality control for the accounting and auditing practice of Torres, Hernandez & Punter, CPA, PSC in effect for the year ended October 31, 2009 has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of pass, pass with deficiency (ies) or fail. Torres, Hernandez & Punter, CPA, PSC has received a peer review rating of pass.

Ocariz, Gitlin, & Zomerfeld, LLP

June 17, 2010

Members of:

American Institute of
Certified Public Accountants

Florida Institute of
Certified Public Accountants

National Association of
Certified Valuation Analysts