

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE YAUCO
AUDITORIA 2005-2006

30 DE JUNIO DE 2006

OFICINA DEL COMISIONADO
DE ASUNTOS MUNICIPALES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
SINGLE AUDIT REPORTING PACKAGE
FOR THE YEAR ENDED JUNE 30, 2006

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006

Carlos R. Diáz Negrón

Certified Public Accountant

MEMBER:

American Institute of Certified Public Accountants
Puerto Rico Society of Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT

**To the Honorable Mayor and
Municipal Legislative Body
Municipality of Yauco
Yauco, Puerto Rico**

I have audited the financial statements of the governmental activities, each major funds, and the aggregate remaining fund information of the **Municipality of Yauco** as of and for the year ended June 30, 2006 which collectively comprise the basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. My responsibility is to express an opinion on these financial statements based on my audit.

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

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major funds, and the aggregate remaining fund information of the Municipality of Yauco as of June 30, 2006, and the respective changes in financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, I have also issued a report dated November 15, 2006, in my consideration of Municipality of Yauco's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts grants agreements and other matters. The purposes 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 my audit.

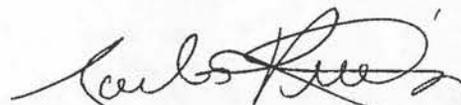
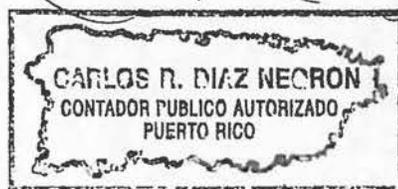
INDEPENDENT AUDITOR'S REPORT (CONTINUED):

The management's discussion and analysis and budgetary comparison information on pages 3 through 9 and 33 are not required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Yauco'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 not a required part of the basic financial statements of the Municipality of Yauco. 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, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

November 15, 2006
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2007

The stamp No. 2204037 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
MANAGEMENT AND DISCUSSION ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2006

Our discussion and analysis of the Municipality of Yauco (Municipality) financial performance provides an overview of the Municipality's financial activities for the year ended June 30, 2006. Please read it in conjunction with the financial statements, which begin on page 10.

FINANCIAL HIGHLIGHTS

- The Net Capital Assets in the Statement of Net Assets increased by \$9.0 millions in comparison with the prior year financial statements. The increase in capital assets came up mainly from donated assets and capital contributions.
- The Statement of Activities shows a favorable change in net assets by \$8.5 millions, when we compared the current with the former year, including prior period adjustments amounted to \$1.1 millions.
- The Municipality ended its operations as of June 30, 2006, as reflected in the General Fund of the Statement of Revenues, Expenditures and Changes in Fund Balance with a deficit of \$401,270, in comparison with a deficit of \$2.4 millions in the prior year. As we can notice, the financial condition of the Municipality improved significantly due to the establishment of a sales tax, which increased the municipality's revenues. Also, the Municipality has kept the reduction in the worked hours for all the employees, with the purpose of reducing the salary costs, employer contributions and utilities.

The Municipality has decreased dramatically its fixed costs from 97% in 2005 to 87% in 2006, including salaries, employer contributions, utilities, insurance, contributions for the health card and other miscellaneous fixed costs.

Even though, the Municipality ended its operations with a reduced deficit, it is important to state that the financial strategies implemented by the management have reduced dramatically the operational deficit, when we compare the current year with the financial operations of prior years.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 10 and 11) provide information about the activities of the Municipality as a whole and present a long-term view of the Municipality's finances. Fund financial statements start on page 12. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Municipalities' operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
MANAGEMENT AND DISCUSSION ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2006

Reporting the Municipality as a Whole

The Statement of Net Assets and the Statement of Activities

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Municipality's *net assets* and changes in them. You can think of the Municipality's net assets, the difference between assets and liabilities, as one way to measure the Municipality's financial health or *financial position*. Over time, *increases or decreases* in the Municipality's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the Municipality's property tax base and the condition of the roads, to assess the *overall health* of the Municipality of Yauco.

In the Statement of Net Assets and the Statement of Activities, we grouped the Municipality's activities into:

Governmental Activities – Most of the Municipality's basic services are reported here, including the municipal police, public works, garbage disposal, public energy and health services, and general administration. Property taxes, municipal license tax, state and federal grants finance most of these activities.

Reporting the Municipality's Most Significant Funds

The fund financial statements begin on page 12 and provide detailed information about the most significant funds, not the Municipality as a whole. Some funds are required to be established by bond covenants. The Municipality's basic services are reported in the governmental funds, that uses an accounting approach which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual accounting*, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the Municipality's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement on Activities) and governmental funds in Reconciliation of the Governmental Funds on page 13 and 15 of this report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
MANAGEMENT AND DISCUSSION ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2006

THE MUNICIPALITY AS A WHOLE

The Municipality's combined net assets increased in the current year by \$8.6 millions, to a total in net assets of \$8.5 millions at end of year. Table 1 and 2 focus on the net assets and changes in net assets of the Municipality's governmental activities for the year ended June 30, 2006 and 2005:

Table 1 Statement in Net Assets (In Millions)	Year Ended June 30, 2006	Year Ended June 30, 2005	Net Change Favorable (Unfavorable)
Cash and other current assets	\$ 1.5	\$ 1.1	\$.4
Cash restricted	1.3	2.9	(1.6)
Accounts receivable	3.1		3.1
Capital assets-net	<u>29.9</u>	<u>20.9</u>	<u>9.0</u>
Total assets	<u>35.8</u>	<u>24.9</u>	<u>10.9</u>
Short-term debt	10.1	8.0	(2.1)
Long-term debt	<u>17.2</u>	<u>17.0</u>	<u>(.2)</u>
Total liabilities	<u>27.3</u>	<u>25.0</u>	<u>(2.3)</u>
Net Assets:			
Invested in capital assets, net of related debt	17.2	8.1	9.1
Restricted for:			
Debt service	1.3	1.5	(.2)
State and federal programs	.8	2.2	(1.4)
Unrestricted	<u>(10.8)</u>	<u>(11.9)</u>	<u>1.1</u>
Total net assets	<u>\$ 8.5</u>	<u>\$(0.1)</u>	<u>\$8.6</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
MANAGEMENT AND DISCUSSION ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2006

Table 2			
Changes in Net Assets	Year Ended	Year Ended	Net Change
(In Millions)	June 30, 2006	June 30, 2005	Favorable
			(Unfavorable)
Revenues			
Program revenues:			
Charge for services	\$.6	\$.8	(\$.2)
Operating grants	.8	1.3	(.5)
Capital grants	2.5	4.5	(2.0)
General revenues:			
Property taxes	5.3	4.9	.4
Municipal license tax	2.2	2.0	.2
Grants and entitlements	4.5	5.8	(1.3)
Donated assets	8.0		8.0
Other income	<u>2.1</u>	<u>1.6</u>	<u>.5</u>
Total Revenues	<u>26.0</u>	<u>20.9</u>	<u>5.5</u>
Program Expenses:			
General administration	7.7	9.7	2.0
Public safety	1.9	2.2	.3
Education	1.4	1.3	(.1)
Public works	5.1	6.4	1.3
Health and welfare	1.7	.4	(1.3)
Other	<u>.8</u>	<u>.8</u>	<u>—</u>
Total Expenses:	<u>18.5</u>	<u>20.8</u>	<u>2.3</u>
Increase in Net Assets	<u>\$ 7.5</u>	<u>\$ 1.1</u>	<u>\$ 7.4</u>

It is very important to notice that the increase in net assets for the year ended June 30, 2006 resulted in \$7.5 millions plus 1.1 in prior year adjustments for total of 8.5. It also denotes that the net operations for the current year increased by \$8.4 millions in comparison with the former year. *Unrestricted* net assets is the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
MANAGEMENT AND DISCUSSION ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2006

Governmental Activities

The principal revenues of the Municipality are composed of property taxes, municipal license taxes and grant contributions. Table 2 presents an increase in property taxes, municipal license taxes and donated capital for \$10.7 millions in comparison with prior year. However, the aforementioned increase was accompanied with a decrease in capital contributions, grants and entitlements for \$3.3 millions. For the current year, the Municipality had a decrease in general administration expenses for \$2 millions, in comparison with prior year, mainly from salaries and related expenses. These are the main reasons because the Municipality improved its operations and the change in net assets increased dramatically in relation to the former year.

General Fund Budgetary Highlights

Once the Municipality's budget for the fiscal year 2005-2006 was approved on June 2005, the financial decisions were taken based on the available appropriations. However, during the course of the year, the Municipal Legislative Body revised the Municipality of Yauco' budget to adjust the original projections to the actual needs of the citizenship. The budget amendments fall into various categories. The first category includes transfers between expenditure accounts and the second one includes revisions to the amount of budget originally approved. The latest is related to additional revenues collected during the year, which exceeds the expectations originally included in the budget.

During the year ended June 30, 2006, the Mayor of the Municipality and the Municipal Legislative Body authorized various transfers among expenditure accounts based on the needs that arose during the year.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2006, the Municipality of Yauco had \$29.9 millions invested in a broad range of capital assets, including land, land improvements, buildings, parks, roads, bridges and equipment.

Table 3 Capital Assets (Net of depreciation, in Millions)	Year Ended June 30, 2006	Year Ended June 30, 2005	Net Change Favorable (Unfavorable)
Land and works of art	\$ 1.0	\$ 1.0	\$ -
Land improvements	.3	.3	-
Buildings and improvements	6.3	6.1	.2
Equipment	2.6	3.1	(.5)
Infrastructure	<u>19.7</u>	<u>10.4</u>	<u>9.3</u>
Totals	<u>\$29.9</u>	<u>\$20.9</u>	<u>\$ 9.0</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
MANAGEMENT AND DISCUSSION ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2006

CAPITAL ASSET AND DEBT ADMINISTRATION (CONTINUED)

As we can notice in Table 3, the Municipality increased its capital assets in \$9 millions in comparison with prior year financial statements. The main portion of the increase in capital assets was financed through donated assets and capital contributions as shown in Note 9 to the financial statements.

The Municipality has elected to postpone the recognition of the infrastructure capital assets existent prior to the year ended June 30, 2003, according to the provisions the mentioned GASB provides. On or before the year ended June 30, 2007 all those capital assets will be accounted for and included in the Financial Statements.

Long-Term Debt

As of June 30, 2006, the Municipality had \$17.9 millions, in bonds, notes and other outstanding debts as shown in Table 4. The outstanding balance of long-term debts was mainly utilized to finance capital projects, including infrastructure, acquisitions of land and construction projects.

Table 4			
Outstanding Debt	Year Ended	Year Ended	Change
(in Millions)	June 30, 2006	June 30, 2005	Favorable
			(Unfavorable)
Bonds and Note Payable	\$ 15.1	\$ 16.3	\$ 1.2
Other	<u>2.8</u>	<u>1.9</u>	<u>(.9)</u>
Totals	<u>\$17.9</u>	<u>\$18.2</u>	<u>\$.3</u>

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's elected and appointed officials considered many factors when setting the fiscal year 2006 budget. The most significant goal in the next year's budget in comparison with the amounts included for the year ended June 30, 2006, is to continue with the aggressive collection procedure to increase the municipal construction taxes and the city tax implementation, and also with the reduction of the salary expenditures for temporary employees. The purpose of these management decisions is focus to reduce the undesignated deficiency accrued as of June 30, 2006.

We expect to end the operations for the fiscal year on June 30, 2007 with a surplus based on the economies in various budgeted expenditure accounts that the management has identified during the present year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
MANAGEMENT AND DISCUSSION ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2006**

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers and creditors with a general overview of the Municipality's finances and to show the accountability for the money it receives. If you have questions about this report or need additional financial information, contact us at the Municipality of Yauco, PO Box 1, Yauco, Puerto Rico 00698.

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

	ASSETS	<u>PRIMARY GOVERNMENT</u>
Cash and cash equivalents		\$ 255,407
Receivable other agencies		206,598
Other receivable:		
Property tax		2,758,495
Sale taxes		44,314
Other		37,500
Capital assets, net		29,884,039
Restricted assets:		
Cash with fiscal agent		<u>2,582,279</u>
Total Assets		<u>\$35,768,632</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses		\$ 3,743,165
Due to other agencies		4,013,526
Deferred revenue		1,620,150
Non-current liabilities:		
Due within one year		700,195
Due in more than one year		<u>17,209,244</u>
Total Liabilities		<u>27,286,280</u>
Net Assets:		
Invested in capital assets, net of related debt		17,187,422
Restricted for:		
Debt service		1,296,510
Capital projects and other specific purpose		811,846
Unrestricted (Deficit)		<u>(10,813,427)</u>
Total Net Assets		<u>\$ 8,482,351</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2006

<u>FUNCTIONS AND PROGRAMS</u>	<u>EXPENSES</u>	<u>PROGRAMS REVENUES</u>			<u>NET (EXPENSES) REVENUES AND CHANGES IN NET ASSETS</u>
		<u>CHARGE FOR SERVICES</u>	<u>OPERATING GRANTS AND CONTRIBUTIONS</u>	<u>CAPITAL GRANTS AND CONTRIBUTIONS</u>	<u>PRIMARY GOVERNMENT</u>
Primary Government:					
General administration	\$ 7,678,387		\$571,939		\$ (7,106,448)
Public safety	1,879,602				(1,879,602)
Education, culture and recreational	1,360,410		122,330		(1,238,080)
Public works and Sanitation	5,173,811	\$581,508		\$2,458,984	(2,133,319)
Health and welfare	1,687,794		136,307		(1,551,487)
Interest	<u>772,415</u>				<u>(772,415)</u>
Total Expenditures	<u>\$18,552,419</u>	<u>\$581,508</u>	<u>\$830,576</u>	<u>\$2,458,984</u>	<u>\$(14,681,351)</u>
General Revenues:					
Taxes:					
Property taxes					5,263,035
Municipal tax					2,216,258
Grants and entitlements					4,491,999
Donated assets					8,016,007
Licenses and permits					1,067,306
Interest					83,267
Other income					<u>994,555</u>
Total General Revenues					<u>22,132,427</u>
Changes in net assets					<u>7,451,076</u>
Net assets at beginning of the year as period reported					(155,192)
Prior period adjustments					<u>1,186,467</u>
Net asset beginning of year as restated					<u>1,031,275</u>
Net assets at end of the year					<u>\$ 8,482,351</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
BALANCE SHEET
GOVERNMENTAL FUNDS
AS OF JUNE 30, 2006**

	<u>MAJOR FUNDS</u>			<u>TOTAL GOVERNMENTAL FUNDS</u>
	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	
Assets:				
Cash:				
Cash in commercial bank	\$ 17,895		\$ 237,512	\$ 255,407
Cash with fiscal agent		\$1,296,510	1,285,769	2,582,279
Receivables:				
Due from governmental agencies			206,598	206,598
Due from other funds	413,562		561,227	974,789
Property tax	2,251,469	507,026		2,758,495
Sale tax			44,314	44,314
Other	<u>37,500</u>			<u>37,500</u>
Total assets	<u>\$ 2,720,426</u>	<u>\$1,803,536</u>	<u>\$2,335,420</u>	<u>\$6,859,382</u>
Liabilities and other credits				
Liabilities:				
Accounts payable and accrued expenses	\$ 1,545,271		\$1,061,183	\$ 2,606,454
Deferred revenues	3,779,558	\$ 497,077	48,829	4,325,464
Deposits	119,571			119,571
Due to governmental agencies	4,013,526			4,013,526
Due to other fund	<u>561,227</u>		<u>413,562</u>	<u>974,789</u>
Total liabilities	<u>10,019,153</u>	<u>497,077</u>	<u>1,523,574</u>	<u>12,039,804</u>
Fund balance deficiency:				
Reserved for:				
Debt service		1,306,459		1,306,459
State and federal programs			811,846	811,846
Undesignated deficit	<u>(7,298,727)</u>			<u>(7,298,727)</u>
Total fund balance deficiency	<u>(7,298,727)</u>	<u>1,306,459</u>	<u>811,846</u>	<u>(5,180,422)</u>
Total liabilities and fund balance	<u>\$ 2,720,426</u>	<u>\$1,803,536</u>	<u>\$2,335,420</u>	<u>\$ 6,859,382</u>

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

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

Fund Balances in Governmental Funds	\$(5,180,422)
 <i>Amounts reported for Governmental Activities in the Statement of Net Assets are different because:</i>	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	29,884,039
Deferred property tax recorded as revenue in the governmental activities	2,705,314
Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:	
Notes and bonds	(15,142,000)
Accrued interest	(330,957)
Landfill	(101,716)
Capital leave	(60,794)
Accrued vacation	(1,887,021)
Claims and judgements	(686,184)
Intergovernmental payable to ASES	(717,908)
 <i>Net Assets of Governmental Activities</i>	 <u>\$ 8,482,351</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCE-GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2006

	<u>MAJOR FUNDS</u>			
	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
Revenues:				
Taxes:				
Property taxes	\$ 3,925,489	\$1,337,546		\$ 5,263,035
Municipal tax	2,216,258			2,216,258
Sale tax			\$ 544,008	544,008
Grants and entitlements	4,496,017		3,285,542	7,781,559
Rental income	191,832			191,832
Licenses and permits	1,067,306			1,067,306
Solid waste disposal	37,500			37,500
Interest	51,579	31,688		83,267
Other	<u>606,272</u>		<u>196,451</u>	<u>802,723</u>
Total Revenues	<u>12,592,253</u>	<u>1,369,234</u>	<u>4,026,001</u>	<u>17,987,488</u>
Expenditures:				
General administration	5,749,722		1,449,144	7,198,866
Public safety	1,783,425		6,820	1,790,345
Education, culture and recreational	1,121,952		126,858	1,248,810
Public works and sanitation	3,259,803		580,970	3,840,673
Health and welfare	790,148		209,245	999,393
Capital outlays			2,897,850	2,897,850
Debt service:				
Principal		1,118,000		1,118,000
Interest		<u>813,148</u>		<u>813,148</u>
Total Expenditures	<u>12,705,050</u>	<u>1,931,148</u>	<u>5,270,887</u>	<u>19,907,085</u>
Excess (deficiency) of revenues over (under) Expenditures	<u>(112,797)</u>	<u>(561,914)</u>	<u>(1,244,886)</u>	<u>(1,919,597)</u>
Other financing sources (uses):				
Operating transfer in	171,764	460,237		632,001
Operating transfer out	<u>(460,237)</u>	<u>(43,137)</u>	<u>(128,627)</u>	<u>(632,001)</u>
Total other financing sources (uses)	<u>(288,473)</u>	<u>417,100</u>	<u>(128,627)</u>	
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(401,270)	(144,814)	(1,373,513)	(1,919,597)
Fund balance (deficit) at beginning of year	<u>(6,897,457)</u>	<u>1,451,273</u>	<u>2,185,359</u>	<u>(3,260,825)</u>
Fund balance (deficit) at end of year	<u>\$ (7,298,727)</u>	<u>\$1,306,459</u>	<u>\$ 811,846</u>	<u>\$ (5,180,422)</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCE-GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2006**

	<u>MAJOR FUNDS</u>			
	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
Revenues:				
Taxes:				
Property taxes	\$ 3,925,489	\$1,337,546		\$ 5,263,035
Municipal tax	2,216,258			2,216,258
Sale tax			\$ 544,008	544,008
Grants and entitlements	4,496,017		3,285,542	7,781,559
Rental income	191,832			191,832
Licenses and permits	1,067,306			1,067,306
Solid waste disposal	37,500			37,500
Interest	51,579	31,688		83,267
Other	<u>606,272</u>		<u>196,451</u>	<u>802,723</u>
Total Revenues	<u>12,592,253</u>	<u>1,369,234</u>	<u>4,026,001</u>	<u>17,987,488</u>
Expenditures:				
General administration	5,749,722		1,449,144	7,198,866
Public safety	1,783,425		6,820	1,790,345
Education, culture and recreational	1,121,952		126,858	1,248,810
Public works and sanitation	3,259,803		580,970	3,840,673
Health and welfare	790,148		209,245	999,393
Capital outlays			2,897,850	2,897,850
Debt service:				
Principal		1,118,000		1,118,000
Interest		<u>813,148</u>		<u>813,148</u>
Total Expenditures	<u>12,705,050</u>	<u>1,931,148</u>	<u>5,270,887</u>	<u>19,907,085</u>
Excess (deficiency) of revenues over (under) Expenditures	<u>(112,797)</u>	<u>(561,914)</u>	<u>(1,244,886)</u>	<u>(1,919,597)</u>
Other financing sources (uses):				
Operating transfer in	171,764	460,237		632,001
Operating transfer out	<u>(460,237)</u>	<u>(43,137)</u>	<u>(128,627)</u>	<u>(632,001)</u>
Total other financing sources (uses)	<u>(288,473)</u>	<u>417,100</u>	<u>(128,627)</u>	
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(401,270)	(144,814)	(1,373,513)	(1,919,597)
Fund balance (deficit) at beginning of year	<u>(6,897,457)</u>	<u>1,451,273</u>	<u>2,185,359</u>	<u>(3,260,825)</u>
Fund balance (deficit) at end of year	<u>\$ (7,298,727)</u>	<u>\$1,306,459</u>	<u>\$ 811,846</u>	<u>\$ (5,180,422)</u>

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

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

Net change in fund balances – total governmental funds	\$(1,919,597)
<i>Amounts reported for Governmental Activities in the Statement of Activities are different because:</i>	
Governmental funds report capital outlays as expenditures. However, in the statement of activities and changes in net assets, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount of capital assets recorded in the current period.	2,897,850
Donated capital assets recorded in the statement of activities	8,016,007
Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduce the long-term obligation in the statement of activities.	1,118,000
Disposition of fixed asset	(225,793)
Payment of capital leases reported as expenses in the fund financial statements are presented in the statement of net assets as payment of the capital lease.	14,692
Change in accrued expenses which do not require the use of current financial resources:	
Interest	42,321
Compensating absences	(113,026)
Landfill postclosure expenses	(25,429)
Claims and judgements	(686,184)
Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in governmental funds.	<u>(1,667,765)</u>
<i>Changes in Net Assets of Governmental Activities</i>	<u>\$ 7,451,076</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

1. ORGANIZATION

The Municipality of Yauco (the Municipality) was founded on February 29, 1756. The Municipality is a political and legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession, existence and legal personality separate and independent from the governmental of the Commonwealth of Puerto Rico.

The municipal government is comprised of the executive and legislative bodies, which are elected every four years in the Puerto Rico general elections.

The Municipality provides the following services to its community: health, public works, education, public safety, housing, community and social services, welfare, culture and recreation, as well as many other general and administrative services.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Since June 30, 2003, the Municipality implemented GASB Statement No. 34 (GASB 34), Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments; GASB Statement No. 36 (GASB 36), Recipient Reporting for Certain Shared Non exchange Revenues (and amendment of GASB 33); GASB Statement No. 37 (GASB 37), Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus; GASB Statement No. 38 (GASB 38), Certain Financial Statements Disclosures; and GASB Interpretation No. 6, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements.

GASB 34, as amended by GASB 37, establishes new requirements and a new reporting model for the financial statements of state and local governments. GASB 34 was developed to make the financial statements easier to understand and more useful to the people who use governmental financial information to make decisions and includes:

Management's Discussion and Analysis - GASB 34 requires the financial statements be accompanied by a narrative introduction and analytical overview of the government's financial activities in the form of management's discussion and analysis (MD&A).

Government - Wide Financial Statements - The new reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REPORTING ENTITY

The Municipality's financial statements include all governmental funds relevant to the operations of the Municipality of Yauco. The Municipality receives funding from local, state and federal government sources and must comply with the requirements of these entities. However, the Municipality is not included in any other governmental "reporting entity" as defined by the GASB pronouncements, since the Mayor and the Members of the Municipal Legislative Body are elected by the citizens of the Municipality and have decision making authority.

GOVERNMENT WIDE AND FUND FINANCIAL STATEMENTS

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities which normally are supported mainly by taxes and intergovernmental revenues are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Municipality reports the following major governmental funds:

1) General Fund

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

2) Debt Service Fund

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

MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION

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

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION (CONTINUED)

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

Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private -sector guidance.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

CASH, CASH EQUIVALENTS, AND CASH WITH FISCAL AGENT

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts and certificates of deposit with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB). The Municipality's policy is to invest any excess of cash in interest bearing deposits with institutions qualified by the PRTD. Earnings from these funds are recorded in the corresponding fund as interest income.

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

The Municipality considers all investments with an original maturity of three months or less to be cash equivalents.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INTERFUND RECEIVABLES AND PAYABLES

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

CAPITAL ASSETS

Capital assets, which include property, plant, equipment, and infrastructure (which is normally immovable and of value only to the Municipality, such as roads, bridges, streets sidewalks, and drainage system), are reported in the applicable governmental columns in the government-wide financial statements.

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. When historical cost is not available it is estimated using historic sales of the year of the acquisition of the related capital assets.

Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Buildings and building improvements	20-50 years
Land improvements	15-30 years
Machinery and equipment	5-20 years
Infrastructure	5-30 years

The Municipality decides when to capitalize an asset using the following capitalization thresholds amounts:

<u>Type of Asset</u>	<u>Threshold Amount</u>
Land/land improvements	Capitalized All
Buildings/buildings improvements	\$50,000.00
Other improvements	\$25,000.00
Equipment	\$ 2,000.00
Library books (collections)	Capitalized All
Works of Arts	Capitalized All
Leasehold improvements	\$10,000.00
Vehicles and Machinery	Capitalized All

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Municipality has elected to postpone the recognition of the infrastructure capital assets existent prior to the year ended June 30, 2003, the year of the GASB 34 implementation, according to the provisions the mentioned GASB provides. On or before the year ended June 30, 2007 all those capital assets will be accounted for and included in the financial statements.

RESERVATION OF FUND BALANCE

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

A) Debt Service

Represents net assets available to finance future debt service payments.

B) State and Federal Programs

Represent the reservations of amounts available for specific use under state and federal grant programs.

RISK FINANCING

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2006 amounted to approximately \$276,213. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$298,655 for workers compensation insurance covering all municipal employees.

COMPENSATED ABSENCES

Employees accumulate vacation leave at a rate of 2.5 days per month up to maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. In the event of employee resignation, the employee is paid for accumulated vacations days up to the maximum allowed.

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum 90 days. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years or more of service who are entitled to sick leave pay up to the maximum allowed.

Employees' maximum allowed vacations and vested sick benefits are accounted for in the Statement of Net Assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

USE OF ESTIMATES

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

3. DEPOSITS AND INVESTMENTS

Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$.3 million in other governmental funds were fully collateralized at June 30, 2006. The deposits at GDB of approximately \$1.3 million that are restricted principally for capital projects, and the \$1.3 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

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

4. PROPERTY TAX

The personal property tax is self assessed by the taxpayer on a return, which is to be filed by May 15 of each year with the Municipal Revenue Collector Center (the CRIM), a governmental entity created by the Commonwealth of Puerto Rico. Real property tax is assessed by the CRIM on each piece of real state and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1.

The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Before the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, where by a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

4. PROPERTY TAX (CONTINUED)

This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a liability to the CRIM is recorded at June 30.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempt amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$3,500 for which no payment is made. As part of Law No. 83 of August 30, 1991, as amended, the exempt amount to be paid by Puerto Rico Treasury Department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$50,000 of the assessed value to retailers having annual net sales of less than \$150,000.

The annual rate for fiscal year 2006 is 9.03% for real property and 7.03% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The Commonwealth also contributes an annual tax rate of 0.2% of the property tax collected. The remaining percentage is distributed as follows: (a) 6.0% and 4.0%, respectively, represent the Municipality's basic property tax rate, which is appropriated for general purposes and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico Electronic Lottery and subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 2.00% represents the special ad valorem tax restricted for debt service and accounted for in the debt service fund.

5. VOLUME OF BUSINESS TAX

The municipal license tax is levied annually based on the volume of business of certain businesses and industrial organizations that operate in the Municipality. The tax rates are 1.50% for financing institutions and .50% for the other business institutions. The taxpayers must file a return not later than April 15 of every year and the tax is payable in two installments, due in July 1st and January 1st of the following fiscal year. The amount levied could be paid with a five percent (5%) discount if payment is made on or before the filing date. The Municipality levied and collected during the year ended June 30, 2006, \$1,571,321 corresponding to the following fiscal year volume of business tax. This amount was recorded as deferred revenue, and is presented as a liability in the accompanying combined balance sheets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

6. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues sources consist of contributions received from certain quasi-public corporations of the Commonwealth of Puerto Rico, such as the Puerto Rico Aqueduct and Sewer Authority and the Puerto Rico Electric Power Authority. Also, the Municipality receives some subsidies from the Commonwealth of Puerto Rico which include, among others, a subsidy for general operations and for the financing of capital improvements. The intergovernmental revenues are recorded in the General fund, except for those that are legally restricted for expenditure for specified purposes which are recorded in the Other Governmental Funds.

7. DEFERRED REVENUE

Municipal and Property Tax

Deferred revenues amounting to \$1,571,321 in the general fund related to the municipal license tax collected in the fiscal year 2005-2006 that will be earned in fiscal year 2006-2007 and \$2,758,494 related to property taxes receivable that were not available to pay current liabilities.

Federal Government

The deferred revenues of \$48,829 in other governmental funds is the portion of federal grants received for which qualifying expenditures have not been incurred.

8. COMMITMENTS AND CONTINGENCIES

At June 30, 2006, the Municipality is a defendant and/or codefendant in several litigations arising out of the normal Municipality's operations. Most of the cases are covered by insurance. Management, after consultation with legal counsel, is of the opinion that the ultimate liability, in excess of insurance coverage, if any, resulting from such pending litigations would not be material in relation to the financial position of the Municipality.

Amounts received or receivable from grantor agencies are subject to audit and adjustment by grantor agencies. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of the expenditures which may be disallowed by the grantor cannot be determined at this time, although the Municipality expects such amounts, if any, to be immaterial.

With respect to pending and thereafter litigation, the Municipality has reported a liabilities of \$686,184 at June 30, 2006, for anticipated unfavorable judgments. This amount was included the financial statements and represents the amount estimated as probable liabilities, which will require future available financial resources for its payments.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

9. CAPITAL ASSETS

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

<u>Primary government</u>	<u>Balance June 30, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2006</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 872,472	\$ 17,733		\$ 890,205
Work of art	<u>150,000</u>	<u>6,000</u>		<u>156,000</u>
Total capital assets , not being depreciated	<u>1,022,472</u>	<u>23,733</u>		<u>1,046,205</u>
Capital assets being depreciated:				
Land improvements	800,308			800,308
Buildings and building improvements	7,702,148	358,213		8,060,361
Machinery and equipment	5,816,964		\$900,266	4,916,698
Infrastructure	<u>11,465,342</u>	<u>10,531,911</u>		<u>21,997,253</u>
Total capital assets being depreciated	<u>25,784,762</u>	<u>10,890,124</u>	<u>900,266</u>	<u>35,774,620</u>
Less accumulated depreciation for:				
Land improvements	529,987	8,733		538,720
Buildings and building improvements	1,617,776	143,650		1,761,426
Machinery and equipments	2,695,294	339,326	674,473	2,360,147
Infrastructure	<u>1,100,437</u>	<u>1,176,056</u>		<u>2,276,493</u>
Total accumulated depreciation	<u>5,943,494</u>	<u>1,667,765</u>	<u>674,473</u>	<u>6,936,786</u>
Total capital assets being depreciated, net	<u>19,841,268</u>	<u>9,222,359</u>	<u>225,793</u>	<u>28,837,834</u>
Governmental activities capital assets, net	<u>\$20,863,740</u>	<u>\$ 9,246,092</u>	<u>\$225,793</u>	<u>\$29,884,039</u>

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

General administration	\$ 156,982
Public safety	89,257
Public works	1,307,709
Education, culture and recreation	111,600
Health and welfare	<u>2,217</u>
Total depreciation expense	<u>\$1,667,765</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

10. GENERAL LONG-TERM DEBT

Long-term liability activity for the year ended June 30, 2006 was as follows:

Primary Government Governmental Activities	Beginning Balance	Additions	Reductions	Ending Balance	Due within one year
Bonds and note payable	\$16,260,000		\$1,118,000	\$15,142,000	\$681,000
Capital leases	75,486		14,692	60,794	19,195
Accrued vacation	1,773,995	\$113,026		1,887,021	
Amount due to PR Health Insurance Administration	717,908			717,908	
Accrued for landfill postclosure expense	<u>76,287</u>	<u>25,429</u>		<u>101,716</u>	
Total Non-Current Liabilities	<u>\$18,903,676</u>	<u>\$138,455</u>	<u>\$1,132,692</u>	<u>\$17,909,439</u>	<u>\$700,195</u>

A. Bonds and notes payable:

1984 - \$171,000 due in two annual principal installments of \$11,000 and \$12,000 through January 1, 2008, plus interest at 5%.	\$ 23,000
1996 - \$4,585,000 due in annual principal installments ranging from \$215,000 to \$345,000 through July 1, 2015, plus interest ranging from 4.70% to 6.58%.	3,140,000
2002 - \$2,015,000 due in annual principal installments ranging from \$40,000 to \$165,000 through July 1, 2026, plus interest at 7%.	1,875,000
2003 - \$1,385,000 due in annual principal installments ranging from \$30,000 to \$105,000 through July 1, 2027, plus interest at 5%.	1,315,000
2003 - \$1,005,000 due in annual principal installments ranging from \$20,000 to \$75,000 through July 1, 2029, plus interest at 6%.	945,000
2004 - \$975,000 due in annual principal installments ranging from \$90,000 to \$120,000 through July 1, 2013, plus interest at 5%.	735,000
2004 - \$495,000 due in annual principal installments ranging from \$10,000 to \$35,000 through July 1, 2028, plus interest at 5%.	475,000
2006 - \$615,000 due in annual principal installments ranging from \$30,000 to \$60,000 through July 1, 2029, plus interest at 1.25% over LIBOR rate.	585,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

10. GENERAL LONG-TERM DEBT (CONTINUED)

A. Bonds and notes payable: (continued)

2006 - \$185,000 due in annual principal installments ranging from \$15,000 to \$25,000 through July 1, 2014, plus interest at 1.25% over LIBOR rate.	\$ 170,000
\$2,900,000 special obligations from 1986, due in an annual installment of \$138,000 on July 1, 2007, plus interest at variable rates estimated at 8.50%.	138,000
\$857,000 general obligation note of 1999, due in annual principal installments ranging from \$20,000 to \$57,000 through January 1, 2029 plus interest at 4.75%	819,000
\$670,000 general obligation note of 2004, due in annual principal installments ranging from \$15,000 to \$50,000 through January 1, 2027 plus interest at 6.50%.	625,000
\$505,000 general obligation note of 2002, due in annual principal installments ranging from \$70,000 to \$90,000 through July 1, 2009 plus interest at 6.50%.	315,000
\$730,000 general obligation note of 2002, due in annual principal installments ranging from \$15,000 to \$55,000 through July 1, 2027 plus interest at 6.50%.	690,000
\$1,000,000 general obligation note of 2004, due in annual principal installments ranging from \$20,000 to \$75,000 through July 1, 2027 plus interest at 6.50%.	940,000
\$240,000 general obligation note of 2004, due in annual principal installments ranging from \$30,000 to \$40,000 through July 1, 2010 plus interest at 6.00%	150,000
\$410,000 general obligation note of 2004, due in annual principal installments ranging from \$10,000 to \$30,000 through July 1, 2028 plus interest at 5.50%	390,000
\$376,000 general obligation note due in annual principal installments ranging from \$9,000 to \$24,000 through January 1, 2030, plus interest at 4.25%	367,000
\$1,191,000 general obligation note due in annual principal installments ranging from \$28,000 to \$69,000 through January 1, 2029 plus interest at 4.25%	1,040,000
\$130,000 general obligation note due in annual principal installments ranging from \$15,000 to \$20,000 through July 1, 2011 plus interest at 1.25% over LIBOR rate.	115,000
\$85,000 general obligation note due in annual principal installments ranging from \$5,000 to \$15,000 through July 1, 2019 plus interest at 1.25% over LIBOR rate.	80,000
\$215,000 special obligation note due in annual principal installments ranging from \$10,000 to \$25,000 through July 1, 2020 plus interest at 1.25% over LIBOR rate.	<u>210,000</u>
Total bonds and note payable	<u>\$15,142,000</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

10. GENERAL LONG-TERM DEBT (CONTINUED)

The annual debt service requirements to maturity notes and bonds payable as of June 30, 2006 are as follows:

<u>Bonds Payable</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 681,000	\$ 710,440
2008	761,000	823,893
2009	787,000	779,209
2010	844,000	732,120
2011	804,000	684,796
2012-2016	4,257,000	2,686,407
2017-2021	2,520,000	1,679,442
2022-2023	2,917,000	899,785
2027-2030	<u>1,571,000</u>	<u>116,944</u>
	<u>\$15,142,000</u>	<u>\$9,113,036</u>

C. Capital lease

The Municipality is obligated under a capital lease with a third party that expires in 2010 for the acquisition of office equipment. At June 30, 2006, the capitalized costs and the related accumulated amortization of the leased equipment amounted to \$83,533 and \$26,453 respectively, which are accounted for as capital assets in the accompanying government-wide statement of net assets. The present value of the future minimum capital lease payments at June 30, 2006 reported in the accompanying government-wide statement of net assets is as follows:

<u>Year ending</u> <u>June 30</u>	<u>Amount</u>
2007	\$20,720
2008	17,760
2009	17,760
2010	<u>7,400</u>
 Total future minimum lease payments	 63,640
Less amount representing interest	<u>2,846</u>
Present value of capital lease obligations	<u>\$60,794</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

10. GENERAL LONG-TERM DEBT (CONTINUED)

D. Amount due to PR Health Insurance Administration:

The amount due to the Puerto Rico Health Insurance Administration is related with a unpaid balance from year ended at June 30, 1997 accordingly with the implementation of Act No. 72 of September 7, 1993, which establishes contributions for the medical services covered by the Health Reform based on the operational budget of the municipalities. The unpaid balance will be amortized through the proportional participation of the municipalities to the annual increase in electronic lottery income which will be collected and withheld by the Treasury Department of Puerto Rico.

11. RETIREMENT SYSTEM

DEFINED BENEFIT PENSION PLAN

The Employees' Retirement System of the Commonwealth and its instrumentalities (the "Retirement System"), created pursuant to Act. No. 447 of May 15, 1951, as amended, is a cost-sharing multiple employer defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth. All regular employees of the Municipality hired before January 1, 2000 and under 55 years of age at the date of employment became members of the Retirement System as a condition to their employment. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation. Disability benefits are available to members for occupational and non-occupational disabilities. However, a member must have at least ten years of service to receive non-occupational disability benefits.

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

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined, otherwise they will receive 75 percent of the average compensation, as defined.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

11. RETIREMENT SYSTEM (CONTINUED)

DEFINED CONTRIBUTION PLAN

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary.

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447 to establish, among other, a defined contribution savings plan program (the "Program") to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000 and former employees who participated in the defined benefit pension plan, and are rehired on or after January 1, 2000 become members of a Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the defined pension plan, had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interest thereon to the Program received a refund of their contributions.

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to his/her individual account established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant's account semi-annually.

The Municipality is required by Act No. 305 to contribute 9.275% of the participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan.

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant's spouse in case of the participant's death. Participants with a balance of \$10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in the participant's account will be paid in a lump-sum to his/her beneficiaries. Participants have the option of a lump-sum or purchasing an annuity contract in case of permanent disability.

Employees and employer were required to contribute to the above mentioned plans during the year ended June 30, 2006 approximately \$310,055 and \$281,529, respectively. As of June 30, 2006, the Municipality due to the plans \$608,794 of the required contributions.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2006, a copy of which can be obtained from the Retirement System.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

12. CLOSURE AND POSTCLOSURE CARE COSTS

State and federal laws and regulations require that the Municipality of Yauco place a final cover on its landfill when closed and perform certain maintenance and monitoring functions at the landfill site for thirty years after closure. In addition to operating expenses related to current activities of the landfill, an expense provision and related liability are being recognized based on the future closure and postclosure care costs that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and postclosure care costs is based on the amount of the landfill used during the year. The estimated liability for landfill closure and postclosure care costs has a balance of \$101,716 as of June 30, 2006, which is based on 3% usage (filled) of the landfill. It is estimated that an additional \$813,937 will be recognized as closure and postclosure care expenses between the date of the balance sheet and the date the landfill is expected to be filled to capacity (2050). The estimated total current cost of the landfill closure and postclosure care (\$890,224) is based on the amount that would be paid if all equipment, facilities, and services required to close, monitor, and maintain the landfill were acquired as of June 30, 2006. However, the actual cost of closure and postclosure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations.

The Municipality of Yauco issued the ordinance 89, series 2001-02 to make annual contributions from general fund budget to finance closure and postclosure care. The remaining portion of anticipated future inflation costs and additional costs that might arise from changes in postclosure requirements (due to changes in technology or more rigorous environmental regulations, for example) may need to be covered by charges to future landfill users, taxpayers, or both.

13. RESTATEMENT OF FUND BALANCE

The fund balance of governmental activities as presented in 2006 statement of net assets has been adjusted because a deferred revenue and property taxes receivable were recorded. The corrections has no effect on the results of current year's activities, however, the cumulative effect increase the beginning fund balance by \$1,138,048.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
SCHEDULE OF BUDGETARY COMPARISON
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2006**

	<u>ORIGINAL BUDGET</u>	<u>FINAL BUDGET</u>	<u>ACTUAL AMOUNT AT BUDGETARY BASIS</u>	<u>VARIANCE WITH FINAL BUDGET POSITIVE (NEGATIVE)</u>
Revenues:				
Taxes:				
Property taxes	\$ 3,882,257	\$ 3,882,257	\$ 3,925,489	\$ 43,232
Municipal tax	2,291,195	2,191,195	2,216,258	25,063
Grants and entitlements	4,855,094	4,855,094	4,496,017	(359,077)
Rental income	225,000	110,000	191,832	81,832
Licenses and permits	1,252,418	941,960	1,067,306	125,346
Solid waste disposal	195,000	95,000	37,500	(57,500)
Interest	120,000	82,000	94,716	(12,716)
Other	<u>829,389</u>	<u>619,770</u>	<u>734,899</u>	<u>(115,129)</u>
Total Revenues	<u>13,650,353</u>	<u>12,777,276</u>	<u>12,764,017</u>	<u>(13,259)</u>
Expenditures:				
General administration	6,526,958	6,719,480	5,749,722	969,758
Public safety	2,290,597	1,755,414	1,783,425	(28,011)
Education, culture and recreational	1,113,545	1,002,499	1,121,952	(119,453)
Public works and sanitation	2,480,913	2,061,543	3,259,803	(1,198,260)
Health and welfare	790,070	790,070	790,148	(78)
Debt service	<u>448,270</u>	<u>448,270</u>	<u>460,237</u>	<u>(11,967)</u>
Total Expenditures	<u>13,650,353</u>	<u>12,777,276</u>	<u>13,165,287</u>	<u>(388,011)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>\$ _____</u>	<u>\$ _____</u>	<u>\$ (401,270)</u>	<u>\$ (401,270)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO SCHEDULE OF BUDGETARY COMPARISSON
JUNE 30, 2006

1. BUDGETS AND BUDGETARY ACCOUNTING

The Municipality follows these procedures in establishing the budgetary data reflected in the financial statements:

- A) Formal budgetary integration is employed as a management control device during the year for the General Fund. Formal budgetary integration is not employed for special revenue funds because effective budgetary control is alternatively achieved through legal and contractual grant requirements provisions.
- B) On or before May 15, the Mayor submits to the Municipal Legislative Body a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means for financing them.
- C) Public hearing are conducted at the Municipal Legislative Body to obtain citizens comments.
- D) Prior to June 13, the budget is legally enacted through passage of an ordinance.
- E) The Municipal Legislative Body approves, by ordinance budget appropriations by functional basis. The Mayor is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total appropriations of any fund must be approved by the Municipal Legislative Body.
- F) Unused appropriations for the annual budgeted funds lapse at the end of the year.

The budget is prepared on the budgetary basis of accounting. The actual results of operations, presented in the Statement of Revenues and Expenditures – Budget and Actual General Fund, is in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO SCHEDULE OF BUDGETARY COMPARISSON (CONTINUED)
JUNE 30, 2006**

2. RECONCILIATION OF GAAP TO BUDGETARY BASIS

Adjustments necessary to reconcile the revenues and expenditures of the general fund at the end of the year, from the generally accepted accounting principles to budgetary basis, are as follows:

	<u>REVENUES</u>	<u>EXPENDITORES</u>
Generally accepted accounting principles (GAAP) basis	\$12,592,253	\$12,705,050
Transfer in concluded as revenues/expense in budgetary basis	<u>171,764</u>	<u>460,237</u>
Budgetary basis	<u>\$12,764,017</u>	<u>\$13,165,287</u>

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

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

	<u>NUMBER</u>	<u>EXPENDITURES</u>
<u>US Department of Housing and Urban Development</u>		
Passed through:		
Municipal Service Administration:		
Community Development Block Grant/ State Program	14.228	\$ 186,166
Direct programs:		
Section 8- Housing Choice Vouchers	14.871	101,415
Community Development Block Grant/ Entitlement Grant	14.118	1,322,549
<u>US Department of Health and Human Services</u>		
Passes through:		
PR Department of Family:		
Child Care and Development Block Grant	93.575	128,800
<u>US Department of Agriculture</u>		
Direct program:		
Water and Waste Disposal Systems for Rural Communities	10.760	1,297,982
Passes through:		
Puerto Rico Department of Education Child and and Adult Food Program	10.558	16,484
<u>US Department of Home and Security</u>		
Passes through:		
PR Office of Management and Budget (GAR)		
Public Assistance Grant	97.036	429,741
PR Department Of Justice		
Emergency Management Performance Grant	97.042	3,363
<u>US Department of Justice</u>		
Direct program:		
Public Safety Partnership and Community Policing Grant	16.710	468
Passed through:		
Edward Byne Memorial		
State and Local Law Enforcement Assistance Discretionary Program	16.580	<u>13,236</u>
		<u>\$3,500,204</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF YAUCO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2006

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Yauco and is presented on the cash basis of accounting. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, Audit 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 financial statements.

**REPORT ON INTERNAL
CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENT PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARD**

**To the Honorable Mayor and
Municipal Legislative Body
Municipality of Yauco
Yauco, Puerto Rico**

I have audited the financial statements of governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the **Municipality of Yauco, Puerto Rico**, as of and for the year ended June 30, 2006 which collectively comprise the Municipality of Yauco's basic financial statements and have issued my report there on dated November 15, 2006. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Municipality of Yauco's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing my opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, I noted certain matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect Municipality of Yauco's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 01-06 to 03-06.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, I believe none of the reportable conditions described above is a material weakness.

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL (CONTINUED):

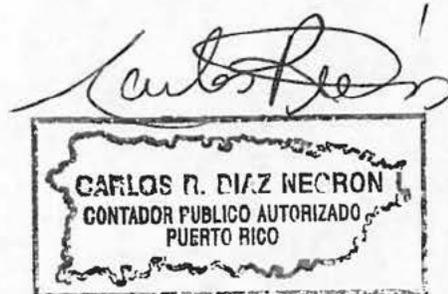
Compliance

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

This report is intended solely for the information and use of the management and the Municipal Legislative Body of Municipality of Yauco, federal awarding agencies and passed through-entities and is not intended to be and should not be used by anyone other than these specified parties.

November 15, 2006
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2007



The stamp No. 2204038 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

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

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

**To the Honorable Mayor and
Municipal Legislative Body
Municipality of Yauco
Yauco, Puerto Rico**

Compliance

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

I conducted my 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 State and Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that I plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Municipality of Yauco, Puerto Rico's compliance with those requirements and performing such other procedures as we considered necessary in the circumstance. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination on Municipality of Yauco, Puerto Rico's compliance with those requirements.

As described in item 04-06, in the accompanying schedule of findings and questioned cost, the Municipality of Yauco did not comply with the requirement regarding Special Tests and Provisions that is applicable to its Community Development Block Grant/ Entitlement Grant Program. Compliance with such requirement is necessary in our opinion, for Municipality of Yauco to comply with the requirements applicable to that program.

REPORT ON COMPLIANCE WITH REQUIREMENT APPLICABLE (CONTINUED):

In my opinion, except for the non compliance described in the preceding paragraph, Municipality of Yauco, Puerto Rico, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal program for the year ended June 30, 2006.

Internal Control Over Compliance

The management of Municipality of Yauco, Puerto Rico 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 my audit, I considered the Municipality of Yauco, Puerto Rico's internal control over compliance with requirement that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

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

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

November 15, 2006
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2007




CARLOS R. DIAZ NECRON
CONTADOR PUBLICO AUTORIZADO
PUERTO RICO

The stamp No. 2204039 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

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

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

SECTION I. - SUMMARY OF AUDITOR'S RESULTS

FINANCIAL STATEMENTS

Type of auditor's report issued

Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? __yes X no
- Reportable condition(s) identified that are not considered to be material weaknesses? X yes __no

Noncompliance material to financial statement noted? __yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? __yes X no
- Reportable condition(s) identified that are not considered to be material weakness(es) X yes __no

Type of auditor's report issued on compliance for major programs

Unqualified

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

X yes __no

Identification of major programs:

CFA Number(s)

Name of Federal Program Cluster

10.760

Water and waste disposal systems for Rural Communities

14.218

Community Development Block Grant Entitlement Grant

Dollar threshold used to distinguish between type A And type B programs:

\$300,000

Audit qualified as low-risk audited?

X yes __no

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

SECTION II. - FINANCIAL STATEMENT FINDINGS

Finding No. 01-06 - General Fund Deficit:

As of June 30, 2006 the Municipality closed with an accumulated deficit of \$7,298,727 in the general fund as presented in the statement of revenue, expenditures and changes in fund balance- governmental funds. This is the eight consecutive year that the Municipality closed its operations reporting deficit. The deficit has increase since fiscal year ended June 30, 1998 as follow.

<u>Year ended</u> <u>June 30</u>	<u>Amount</u>	<u>Increase</u>
1998	\$ 175,999	\$ 175,999
1999	366,626	190,627
2000	638,134	271,508
2001	757,675	119,541
2002	1,789,765	1,032,090
2003	3,275,649	1,485,884
2004	4,489,845	1,214,196
2005	6,897,457	2,407,612
2006	7,298,727	401,270

The deficit is caused by the overstatement of the estimated revenues and/or the incurrence of obligations without credit available in the budgetary accounts.

The Article 7.011(a) of Autonomous Municipal Act (Law 81), as amended, stay that if the Municipal closes its operations on deficit it must provide for sufficient resources to cover it during the next fiscal year.

Section 3 of the Revised Regulation over Basic Standards for Municipalities of Puerto Rico (The Regulation) states that it must be special care to prepare the revenues estimates so these do not results in budget appropriations in excess of available resources.

We recommend that the Municipality take the necessary measures to reduce the accumulated deficit.

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

SECTION II. - FINANCIAL STATEMENT FINDINGS (CONTINUED)

Finding No. 02-06 - Accounting and Reporting System:

The Municipality of Yauco has not established the accounting procedures, controls and records necessary to provide accurate information to prepare the financial statements and federal reports in conformity with generally accepted accounting principles and the related grand agreements.

The following conditions were noted:

- A. At present transactions are accounted through manual and computerized accounting systems. However, no reconciliation has been made between these two systems. The balance sheet accounts in the computerized system are not reconciled and adjusted making the system unable to produce reliable financial statements.
- The manual accounting system does not provide for a self balancing set of accounts for each fund including assets, liabilities and residual fund balances, and changes there in.
 - The accounting records do not provide for segregation between expenditures incurred and encumbered. However, at year end the fund balance that should be reserved for encumbrances is not considered to have a material effect on the financial statement.
 - There are no adequate accounting controls over property and no accurate records are kept for property and equipment.
 - Certain accounting information kept in various accounting records was also provided by other records or reports, resulting in extra work load to accounting personnel.
 - The Department of Federal Funds keeps a separated manual system of accounting for the programs that they managed. This accounting is not incorporated in the main manual accounting system or in the computerized accounting system. The accounting records and the financial reporting is not being monitored by the Finance Department, therefore, such accounting is not being reconciled with the Municipality accounting records.

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

SECTION II. - FINANCIAL STATEMENT FINDINGS (CONTINUED)

Finding No. 03-06 - Municipal Solid Waste Landfill GASB 18

The estimated liability and the related disclosure presented in the financial statement related to costs of closure and postclosure of the Municipal solid waste landfill is not based on actual engineering studies. Therefore, we were unable to obtain a reliable base on which those estimates were based. Management believe that the effect in the June 30, 2006 financial statements is not be material. However, as years going by the accrual will be material and the amount must be based on reliable sources.

We recommend to perform the engineering studies to determine the factors necessary to calculate the amount to be accrued for cost closure and postclosure care. These costs include the following:

- The cost of equipment expected to be installed and facilities expected to be constructed near or after the date the landfill stops accepting waste and during the postclosure period. Such equipment might include gas monitoring and collection systems, storm water management systems, and groundwater monitoring wells.
- The cost of final cover (i.e., capping) expected to be applied near or after the closure date.
- The cost of monitoring and maintaining the expected usable landfill area during the postclosure period.

The amount to be accrued each period should be determined using a depletion approach and should be based on the percentage of capacity used during the period.

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

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

Finding No. 04-06 – Special Tests and Provisions

Federal Program

CFDA – 14-218 – Community Development Block Grant/Entitlement Grants

Compliance requirement:

Special test and Provisions Rehabilitation

Category:

Compliance

Condition:

As part of our audit procedures we tested 25 participans of the rehabilitation program. In 11 of the 25 files examined intermediate inspections, nor final inspections were performed.

Criteria:

24 CFR section 570.506 establishes that CDBG funds are used for rehabilitation, the gantee must assure that the work is properly complete.

Effect:

The Municipality could be exposed to administrative action by the grantor.

Questioned cost:

None

Recommendation:

I recommend the Municipality to establish an adequate intenal control system to ascertain that comply with the requirements of the program.

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF YAUCO

EXHIBIT - I

STATUS OF PRIOR YEAR AUDIT FINDINGS

AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2006



ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL DE YAUCO
APARTADO 1
OFICINA DEL ALCALDE
YAUCO, PUERTO RICO 00698
TELÉFONO (787) 856-1345



Abel Nazario Quiñones
Alcalde

January 9, 2007

Status of Prior Year Ended June 30, 2005

Finding No. 01-05 – General Fund Deficit

We will continue taking all of the necessary measurements so that we can reduce the accumulated deficit.

Finding No. 02-05 – Accounting and Reporting System

We will continue our effort to correct these deficiencies.

Finding No. 03-05 – Municipal Solid Waste Landfill GASB 18

The Municipality in coordination with the private business will be taken in consideration all the recommendations and improve the deficiencies that it had before.

If you have questions about this plan, please called at (787) 856-1345.

Sincerely yours,

Hon. Abel Nazario Quiñones
Yauco City Mayor

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF YAUCO

EXHIBIT - II

CORRECTIVE ACTION PLAN

FOR THE YEAR ENDED JUNE 30, 2006

March 5, 2007

Corrective Action Plan

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

Name and address of independent public accounting firm:

CARLOS R. DIAZ NEGRON
Certified Public Accountants
P.O. Box 408
Rafael Lasa No. 44
Aguas Buenas, P.R. 00703

Audit. Period: Year ended June 30, 2006
Yauco City Mayor: Hon Abel Nazario Quiñones
Person Design: Magaly Rodríguez Caraballo
Internal Auditor
Number of contact: (787) 856-3566 ext. 253

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

ANSWERS FINDING AND QUESTION COST FOR THE YEAR ENDED JUNE 30, 2006

Finding No. 01-06 – General Fund Deficit:

We will continue taking all of the necessary measurements so that we can reduce the decrease budget of our city.

Finding No. 02-06 – Accounting and Reporting System:

We will continue our effort to correct these deficiencies.

Finding No. 03-06 – Municipal Solid Waste Landfill GASB 18:

The Municipality in coordination with the private business will be taken in consideration all the recommendations; however the signed contract is clear as to the responsibility of the private business and the Municipality in relation of the creation of the fund.

Finding No. 04-06 – Special Tests and Provisions:

The load of cases is very high and the rate of the construction process is slow and require greater amount of time for the final inspection. In many cases we provided assistance in phases and we have to inspect them and take pictures one by one and we have had over two thousand five hundred (2,500) rehabilitation cases in the last three (3) years. The auditor should have concentrated specifically in the chosen cases and verified them personally and this way would see that in effect we complied one hundred percent (100%) with those cases. However, we gave instructions to the Director of Federal Funds to accelerate the process of the performance of intermediate and final inspection of the rehabilitation program and assure that the works are properly done, and integrate the information in the participants files.

If you have any questions about this plan please communicate with us.

Sincerely yours,

Hon. Abel Nazario Quiñones
Yauco City Mayor