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AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE VILLALBA

AUDITORIA 2006-2007

30 DE JUNIO DE 2007

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DE ASUNTOS MUNICIPALES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA
VILLALBA, PUERTO RICO

BASIC FINANCIAL STATEMENTS

FISCAL YEAR ENDED JUNE 30, 2007

(WITH THE ADDITIONAL REPORTS AND
INFORMATION REQUIRED BY
THE GOVERNMENT AUDITING STANDARDS AND
OMB CIRCULAR A-133)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO
BASIC FINANCIAL STATEMENTS
JUNE 30, 2007
(WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS
AND OMB CIRCULAR A-133)

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MENDOZA & RAMOS
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

INDEPENDENT AUDITOR'S REPORT

TO THE HONORABLE MAYOR AND
MEMBERS OF THE MUNICIPAL LEGISLATURE
MUNICIPALITY OF VILLALBA, 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 VILLALBA, Puerto Rico (Municipality), as of and for the year ended June 30, 2007, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statements presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2007, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis and budgetary comparison information on pages 3 through 11 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we also issued our report dated November 30, 2007, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 considered in assessing the results of our audit.

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

Mendoza & Ramos CPA's
MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
November 30, 2007

Stamp number 2283094 was
affixed to the original of this
report.



COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF VILLALBA

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

The management of the Autonomous Municipality of Villalba in order to comply with the requirements of the Governmental Accounting Standards Board Statement Number 34, "BASIC FINANCIAL STATEMENTS AND MANAGEMENT'S DISCUSSION AND ANALYSIS FOR STATE AND LOCAL GOVERNMENTS", present an overview and analysis of the financial activities sustained by the municipality for the fiscal year ended on June 30, 2007.

This Management's Discussion and Analysis (MD&A) is focused on the current year activities, resulting changes and currently known facts; therefore it should be read in conjunction with the Municipality's Basic Financial Statements. This (MD&A) will provide comparable information to the readers with prior year's financial statements. Also, it can assist readers to get a more specific understanding of the financial activities that have taken place during the fiscal year ended on June 30, 2007.

FINANCIAL HIGHLIGHTS

- The Municipality's Net Assets for the fiscal year ended on June 30, 2007 were \$12,716,175 in comparison with fiscal year 2006 which were \$15,105,520 a \$2,389,345 decrease.
- The Municipality's Fund Financial Statements show that Governmental Activities Revenues were \$16,779,951 for the fiscal year ended on June 30, 2006. In comparison with current fiscal year that was \$14,805,011 a \$1,974,940 Governmental Activities Revenues decreased.
- The General fund showed an Excess of Revenues over Expenditures of \$253,868 during the course of 2006 fiscal year. In comparison with fiscal year 2007, that showed a Deficiency of Revenue over Expenditures of (\$1,209,091).
- The Governmental Activities Expenditures for the fiscal year 2006 were \$15,577,226 in comparison with this fiscal year ended on June 30, 2007, which balance was \$17,194,356 a \$1,617,130 increase over last fiscal year.
- The Municipality's Governmental Funds reported an ending Fund Balance for the current fiscal year, amounting to \$162,225.
- In the current fiscal year the Administration started the construction of very important projects that will help boost an impact over the economy of the city as well as to improve the intern tourism. Such projects are:
 - "*Bolera Municipal*", a ten lane bowling alley with conference and activities room, sport bar and game room, among other facilities.
 - "*Area Recreativa de Villalba* ", a sport complex that includes a basketball court, a volleyball concrete and sand courts, two public pools with a splash pad for the kids, an extreme sports skating park, a jogging track, a little league baseball park, two tennis courts and a lot other family interesting things.
 - *Dos Lagos Hotel*, is actually in the design and planning process and it will began construction during 2008 and it will consist of 200 accommodating rooms plus 200 luxury villas with a casino and an equestrian park with other entertainment facilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

- *Villalba Movie theaters*, this is another important project which is in the design and planning process and it will consist of three movie rooms and one game room for the entertainment of the kids.
- *Multi space parking lot*, this is another project that will have a direct impact to the economy, because it will make more accessible the services provided to the citizens from our downtown.

USING THIS FINANCIAL REPORT AND BRIEF DISCUSSION OF THE BASIC FINANCIAL STATEMENTS

This Report will present relevant information capable of being the basis for comparison, between more than one fiscal year. Also, this MD&A will enhance the Municipality's accountability by providing both, *Government – Wide and Fund – Type* overview, of the Municipality's Financial Structure.

The Basic Financial Statements of the Municipality consist of *Government- Wide Financial Statements and Fund- Type Financial Statements*, as well as *Notes to the Financial Statements*. The Municipality's Basic Financial Statements includes two new Government- Wide Financial Statements: *The Statement of Net Assets and the Statement of Activities*. This report also contains other supplementary information in addition to the Basic Financial Statements. The Municipality's Government- Wide Financial Statements are composed of only Governmental Activities, because no Business- Type Activities were made during the Fiscal year ended on June 30, 2007.

A – GOVERNMENT WIDE FINANCIAL STATEMENTS

The Government-Wide Financial Statements are designed to provide users with an overview of the Municipality's finances, much like to a private-sector business.

The Statement of Net Assets, one of the two new Government- Wide Financial Statements, presents the information on all of the Municipality's assets and liabilities with the difference between both, reported as *Net Assets*. Over time any increase or decrease in the amount reported as *Net Assets* may serve as an indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities, presents information on how the Municipality's *Net Assets* changed during the course of the fiscal year. In this statement, all revenues and expenses are included regardless of when cash was paid or received. All changes in *Net Assets* are reported as the event which gives rise to the change occurs. This Statement is focused on the gross and net costs of various activities and is intended to summarize and simplify the user's analysis of cost of the multiple governmental services.

The Government- Wide Financial Statements of the Municipality are principally supported by *Intergovernmental Revenues*. The Government- Wide Financial Statements of the Municipality are fully presented on pages 11 to 12.

B – FUND -TYPE FINANCIAL STATEMENTS

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Fund- Type Financial Statements will focus on the Municipality's Major Funds, which will be reported separately from all of the other funds. *The Fund- Type Financial Statements* provide detailed information about the Municipality's most significant Funds, not the Municipality as a whole. Unlike *The Government- Wide Financial Statements*, *Fund- Type Financial Statements*, focus on near term inflows

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. The Government funds are reported using modified accrual accounting, which measures cash and all other financial assets that can readily be converted into cash. Because the focus of Governmental Funds is narrower than that of the *Government- Wide Financial Statements*, it is recommended to compare the information presented for Governmental Funds, with comparable information presented, for Governmental Activities in the *Government- Wide Financial Statements*.

The Fund- Type Financial Statements are composed of both, the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances. These Statements will provide the user of this information a better comparison between Governmental Funds and Governmental Activities.

The Municipality's *Fund- Type Financial Statements* are presented on pages 13 to 16.

C – NOTES TO THE FINANCIAL STATEMENTS

The Basic Financial Statements of the Municipality also includes *Notes to the Financial Statements*. These Notes accompanied the Basic Financial Statements and they'll help to get a full understanding of the data provided in the *Government- Wide and Fund- Type Financial Statements*.

The *Notes to the Financial Statements* are presented on pages 17 to 39.

D – OTHER SUPPLEMENTARY INFORMATION

In addition to the Basic Financial Statements and accompanying Notes, this report also presents certain required supplementary information containing budget to actual comparisons for the General and Major funds.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

The Municipality implemented this financial reporting model in the fiscal year ended on June 30, 2004 and for last fiscal year it presented the Financial Statements using this financial model. For this current year, new financial information has been accumulated which has caused a change in *Net Assets* that must be observed and used, to discuss or compare the changing Financial Position of the Municipality as a whole.

GOVERNMENT – WIDE FINANCIAL ANALYSIS

A – GOVERNMENTAL NET ASSETS

The *Net Assets* are the excess of assets over liabilities. The *Net Assets* may serve as an indicator of the Municipality's financial position. The Municipality's *Net Assets* at fiscal year end were \$12,716,175. The following table provides a summary of the Municipality's *Net Assets*:

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

MUNICIPALITY OF VILLALBA
SUMMARY OF NET ASSETS
JUNE 30, 2006 and 2007

	<u>Governmental Activities</u>	
	2006	2007
Assets:		
Current Assets and Other Assets	\$ 8,619,247	\$ 9,236,682
Capital Assets	<u>15,074,043</u>	<u>17,546,268</u>
Total Assets	\$ 23,693,290	\$26,782,950
Liabilities:		
Current liabilities	2,084,754	4,866,019
Non current liabilities	988,399	1,245,292
Long- Term liabilities	<u>5,514,617</u>	<u>7,955,464</u>
Total liabilities	\$ 8,587,770	\$ 14,066,775
Net Assets:		
Invested in Capital Assets, Net of Debt	10,332,901	13,095,270
Restricted	3,927,745	4,532,784
Unrestricted	<u>844,874</u>	<u>(4,911,879)</u>
Total of Net Assets	\$ 15,105,520	\$ 12,716,175

Our analysis on the *SUMMARY OF NET ASSETS* reflects that the largest portion of the Municipality's *Net Assets* for 2007 consisted of Capital Assets, 65% of the Governmental Activities' Total Assets, and for 2006 it was approximately, 64%. These Capital Assets are used to provide services to citizens; consequently these assets are not available for future spending. Also, it should be noted that the resources required to repay the related debt must be provided from other sources, since, the Capital Assets themselves cannot be used to liquidate these liabilities. The Unrestricted portion of the *Net Assets* was \$844,874 in comparison with last year, which was a deficit of (\$1,491,879).

CURRENT RATIO

- Current Assets / Current Liabilities:
 \$9,236,682 / \$4,866,019

The Current Ratio for the Municipality is 1.90 percent for the fiscal year 2007, .85 percent less than fiscal year 2006, 2.75 percent; this ratio indicates the ability of the Municipality to pay current fiscal year obligations.

B – CHANGES IN NET ASSETS

This Municipality is strongly supported by the Intergovernmental Revenues for its operations. In the other hand, the Municipality's *Expenses* covered a range of activities, from which the largest expensed activity was General Administration, followed by Public Works, Mayor and Municipal Legislature, Urban Development, Capital Outlays, Public Safety and so on. The following table will show a summary of the Municipality's *Changes in Net Assets*:

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

MUNICIPALITY OF VILLALBA
SUMMARY OF CHANGES IN NET ASSETS
JUNE 30, 2006 and 2007

	<u>Governmental Activities</u>	
	2006	2007
Revenues:		
Program Revenues		
Property Taxes	\$1,122,995	\$ 1,405,553
Volume of Business Tax	1,705,772	1,689,606
Federal Financial Assistance	1,437,402	1,496,407
Licenses and Permits	352,688	921,880
Intergovernmental Revenues	11,587,533	10,126,230
Rent of Property	61,261	62,608
Interest	----	198,106
Miscellaneous	<u>412,300</u>	<u>401,028</u>
Total Revenues	\$ 16,779,951	\$ 14,805,011
Expenses:		
Program Expenses:		
Mayor and Municipal Legislature	\$ 894,214	\$ 1,893,420
General Administration	6,835,310	7,384,884
Public Safety	933,324	1,159,323
Public Works	2,957,011	2,183,446
Culture and Recreation	764,000	944,285
Health and Sanitation	544,499	330,055
Human Services and Welfare	625,526	1,800,031
Urban Development	1,465,285	1,213,482
Capital Outlay	51,708	-----
Interest (<i>Debt Service</i>)	<u>161,201</u>	<u>235,430</u>
Total Expenses	\$ 15,577,226	\$ 17,194,356
Change in Net Assets	1,202,725	(2,389,345)
Ending Net Assets	<u>\$ 15,105,520</u>	<u>\$ 12,716,175</u>

Our analysis of the *SUMMARY OF CHANGES IN NET ASSETS* reflects that the largest portion of the Municipality's Total Revenues for 2007 consisted of Intergovernmental Revenues, 68% and for fiscal year 2006, was 69.1% approximately. The Governmental Activities' Expenditures, increased from \$15,577,226 to \$ 17,194,356 for fiscal year 2007. The major expenditure category for both fiscal years was General Administration, which compromises 43.9% and 42% for 2006 and 2007, respectively. Public Work program showed a decreased of \$773,565 for 2007. Also, Urban Development was 9.4% of the Municipality's Total Expenditures for fiscal year 2006 while for fiscal 2007, it was 7%.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

The Municipality uses fund accounting to ensure and demonstrate compliance with finance related legal requirements.

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

A – GOVERNMENTAL FUNDS

The Municipality's *Governmental Funds* information is useful in assessing the Municipality's financial requirements. At the end of the fiscal year any resource available for spending should be measured by the unreserved fund balance. In the current fiscal year, the Municipality's *Governmental funds* reported an ending Fund Balance of \$3,704,529 a \$1,037,137 decrease. There are reservations of Fund Balance up to \$4,453,315 a decrease of \$940,763 over last fiscal year. This reserved Fund Balance is committed to cover balances shown as follows:

- \$256,308 is reserved to cover purchase orders of prior fiscal years.
- \$419,993 is to pay Debt Service.
- \$3,775,014 is reserved for HUD Programs, for State Assignments and for other Governmental purposes.

The Municipality's *Governmental Funds* includes the General Fund, which is the Major Operating Fund of the Municipality and as of June 30, 2007, it showed a Fund Balance of \$162,225. Also, the Municipality has Unreserved Fund (Deficit) of (\$746,786) for the fiscal year ended on June 30, 2007 in comparison with an Unreserved Fund (Deficit) of (\$650,412) for fiscal ended on June 30, 2006.

BUDGETARY HIGHLIGHTS

The Budgetary Comparison schedules for budgeted and actual amounts from General Fund are presented in the Municipality's *Basic Financial Statements*. These Schedules will show the original adopted budget, the final revised budget, actual results, and variance between final and actual budgeted amounts for the General Fund. An Original Budget is presented by the Mayor and approved by the Municipality's Legislature in an ordinary session, but it may be revised for various reasons and circumstances, or due to unanticipated budget issues that rose during the course of the fiscal year.

For fiscal year 2007, the summary of the minor differences between the Original and Final 2007 budgeted amounts of the General Fund are presented below:

- Resources increased primarily from Intergovernmental Revenues totaling \$788,333.
- The Original Budget was not amended to increase expenditures between expenditures accounts meanwhile, the total expenditures budgeted exceeded the actual expenditures incurred during fiscal 2007.
- A Decrease of \$207,481 was shown to total charges for appropriations.
- The final budget amount showed an excess of Resources over Appropriations of \$995,814.

CAPITAL ASSETS AND DEBT ADMINISTRATION

The Municipality's investment in Capital Assets as of June 30, 2007 is \$26,782,950, net of Accumulated Depreciation of (\$14,990,628), leaving a Net Book Value of \$11,792,322. The investment in capital assets includes land, buildings improvement, equipment, infrastructure, motor vehicles, recreation facilities and construction in progress.

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

The total decrease in the Municipality's *investment in Capital Assets* as of June 30, 2007 was \$2,096,958 in terms of Net Book Value in comparison with fiscal year 2006. Depreciation charges also increase for the fiscal year by \$209,485 in comparison with fiscal 2006.

The Municipality finances a significant portion of its construction activities through Bond Issuances and Grants. The proceeds from Bond Issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. A summary of the Capital Assets is presented as follows:

MUNICIPALITY OF VILLALBA
CAPITAL ASSETS
(NET OF DEPRECIATION)

	<u>2006</u>	<u>2007</u>
Capital Assets:		
Land	\$ 946,026	\$ 1,003,026
Construction in progress	652,696	1,552,614
Buildings	7,197,337	7,415,885
Infrastructure	2,460,867	3,995,001
Recreation Facilities	4,821,842	5,380,252
Machinery and Equipment	658,924	799,186
Motor Vehicles	<u>2,905,535</u>	<u>3,053,245</u>
Total Capital Assets	\$19,643,226	\$ 20,643,569

DEBT ADMINISTRATION

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each Municipality may be pledged.

The Law requires that in order for a Municipality to be able to issue additional general obligations bonds and notes, such Municipality must have sufficient "Payment Capacity". The "Payment Capacity" is determine with the moneys deposits in the Redemption Fund of the Municipality and the amounts collected with respect to the Municipality's Special Additional Tax, as projected by the *Government Development Bank* (GDB) be enough to fulfill the general and the proposed, additional general obligation. For a Municipality to incur additional general obligation debt it must be sufficient to service to maturity, the Municipality's outstanding general obligation debt and the additional proposed general obligation debt.

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of an interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's *Basic Tax revenues*. Accordingly, the Municipality's *Basic Tax revenues* would be available to make Debt Service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, are not sufficient to cover such Debt Service. It has never been necessary to apply Basic Taxes to pay Debt Service on general obligation debt for the Municipality.

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

MUNICIPALITY OF VILLALBA
LONG TERM AND OTHER DEBTS

	<u>2006</u>	<u>2007</u>
General Obligations Bonds	\$ 2,434,000	\$ 4,862,000
Special Notes Payable	990,000	1,100,000
Property Taxes (CRIM, PRTD)	1,944,832	1,905,276
Water Company	69,828	25,727
Compensated Absences	<u>1,064,356</u>	<u>1,307,753</u>
Total Long-Term and Other Debts	<u>\$6,502,470</u>	<u>\$ 9,177,556</u>

The Municipality continues to meet its financial needs through prudent use of its revenues and creative debt financing programs. A more specific and detailed information regarding the Long - Term Debt of the Municipality is presented in the *Notes to the Financial Statements* of the Municipality's *Basic Financial Statements*.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on Intergovernmental Revenues as well as Federal Financial Assistance to carry out the Governmental Activities. Historically, these amounts have been predictable for every fiscal year, providing the Municipality with increases of approximately, five percent (5%). Federal Financial Assistance may vary if new grants are available, but the revenue is also predictable.

Local, national and international economic factors may influence the Municipality's revenues, positively or negatively. Positive economic growth is correlated with increased revenues from Property Taxes, Volume of Business Taxes, Charges for Services as well as State and Federal Grants. In a local economy the growth may be measured by a variety of indicators such as employment growth, unemployment, new construction, assessed valuation, and other revenues.

All of these factors are considered when preparing the Municipality's Budget for the fiscal year ended on June 30, 2008.

FINANCIAL CONTACT

The Municipality's *Basic Financial Statements* are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability.

If you have any questions about the report or need some additional financial information concerning the Municipality's *Basic Financial Statements*, contact the Municipality's Finance Department at (787) 847-9154.

BASIC FINANCIAL STATEMENTS:

Governmental-Wide Statement

- **Statement of Net Assets**
- **Statement of Activities**

Governmental Funds Statements

- **Balance Sheet**
- **Reconciliation of the Governmental Funds Balance Sheet**
- **Statement of Revenues Expenditure and Change in Fund Balance**
- **Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund Balance of Governmental Funds to the Statements of Activities.**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2007

	<u>Governmental Activities</u>
ASSETS:	
Cash and Cash Equivalents	\$ 3,615,637
Cash with Fiscal Agent	1,552,948
Accounts Receivable (net):	
Property Taxes	40,018
Proceed of Bond	2,110,000
Federal Grants	799,520
Other	<u>1,118,559</u>
Capital Assets (Note 5):	
Land, Improvements, and Construction in Progress	2,555,640
Other Capital Assets, (Net of Depreciation)	<u>14,990,628</u>
Total Capital Assets	<u>17,546,268</u>
TOTAL ASSETS	<u>\$ 26,782,950</u>
LIABILITIES:	
Accounts Payable and Accrued Expense	502,310
Claims and Judgments Debt	2,110,000
Accrued Interest	85,008
Deferred Revenues	2,168,701
Long-Term Liabilities (Note6):	
Due within One Year	1,245,292
Due in More than One Year	<u>7,955,464</u>
Total Liabilities	<u>14,066,775</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	13,095,270
Restricted for:	
Community Development Projects	783,883
Special Revenue	1,395,787
State Assignment Funds	1,933,121
Debt Service	419,993
Unrestricted (Deficit)	<u>(4,911,879)</u>
TOTAL NET ASSETS	<u>\$ 12,716,175</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Functions/Programs	Expenses	Charges For Services	Program Revenue		Net (Expenses) Revenues and Changes in Net Assets
			Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
Mayor and Municipal Legislature	\$ 1,893,420	\$ -	\$ -	\$ -	\$ (1,893,420)
General Administration	7,384,884	-	430,240	-	(6,954,644)
Public Safety	1,159,323	-	152,656	-	(1,006,667)
Public Works	2,183,446	-	1,981,196	849,319	647,069
Culture and Recreation	994,285	-	27,300	-	(966,985)
Health and Sanitation	330,055	-	-	-	(330,055)
Solid Waste Disposal	-	-	-	-	-
Human Services and Welfare	1,780,010	-	485,339	-	(1,294,671)
Urban Development	1,213,482	-	75,366	-	(1,138,116)
Capital Outlay	-	-	-	-	-
Education	20,021	-	-	-	(20,021)
Interest on Long-Term Debt	235,430	-	-	-	(235,430)
Total Governmental Activities	\$ 17,194,356	\$ -	\$ 3,152,097	\$ 849,319	\$ (13,192,940)

General revenues:

Taxes:

Property tax, levied for General Purposes	1,112,603
Property tax, levied for Debt Service	292,950
Volume of Business Tax	1,689,606
Licenses and Permits	921,880
Intergovernmental Revenues	6,124,814
Interest	198,106
Miscellaneous	463,636
Total General Revenues and Special Items	10,803,595
Change in the Net Assets	(2,389,345)
Net Assets - Beginning of Year	15,105,520
Net Assets - Ending of Year	\$ 12,716,175

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO

BALANCE SHEET - GOVERNMENTAL FUNDS

JUNE 30, 2007

	General Fund	HUD Fund	State Assignment Fund	Other Governmental Funds	Total Funds
ASSETS:					
Cash and cash equivalents (Note 2)	\$ 823,634	\$ 38,101	\$ 1,231,346	\$ 1,522,556	\$ 3,615,637
Cash with Fiscal Agent	817,797	-	-	735,151	1,552,948
Accounts receivable:					
Property Tax	17,531	-	-	4,956	22,487
Procced of Bond	2,110,000				2,110,000
Federal Grant	-	799,520	-	-	799,520
Due from Other Funds	2,679,763	-	801,041	930,769	4,411,573
Others	111,525	12,177	207,485	787,372	1,118,559
TOTAL ASSETS	\$ 6,560,250	\$ 849,798	\$ 2,239,872	\$ 3,980,804	\$ 13,630,724
LIABILITIES AND FUND BALANCE:					
Liabilities:					
Accounts Payable and Accrued Expense Liabilities	314,899	-	271	27,937	343,107
Claims and Judgments Debt	2,110,000				2,110,000
Due to Governmental Units	159,203	-	-	-	159,203
Due to Other Funds	1,731,810	65,915	306,480	2,307,368	4,411,573
Deferred Revenues:					-
Volume of Business Tax	2,082,113	-	-	-	2,082,113
Property Taxes	-	-	-	-	-
Federal Grants	-	733,611	-	86,588	820,199
Total Liabilities	6,398,025	799,526	306,751	2,421,893	9,926,195
Fund Balances:					
Reserve For:					
Encumbrances	256,308	-	-	-	256,308
Debt Service	-	-	-	419,993	419,993
Other Purposes	652,703	50,272	1,933,121	1,138,918	3,775,014
Unreserved (Deficit)	(746,786)	-	-	-	(746,786)
Total Fund Balances	162,225	50,272	1,933,121	1,558,911	3,704,529
TOTAL LIABILITIES AND FUND BALANCES	\$ 6,560,250	\$ 849,798	\$ 2,239,872	\$ 3,980,804	\$ 13,630,724

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO

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

JUNE 30, 2007

Total Fund Balances- Governmental Funds \$ 3,704,529

Amounts reported for Governmental Activities in the Statement of Net Assets are different because:

Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:

Non Depreciable Capital Assets	\$ 2,555,640	
Depreciable Capital Assets	16,648,568	
Infrastructure Assets	3,995,001	
Accumulated Depreciation	<u>(5,652,941)</u>	
Total Capital Assets		17,546,268

Some of the Municipality's revenues will be collected after year-end but are not available soon enough to pay the current period's expenditures and therefore are deferred in the fund:

CDBG	733,611	
Municipal Revenue Collection Center	<u>17,531</u>	
Total Deferred Revenues		751,142

Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

Interest Payable	(85,008)	
General Bonds and Notes Payable	(5,962,000)	
Compensated Absences	(1,307,753)	
Municipal Revenue Collection Center	(1,847,398)	
Other	<u>(83,605)</u>	
Total Long-Term Liabilities		<u>(9,285,764)</u>

Total Net Assets of Governmental Activities \$ 12,716,175

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	HUD Fund	State Assignment Fund	Other Governmental Funds	Total Funds
REVENUES					
Property Tax	\$ 1,180,264	\$ -	\$ -	\$ 292,950	\$ 1,473,214
Volume of Business Tax	1,689,606	-	-	-	1,689,606
Federal Assistance	-	1,480,799	-	15,608	1,496,407
Intergovernmental Revenues	6,124,814	-	1,856,471	1,635,071	9,616,356
Licenses and Permits	921,880	-	-	-	921,880
Rent	62,608	-	-	-	62,608
Interest	198,106	-	-	-	198,106
Miscellaneous	401,028	-	-	19,280	420,308
TOTAL REVENUES	10,578,306	1,480,799	1,856,471	1,962,909	15,878,485
EXPENDITURES					
Mayor and Municipal Legislature	1,836,771	56,649	-	-	1,893,420
General Administration	6,322,379	98,509	39,306	953,008	7,413,202
Public Safety	854,560	-	-	255,076	1,109,636
Public Works	1,502,129	-	935,804	2,073,828	4,511,761
Culture and Recreation	576,188	-	499,399	152,047	1,227,634
Health and Sanitation	330,055	-	-	-	330,055
Human Services and Welfare	345,294	403,559	36,576	978,978	1,764,407
Urban Development	-	1,001,276	-	-	1,001,276
Education	20,021	-	-	-	20,021
Capital Outlay	-	-	-	-	-
Debt Service:	-	-	-	-	-
Principal	-	-	-	397,093	397,093
Interest and Other Charges	-	-	-	132,117	132,117
TOTAL EXPENDITURES	11,787,397	1,559,993	1,511,085	4,942,147	19,800,622
Excess (deficiency) of revenue over expenditures	(1,209,091)	(79,194)	345,386	(2,979,238)	(3,922,137)
OTHER FINANCIAL SOURCES (USES):					
Bonds Issued	2,530,000	-	-	355,000	2,885,000
Operating Transfer Out	(1,239,088)	-	-	-	(1,239,088)
Operating Transfer In	-	-	-	1,239,088	1,239,088
Net Other Financing Sources (Uses)	1,290,912	-	-	1,594,088.00	2,885,000
Net Change in the Fund Balance	81,821	(79,194)	345,386	(1,385,150)	(1,037,137)
FUND BALANCE - BEGINNING, AS RESTATED	80,404	129,466	1,587,735	2,944,061	4,741,666
FUND BALANCES AT END OF YEAR	\$ 162,225	\$ 50,272	\$ 1,933,121	\$ 1,558,911	\$ 3,704,529

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO

RECONCILIATION OF THE STATEMENT OF REVENUE, EXPENDITURE, AND CHANGE
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

JUNE 30, 2007

Net Change in Fund Balance - Total Governmental Funds \$ (1,037,137)

Amounts reported for Governmental Activities in the Statement of Activities are different because:

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:

Urban Development and Capital Outlay	\$ 3,555,983	
Depreciation Expense	<u>(1,083,758)</u>	
Excess of Capital Outlay over Depreciation Expense		2,472,225

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds (981,432)

Revenues in the Statement of Revenues that correspond to Prior Year resources are record as Revenue in the Statement of Activities (145,262)

Bonds proceeds provide current financial resources to governmental funds, but issuing debt Increases Long-Term Liabilities in the Statement of Net Assets. In the current period, proceeds Received was: (2,885,000)

Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the repayments were: 347,000

Some expenses reported in the Statements of Activities do not require the use of current financial reurces and therefore are not reported as expenditures in governmental funds. These activities consist of:

Increase in Compensated Absences	(243,396)	
Decrease in Crim Debt	39,556	
Decrease in Other Debt	<u>44,101</u>	
Total Additional Expenditures		<u>(159,739)</u>

Change in Net Assets of Governmental Activities \$ (2,389,345)

MUNICIPALITY OF VILLALBA, PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENTS

- NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (18-27)
- NOTE 2. CASH, CASH EQUIVALENTS AND INVESTMENTS (28)
- NOTE 3. INTERFUND TRANSFER AND BALANCES (28)
- NOTE 4. DUE TO THE OTHER GOVERNMENTAL UNITS (28)
- NOTE 5. CAPITAL ASSETS (29)
- NOTE 6. GENERAL LONG-TERM DEBTS (30-32)
- NOTE 7. DEBT RETIREMENT (32)
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- NOTE 9. VOLUME OF BUSINESS TAX (33)
- NOTE 10. INTERGOVERNMENTAL REVENUES (33-34)
- NOTE 11. EMPLOYEE'S RETIREMENT PLAN (34-36)
- NOTE 12. CONTINGENCIES (36)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Villalba, Puerto Rico (Municipality) was founded in the year 1917, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy 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 14 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.

The accounting policies of the Municipality conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant of such policies.

The accompanying basic financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations) constitutes GAAP for governmental units.

In June 1999, the GASB issued Statement Number 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. The Municipality adopted the provisions of GASBS No. 34 as well as other statements referred to below as of July 1, 2004. They require new information and restructure much of the information that governments have presented in the past.

Comparability with reports issued in prior years is affected. With the implementation of GASBS No. 34, the Municipality has prepared required supplementary information titled Management's Discussion and Analysis, which precedes the basic financial statements.

As previously mentioned, other GASB Statements and Interpretations were required to be implemented in conjunction with GASBS No. 34. Therefore, the Municipality has implemented the following GASB Statements in the current fiscal year 2004-2005: GASBS No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, GASBS No. 38, *Certain Financial Statement Note Disclosures*, GASB No. 41, *Budgetary Comparison Schedules - Perspective Differences*, and GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

The accompanying basic financial statements present the financial position and the results of operations of the Municipality and its various funds and fund types. The basic financial statements are presented as of June 30, 2006, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Financial Reporting Entity

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. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other organizations for which the nature and significance of their relationship with the entity are such that exclusion would cause the Municipality's financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Municipality.

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, 2006, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The government-wide financial statements (the Statement of Net Assets and the Statement of Activities) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for 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 as 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.

Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2006, has been reported only in the government-wide financial statements.

C. Financial Statement Presentation

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the Municipality as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

Government-wide Financial Statements

The government-wide financial statements (the Statement of Net Assets and the Statement of Activities) report information of all the activities of the Municipality. For most part, the effect of interfund activity has been removed from these government-wide 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 and its governmental activities. These statements, combines and consolidates governmental fund's current financial resources (short-term expendable 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 reported in three categories:

Invested in Capital Assets, Net of Related Debt – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, generally it is the Municipality's policy to use restricted resources first, then the unrestricted resources as they are needed.

The Statement of Activities is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Governmental Fund Financial Statements

The fund financial statements (the Balance Sheet, the Statement of Revenues, Expenditures, and Changes in Fund Balances, the Statement of Net Assets) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. 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. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and separate explanation for each differences.

The Statement of Net Assets presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in Capital Assets, Net of Related Debt – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

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.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, generally it is the Municipality's policy to use restricted resources first, then the unrestricted resources as they are needed.

The Statement of Activities is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Governmental Fund Financial Statements

The fund financial statements (the Balance Sheet, the Statement of Revenues, Expenditures, and Changes in Fund Balances, the Statement of Net Assets) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. 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. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in different measurement focus and basis of accounting than the government-wide statements, 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.

The new model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The Municipality reports the following major fund:

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.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

HUD Fund – This is the fund used to account for all the transactions of the HUD Awards. The primary objectives of this program is the development of viable communities by providing decent housing, rent assistance, a suitable living environment and expanded economic opportunities, principally for 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.

GASBS No. 34 eliminates the presentation of Account Groups, but provides for these records to be maintained and incorporates the information into the Governmental column in the government-wide Statement of Net Assets.

D. Budgetary Data

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts Special Revenue Funds. 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. 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.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year. The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the basic financial statements:

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1. Prior of May 31 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.
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the Municipality to CONTINUED making payments for its operating and other expenses until the new budget is approved.
6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund.
7. Budgetary data for the Special Revenue Fund has not been presented in the accompanying basic financial statements as such funds are budgeted over the life of the respective grant or project and not on an annual basis.

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.

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. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP (See Note 8).
3. Interfund transactions of the General and Special Revenue Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary schedule.

The special funds of the Special Revenue Fund have 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 a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

E. Cash, Cash Equivalent and Investment

The Director of Finance of the Municipality 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 other short-term investments are recognized as revenue in the corresponding fund. Cash in the Special Revenue, Debt Service and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico.

Cash balance recognized in the Debt Service Fund is restricted for the payment of the Municipality's obligations, and others are restricted for specific projects, such as the acquisition or construction of permanent improvements. This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with law.

F. Receivable

Receivable are stated nets of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

G. Inventories

The General, Special Revenue and Capital Project Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenses/expenditure in the appropriate fund and the inventory is not recorded in the basic financial statements.

H. Capital Assets

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. The Municipality's

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

capitalization levels are \$500 on personal property. 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. Other costs incurred for repairs and maintenance is expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

CAPITAL ASSETS	YEARS
Buildings	30
Improvement Other Than Buildings	30
Equipments	3-10
Vehicles	5
Recreation facilities	15-20
Infrastructure	10-50

I. 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. 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.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASBS No. 16; the Municipality has accrued a liability for compensated absences for \$1,043,620, which has been earned but not taken by Municipality's employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, 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 (see Note 6 on page X).

J. Insurance

The Municipality has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the Municipality are covered under various surety bonds.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the Municipality's insurance coverage. Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy sent to the Municipality.

K. 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. 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.

L. Reservations of Fund Balance – Governmental Funds

The governmental fund financial statements 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. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for debt service and other specific purposes are examples of the latter.

M. 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. The Long-Term Debt Account includes 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.

N. 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.

MUNICIPALITY OF VILLALBA, PUERTO RICO
 NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS

The Municipality's cash, cash equivalent and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$100,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

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

NOTE 3 INTERFUND TRANSFER AND BALANCES

A. Interfund Transfers

Transfers are indicative of funding for subsidies of various operations.

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS

SOURCES	TRANSFER TO	AMOUNT	PURPOSE
General Fund	Other Governmental Fund	195,279	Payment Debt
General Fund	Other Governmental Fund	<u>1,043,809</u>	Various Purpose
		<u>\$ 1,239,088</u>	

B. Interfund Receivable and Payable Balances

Interfund receivables and payables at June 30, 2007 are summarized as follows:

INTERFUND RECEIVABLE	INTERFUND PAYABLE	AMOUNT
General Fund	HUD Fund	\$ 65,915
General Fund	Debt Service	
General Fund	State Assignment	306,480
General Fund	Other Funds	2,330,317
State Assignment	General Fund	801,041
Other Fund	General Fund	<u>930,769</u>
TOTAL		<u>\$4,434,522</u>

NOTE 4 DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2007, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

AMOUNT	
Water Company.....	\$ 117,535
Department of Labor	29,006
Retirement Administration	9,527
General Services Administration.....	<u>3,135</u>
Total Due to Governmental Units	<u>\$ 159,203</u>

MUNICIPALITY OF VILLALBA, PUERTO RICO
 NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 5 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2007 was as follows:

Description	Balance July 1, 2006	Adjustments	Additions	Retirements	Balance June 30, 2007
Assets:					
Land	\$ 946,026	-	57,000	-	\$ 1,003,026
Construction in Progress	<u>652,696</u>	-	<u>899,918</u>	-	<u>1,552,614</u>
Capital Assets	<u>1,598,722</u>	-	<u>956,918</u>	-	<u>2,555,640</u>
Assets:					
Buildings	7,197,337	-	218,548	-	7,415,885
Infrastructure	2,460,867	-	1,534,134	-	3,995,001
Recreation Facilities	4,821,842	-	558,410	-	5,380,252
Machinery and Equipment	658,924	-	140,262	-	799,186
Motor Vehicles	<u>2,905,534</u>	-	<u>147,711</u>	-	<u>3,053,245</u>
Assets	<u>18,044,504</u>	-	<u>2,599,065</u>	-	<u>20,643,569</u>
Depreciation:					
Buildings	(1,104,713)	-	(243,497)	-	(1,348,210)
Infrastructure	(103,302)	-	(212,205)	-	(315,507)
Recreation Facilities	(1,881,640)	-	(205,296)	-	(2,086,936)
Machinery and Equipment	(255,368)	-	(97,951)	-	(353,319)
Motor Vehicles	<u>(1,224,160)</u>	-	<u>(324,809)</u>	-	<u>(1,548,969)</u>
Depreciation	<u>(4,569,183)</u>	-	<u>(1,038,758)</u>	-	<u>(5,652,941)</u>
Assets (Net)	<u>13,475,321</u>	-	<u>1,515,307</u>	-	<u>14,990,628</u>
CAPITAL ASSETS, NET	<u>\$ 15,074,043</u>	-	<u>-</u>	-	<u>\$ 17,546,268</u>

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

	AMOUNT
General Government.....	156,916
Public Safety.....	49,687
Public Works.....	324,285
Urban Development.....	212,206
Culture and Recreation.....	325,061
Human Services and Welfare.....	<u>15,603</u>
Total Depreciation Expenses.....	\$ 1,083,758

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 6 GENERAL LONG-TERM DEBTS

A. General Obligations Bonds and Special Notes Payable

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 7). The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy send to the Municipality.

General obligations bonds and notes payable as of June 30, 2007, are comprised of the following individual issues

DESCRIPTION	AMOUNT
General Obligations Bonds:	
\$435,000, Series 1991, for construction purposes, payable in annual installments ranging from \$10,000 to \$31,000, excluding interests at 5.0%, through January 1, 2016	\$ 225,000
\$295,000, Series 2001, for construction purposes, payable in annual installments ranging from \$5,000 to \$30,000, excluding interests from 2.89% to 5.6%, through July 1, 2025	260,000
\$1,320,000, Series 2001, for construction purposes, payable in annual installments ranging from \$34,000 to \$94,000, excluding interests at 4.75%, through January 1, 2026	1,212,000
\$100,000, Series 2001, for construction purposes, payable in annual installments \$5,000, excluding interests at 6.50%, through January 1, 2026	90,000
\$85,000, Series 2006, for construction purposes, payable in annual installments ranging from \$5,000 to \$10,000, excluding interests at 6.75%, through January 1, 2020	80,000
\$245,000, Series 2006, for construction purposes, payable in annual installments ranging from \$5,000 to \$20,000, excluding interests at 7.5%, through January 1, 2031	245,000
\$165,000, Series 2007, for construction purposes, payable in annual installments ranging from \$5,000 to \$15,000, excluding interests at 7.5%, through January 1, 2031	165,000
\$2,110,000, Series 2007, for claim and judgment debt purposes, payable in annual installments ranging from \$30,000 to \$175,000, excluding interests at 7.5%, through January 1, 2032..	2,110,000
\$505,000, Series 2006, for construction purposes, payable in annual installments ranging from \$10,000 to \$40,000, excluding interests at 5.0%, through July 1, 2029.....	<u>475,000</u>
Total Bond Payable	4,862,000

MUNICIPALITY OF VILLALBA, PUERTO RICO
 NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 6 GENERAL LONG-TERM DEBTS (CONTINUED)

DESCRIPTION	AMOUNT
Notes Payable:	
\$105,000, Series 2006, for construction purposes, payable in annual installments ranging from \$10,000 to \$20,000, excluding interests from 4.23% to 4.73%, through July 1, 2012.....	\$ 80,000
\$175,000 Series 2006, for construction purposes, payable in annual installments ranging from \$20,000 to \$30,000, excluding interests from 6.62% to 7.5%, through July 1, 20013.....	175,000
\$105,000 Series 2006, for construction purposes, payable in annual installments ranging from \$5,000 to \$10,000, excluding interests from 6.60% to 7%, through July 1, 2021.....	105,000
\$150,000 Series 2002, for construction purposes, payable in annual installments ranging from \$15,000 to \$25,000, excluding interests from 5.0% to 8.0%, through July 1, 2008.....	25,000
\$230,000 Series 2003, for construction purposes, payable in annual installments ranging from \$25,000 to \$40,000, excluding interests from 5.% to 6.5%, through July 1, 2009.....	75,000
\$470,000, Series 2006, for purchase of equipment, payable in annual installments ranging from \$55,000 to \$80,000, excluding interests from 5.0% to 6.0%, through July 1, 2011.....	290,000
\$555,000, Series 2006, for purchase of equipment, payable in annual installments ranging from \$60,000 to \$95,000, excluding interests from 5.0% to 6.0%, through July 1, 2011.....	<u>350,000</u>
Total Notes Payable	<u>1,100,000</u>
Total General Obligations Bonds and Notes.....	<u>\$ 5,962,000</u>

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2007 are as follows:

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2008	371,000	358,281	729,281
2009	374,000	352,024	726,024
2010	452,000	334,656	786,656
2011	281,000	305,001	586,001
2012	209,000	277,572	2,255,840
2013-2017	1,005,000	1,250,840	1,993,047
2018-2022	1,086,000	907,047	1,796,145
2023-2027	1,214,000	582,145	1,796,145
2028-2032	<u>970,000</u>	<u>260,597</u>	<u>1,230,597</u>
TOTAL	<u>\$ 5,962,000</u>	<u>\$ 4,628,161</u>	<u>\$10,590,161</u>

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 6 GENERAL LONG-TERM DEBTS (CONTINUED)

B. Changes in General Long-Term Debts

The following is a summary of changes in long-term debts for the year ended June 30, 2007:

DESCRIPTION	BALANCE JULY 1, 2006	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2007	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
Bonds and Notes.....	\$ 3,424,000	\$ 2,885,000	\$ 347,000	\$ 5,962,000	\$ 341,000	\$ 5,621,000
Property Taxes – MRCC	1,876,037		28,639	1,847,398	28,639	1,818,759
Property Taxes – TD. ..	68,795		10,917	57,878	11,576	46,302
Water Company.....	69,828		44,101	25,727	25,727	-
Compensated Absences	<u>1,064,356</u>	<u>745,169</u>	<u>501,772</u>	<u>1,307,753</u>	<u>838,350</u>	<u>469,403</u>
TOTAL	<u>\$ 6,503,016</u>	<u>\$ 3,630,169</u>	<u>\$ 932,429</u>	<u>\$ 9,200,756</u>	<u>\$ 1,245,292</u>	<u>\$ 7,955,464</u>

NOTE 7 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 8).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality. 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.

NOTE 8 PROPERTY TAXES

The Municipal Revenue Collection Center of the Commonwealth of Puerto Rico 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 property tax contribution is levied each year over the appraised value of the property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957 and the personal property at the current value at the date of the assessment.

The tax rate per annum is 8.58% for real property and 6.58% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 7.25% and 5.25%, respectively, belongs to the Municipality.

From the portion belonging to the Municipality, 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.

The remaining portion belonging to the Municipality of 1.75% represents the ad-valorem property taxes withheld by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico and restricted for debt service, which is accounted for through the debt service fund (See Note 7). 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.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 8 PROPERTY TAXES (CONTUNUED)

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. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000. The Municipal Revenue Collection Center 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 Municipal Revenue Collection Center from taxpayers. The Municipal Revenue Collection Center 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 Municipal Revenue Collection Center.

Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipality Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors. As of June 30, 2006, the Debt Service Fund presented a receivable of \$12,434 for the collection of additional property taxes during the next 60 days after end of year.

NOTE 9 VOLUME OF BUSINESS TAX

The volume of business tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Laws of the Commonwealth of Puerto Rico. All taxpayers are required to file their declarations by April 23 of each year.

The tax rates are as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.50% for 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, the taxpayer is granted a 5% of discount. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

NOTE 10 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

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 10 INTERGOVERNMENTAL REVENUES (CONTINUED)

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.

NOTE 11 EMPLOYEE'S RETIREMENT PLAN

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The ERS was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own 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.

The Municipality adopted the requirements of GASBS No. 25 for all the career employees that are covered under the Commonwealth of Puerto Rico Employee's Retirement System, a multiple-employer public employee retirement system, established by State Laws.

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to contribute 5.775% for the first \$6,600 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. The Municipality contributes to the system 9.275% of the participating employee's salaries.

Law Number 305 of September 24, 1999, amends the Act Number 447 that establish a savings program. All employees active in the system as of December 31, 1999 may elect to transfer from defined contribution programs to the new savings program (a defined contribution plan). Employees in the savings program may now contribute from 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.

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. The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation of each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

MUNICIPALITY OF VILLALBA, PUERTO RICO
 NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 11 EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

A variety of significant actuarial assumptions are used to determine the standard measure of the pension benefit obligation and these assumptions are summarized below:

- a. The present value of the future pension payments was computed by using a discount of 9%.
- b. Future pension payments reflect an assumption of a 6% salary increase.

All employees that do not elect to transfer for the new program and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows:

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS
30 or more	55 or less	65% of the average of the three years of highest salary during the employee's service period.
30 or more	58 or more	75% of the average of the three years of highest salary during the employee's service period.
30 or more	65 or more	75% of the average of the three years of highest salary during the employee's service period (employees started working after April 1, 1990).

The amount of the total pension benefit obligation is based on a standardized measurement established by GASBS No. 27, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosure for Defined Contributions Plans*. The standardized measurement is the actuarial present value of estimated defined pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee services performed to date. The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and non-vested is not readily available.

Contributions in 2006 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by accounting principles generally accepted in the United States of America. An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2007 was approximately \$ 290,833. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

MUNICIPALITY OF VILLALBA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 11 EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS is not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2007. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42004, Minillas Station, San Juan, P.R. 00940.

NOTE 12 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 can not 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.

END OF NOTES

REQUIRED SUPPLEMENTARY INFORMATION:

- **Budgetary Comparison Schedule-General Fund**
- **Notes to Required Supplementary Information**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO

REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Budget Amounts		Actual Amount	Variance with
	Original	Final	(Budgetary Basis)	Final Budget
			(See Note A)	Positive
				(Negative)
Resources (Inflows)				
Property Taxes	1,162,733	1,162,733	1,162,733	-
Volume of Buseness Taxes	1,516,374	1,516,374	1,689,606	173,232
Intergovernmental Revenues	5,838,809	5,838,809	6,054,014	215,205
License and Permits	902,971	902,971	921,881	18,910
Rent	55,000	55,000	62,607	7,607
Miscellaneous	182,000	182,000	386,520	204,520
Interest	17,000	17,000	185,859	168,859
Prior Year Allocation	-	-	-	-
Total Resources (Inflows)	9,674,887	9,674,887	10,463,220	788,333
Charges to Appropriations (Outflows)				
Mayor and Municipal Legislature	1,455,650	2,067,979	1,997,957	70,022
General Government	4,576,937	4,220,016	4,122,635	97,381
Public Safety	887,932	863,384	857,429	5,955
Public Work	1,398,049	1,247,707	1,236,009	11,698
Culture and Recreation	613,324	603,637	581,445	22,192
Health and Sanitation	385,716	331,312	331,079	233
Human Services and Welfare	162,000	145,573	145,573	-
Urban Development	-	-	-	-
Transfer to Other Funds	195,279	195,279	195,279	-
Total Charges to Appropriations	9,674,887	\$ 9,674,887	\$ 9,467,406	207,481
Excess (deficiency) of revunues over(under) expenditures, encumbrances and other financing sources(ue)	\$ -	\$ -	\$ 995,814	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VILLALBA, PUERTO RICO**

**BUDGET COMPARISON SCHEDULE- GENERAL FUND
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION**

JUNE 30, 2007

**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 Basic) " Available for Appropriation" from the Budgetary Comparison Schedule (See Page 39)	\$ 10,463,220
Difference- Budget to GAAP:	
Non-Budgetary Revenues	<u>115,086</u>
Total Revenue as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 15)	<u>\$ 10,578,306</u>
 Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basic) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 39)	\$ 9,467,405
Difference- Budget to GAAP:	
Prior Year expenditures are not outflows of budgetary resources but are expenditures For Financial reporting purposes	213,358
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes	(196,190)
Non- Budgetary Expenditures	2,302,824
Transfer to other funds are outflows of Budgetary Resources but are not Expenditures For Financial Reporting Purpose	<u>1,239,088</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 15)	<u>\$ 13,026,485</u>

Schedule of Expenditures of Federal Awards and Reports on Compliance and Internal Control in accordance with Government Auditing Standards and the requirements of OMB Circular A-133

- **Schedule of Expenditures of Federal Awards**
- **Notes to Schedule of Expenditures of Federal Awards**
- **Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based upon the Audit Performed in Accordance with Government Auditing Standards**
- **Independent Auditor's Report on Compliance and Internal Control over Compliance Applicable to Each Major Federal Award Program and on the Schedule of Expenditures of Federal Awards**

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U. S. Department of Agriculture:			
Pass Through State – Office of the Governor, Regional Elderly Office:			
Child and Adult Care Food Program.....	10.558	N/AV	<u>\$ 27,125</u>
U.S. Department of Housing and Urban Development:			
Pass-Through State – Office of Commissioner Of Municipal Affairs:			
Community Development Block Grant Program/ Small Cities Program.....	14.219	06-AB-72 06-FC-72 05-AB-72 05-FC-72 04-FC-72 04-AB-72 03-FC-72 03-AB-72 02-FC-72 02-AB-72 01-AB-72 00-AB-72	1,099,785
Direct Program:			
Section 8 Housing Choice Voucher Program.....	14.871		<u>406,470</u>
Total U.S. Department of Housing and Urban Development.....			<u>1,506,255</u>
U.S. Department of Justice:			
Pass-Through Police Department of P.R.: Safety Partnership and Community Policing Grants (Cops).....			
	16.710		133,795
Pass-Through Justice Department of P.R.:			
Edward Byrne Justice Assistance Grants	16.738		<u>40,500</u>
Total U.S. Department of Justice			<u>174,295</u>
Subtotal Expenditures of Federal Awards			<u>1,707,675</u>

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

U.S. Department of Transportation:

Direct Program:

Federal Transit.....	20.500		8,900
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U.S. Federal Emergency Management Administration (FEMA):

Pass-Through Office of the Governor:

Public Assistant Grant.....	83.544	1247DR-PR-121 N/AV	1,630 <u>21,012</u>
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Total U.S Federal Emergency Management Administration (FEMA).....			<u>22,642</u>
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U.S. Department of Education:

Pass-Through Department of Education of P.R.:

Twenty First Century Community Learning Centers	84.287	N/AV	33,644
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U.S. Department of Health and Human Services:

Pass-Through Office of Governor – Elderly Office:

Special Program for Aging, Title III, Part C	93.044	N/AV	18,099
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U.S. Department of Homeland Security:

Pass-Through Office of Governor:

Homeland Security Grant.....	97.067	N/AV	19,593
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TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 1,810,553</u>
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See accompanying Notes to Schedule of Expenditures of Federal Awards.

MUNICIPALITY OF VILLALBA, PUERTO RICO

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Villalba, Puerto Rico (Municipality) and is presented on the modified accrual basis. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The reporting entity is defined in Note (1) (A) to the general-purpose combined financial statements.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. The accompanying Schedule of Expenditures of Federal Awards is prepared from Municipality's accounting records and is not intended to present financial position or the results of operations.
- B. The financial transactions are recorded by the Municipality in accordance with the terms and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America.
- C. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

NOTE 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.

NOTE 4 PASS THROUGH GRANTOR'S NUMBER

State or local government redistribution of federal awards to the Municipality, treated as if they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass through entity and identifying number assigned by the pass through entity for federal awards received as a sub-recipient. Numbers identified as N/AV are not available.

NOTE 5 MAJOR PROGRAMS

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

END OF NOTES



MENDOZA & RAMOS
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

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

To the Honorable Mayor and
Members of the Municipal Legislature
MUNICIPALITY OF VILLALBA, PUERTO RICO

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Villalba, Puerto Rico (the "Municipality") as of and for the fiscal year ended June 30, 2007, which collectively comprise Municipality of Villalba's basic financial statements and have issued our report thereon dated November 27, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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

INDEPENDENT AUDITORS' REPORT

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 grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matter that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of the Municipality in a separate letter dated November 27, 2007.

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

Mendoza & Ramos CPA's
MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
November 27, 2007

Stamp number 2283095 was
affixed to the original of this
report.





MENDOZA & RAMOS
Contadores Públicos Autorizados, C.S.P.

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

To the Honorable Mayor and
Members of the Municipal Legislature
MUNICIPALITY OF VILLALBA, PUERTO RICO

Compliance

We have audited the compliance of the Municipality of VILLALBA, Puerto Rico (the "Municipality") with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2007. The 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 the Municipality's management. Our responsibility is to express an opinion on the 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 others procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Municipality's compliance with those requirements.

As described item 07-01, 07-02 and 07-03 in the schedule of findings and questioned costs, the Municipality did not comply with requirements regarding Davis Bacon, Procurements Standards, Suspension and Debarment that are applicable to its Community Development Block Grant Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

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 are applicable to each of its major federal programs for the Fiscal Year Ended June 30, 2007.

INDEPENDENT AUDITORS' REPORT

Internal Control Over Compliance

The management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with 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, 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 Municipality's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of federal program that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies in internal control over control over compliance described in the accompanying schedule of findings and questioned costs as items 07-01, 07-02, 07-03 and 07-04 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of federal program will not be prevented or detected by Municipality's internal control. We do not consider any of the deficiencies described in the accompanying schedule of finding and questioned costs to be material weaknesses.

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

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

Mendoza & Ramos CPAs
MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
January 18, 2008

Stamp number 2283096 was
affixed to the original of this
report.



FINDINGS AND QUESTIONED COST:

- **Schedule of Findings and Questioned Costs**
- **Summary Schedule of Prior Audit Findings**

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION I-FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Financial Statements

Type of auditors' report issued:

- Unqualified Opinion
- Qualified Opinion
- Adverse Opinion
- Disclaimer Opinion

Internal control over financial reporting:

- Material weakness(es) identified? Yes No
- Significant deficiencies identified that are not considered to be material weakness (es)? Yes None Reported

Noncompliance material to financial statements noted?

- Yes No

Federal Awards

Internal control over major programs:

- Material weakness (es) identified? Yes No
- Significant deficiencies identified that are not considered to be material weakness (es)? Yes None Reported

Type of auditors's report issued on compliance for Major Programs:

- Unqualified Opinion
- Qualified Opinion
- Adverse Opinion
- Disclaimer

Any audit findings disclosed that are required to be reported in accordance with 510(a) OMB Circular A-133?

- Yes No

The Municipality's major programs were:

CFDA Number	Name of Federal Program
14.871	Section 8 Housing Choice Vouchers
14.228	State Block Grant Program

Dollar threshold used to distinguish between Type A and Type B Programs:

\$300,000

Auditee qualified as low-risk auditee?

- Yes No

MUNICIPALITY OF VILLALBA, PUERTO RICO

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

SECTION II – FINANCIAL STATEMENT FINDINGS

NO MATTER IS REPORTED.

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III-FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	FINDING	07-01
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.219) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS	
CATEGORY	COMPLIANCE AND INTERNAL CONTROL	
NONCOMPLIANCE	DAVIS-BACON ACT	
TOPIC SENTENCE	Non-compliance with the Davis-Bacon Act	
CONDITION	Municipality did not comply adequately with Davis-Bacon Act applicable regulations. The Municipality did not required to all contractors or subcontractors, for each week in which any contracted work was performed, a copy of the payroll and a statement of compliance. In addition, the Municipality was not verifying that all laborers employed by the contractors were paid according to the wages established by law.	
CRITERIA	As stated in 29 CFR 5.5 (a)(3)(ii)(A), the contractor shall submit weekly for each week in which any contract work is performed a copy of all payrolls to the Municipality. The payrolls submitted shall set out accurately and completely all of the information required to be maintained. The prime contractor is responsible for the submission of copies of payrolls by all subcontractors. Each payroll submitted shall be accompanied by a "Statement of Compliance", signed by the contractor or subcontractor or his or her agent who pays or supervise the payment of the persons employed under the contract and certifying all the information required under 5.5 (a)(3)(ii)(B) (1) to (3).	
CAUSE	The Municipality did not required all contractors the required documentation to ascertain compliance with such requirement.	
EFFECT	The Municipality may have procured services from an organization that is not complying with the applicable Department of Labor regulations and could result in cost disallowances by the federal awarding agency.	
RECOMMENDATION	The Municipality should require to all contractors whose contracts are funded with CDBG award that complies with this requirement and should verify its compliance trough the designated municipal officer.	

MUNICIPALITY OF VILLALBA, PUERTO RICO

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

SECTION III-FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER 07-01 (CONTINUE)

QUESTIONED COSTS None.

MANAGEMENT RESPONSE We designated an employee of our Federal Program Office to be in charge for ascertain that all contractors and the Municipality are complying with the requirements established by the Davis-Bacon Act.

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	07-02
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.219) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	PROCUREMENT STANDARDS
TOPIC SENTENCE	Contracts Provisions
CONDITION	Federally funded contracts did not contain federally required provisions.
CRITERIA	As stated in 24 CFR 85.36(i)(5)(10)(11)(12); a grantee's and subgrantee's contracts must contain, among others, a provision regarding compliance with: the Davis Bacon Act in cases of construction contracts; retention of all required records for three years after grantees or subgrantees make final payments and all other pending matters are closed; access by the grantee, the subgrantee, the Federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions; and all environmental Protection Agency regulations.
CAUSE	The Municipality has not ensured that all contracts granted counts with the required provisions due to the lack of understanding of the applicable federal regulations.
EFFECT	Contracts failure to contain all required federal provisions could expose the Municipality of being liable for contractor's non compliance with applicable federal laws and regulations contained within the required provisions.
RECOMMENDATION	The Municipality should have its legal advisor to verify and amend their contracts in order to include all required provisions as required by Federal regulations.
QUESTIONED COSTS	None.
MANAGEMENT RESPONSE	We know the importance about all the clauses mentioned in this finding. We will improve the format of the contracts because instruction were given to the Municipal Secretary to include in each contract the clauses detailed in the audit.

MUNICIPALITY OF VILLALBA, PUERTO RICO

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	07-03
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.219) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SUSPENSION AND DEBARMENT
TOPIC SENTENCE	Lack of controls over suspension and debarments
CONDITION	<p>The Municipality does not have procedures in place to verify the status of an entity as to suspensions and debarments when contracting services or procuring goods with federal funds.</p> <p>In testing procurement, suspension and debarments, we were not able to find evidence indicating that the Municipality performs procedures to assure that the individuals and entities that receive contracts or subawards are not suspended or debarred from participation in federal programs.</p>
CRITERIA	<p>As stated in 24 CFR 85.35 grantee and subgrantee must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension".</p>
CAUSE	<p>The Municipality has no policies and procedures for the use of the list of parties excluded from federal procurement or non-procurement programs to assure that they do not award assistance to listed parties.</p>
EFFECT	<p>As a result of this deficiency, the Municipality could have procured goods or services from organizations and individuals that are suspended or debarred which could result in cost disallowances by the federal awarding agency.</p>
RECOMMENDATION	<p>The Municipality should amend their procurement procedures and include a step to verify whether or not the individual or entity is on the list of parties excluded from federal participation in procurement and non-procurement programs. The Municipality should also require the entities or individuals to submit a certification stating that they are not suspended or debarred.</p>

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER 07-03 (CONTINUE)

QUESTIONED COSTS None.

MANAGEMENT RESPONSE We gave instructions to verify and amend our procurement procedures in order to include a step to verify whether or not the individuals or entities is on the list of parties excluded from federal participation in procurement and non-procurement programs. Also we will require the entities or individuals to submit a certification stating that they are not suspended or debarred.

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION III-FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	07-04
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA 14.871)
CATEGORY	INTERNAL CONTROLS OVER COMPLIANCE
NONCOMPLIANCE	REPORTING
TOPIC SENTENCE	Inadequate accounting records
CONDITION	Municipality's Section 8 Housing Choice Vouchers Program does not maintain adequate accounting records. Many transactions have not been posted or were posted incorrectly. Proper accounting policies regarding revenue recognition, expenditures accruals and fund balance were not adequately followed. Month-end and year-end closing procedures were incomplete and they were not performed according to Program's federal regulations. These situations cause that general ledger accounts were not in balance as of June 30, 2007.
CRITERIA	As stated in 24 CFR 982.158(a) the PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. In addition, 24 CFR 92.20(b) establishes that the financial management systems of other grantees and subgrantees must meet the following standards: (1) Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant; (2) grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income; (3) Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets.
CAUSE	Program's accountant has not the necessary accounting knowledge and training to perform their duties correctly.
EFFECT	These conditions inhibit the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions plans. Also, Municipality's failure to have accurate and complete accounting records could result in the qualification of the general purposes financial statements audit opinion.

MUNICIPALITY OF VILLALBA, PUERTO RICO

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

SECTION III-FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER 07-04 (CONTINUE)

RECOMMENDATION Accounting personnel should be trained or take some courses in accounting so they can perform their duties adequately. Furthermore, they should be oriented regarding the related federal requirements. Also, the general ledger should be revised to ensure that all Program's transactions and activities are properly recorded and fairly presented in accordance with program requirements.

QUESTIONED COSTS NONE

MANAGEMENT RESPONSE We are going to contract a CPA that trained and oriented our accounting personal regarding the related federal requirements and accounting practice. Also the CPA revised and correct the accounting records to ensured that all Program's transactions and activities are fairly presented in accordance with program requirements.

MUNICIPALITY OF VILLALBA, PUERTO RICO

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

(1) Audit Findings that have been Fully Corrected:

Finding Number	CFDA	Questioned Cost	Comments
06-01 Allowable Costs	14.219	\$11,362	The procedures are corrected.
06-05 Eligibility	14.871	None	The procedures are corrected.
06-06 Special Test	14.871	None	The procedures are corrected.
05-III-01 Allowable Costs	14.871	None	The procedures are corrected.
05-III-03 Eligibility	14.871	None	The procedures are corrected.
2004-15 Eligibility	14.871	None	The procedures are corrected.

(2) Audit Findings not corrected or Partially Corrected:

Finding Number	CFDA	Questioned Cost	Comments
06-02 Davis Bacon Act	14.219	None	Situation still prevails.
06-03 Procurement Standarts	14.219	None	Situation still prevails.
06-04 Suspension and Debarments	14.219	None	Situation still prevails.
05-III-02 Davis Bacon Act	14.228	None	Situation still prevails.
05-III-04 Procurement	14.228	None	Situation still prevails.
2004-20- Davis Bacon Act	11.300	None	Situation still prevails.

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

NONE

(4) Audit findings is no longer valid:

NONE

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

NONE

(6) Audit findings is no longer valid:

NONE

END OF SCHEDULE