

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

**MUNICIPIO DE YAUCO**  
**AUDITORIA 2006-2007**  
**30 DE JUNIO DE 2007**

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**FINANCIAL STATEMENT**  
**FOR THE YEAR ENDED JUNE 30, 2007**

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

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

## 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** (the Municipality) as of and for the year ended June 30, 2007 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; the standards applicable to financial audits contained in Government Audit Standards, issued by the Comptroller General of the United States. 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, 2007, 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.

## INDEPENDENT AUDITOR'S REPORT (CONTINUED):

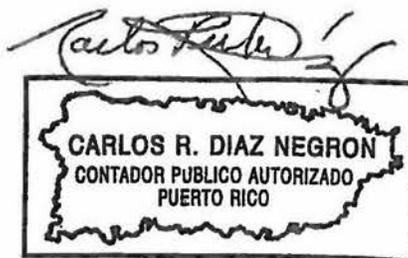
In accordance with Government Auditing Standards, I have also issued my report date October 26, 2007 on my consideration of **Municipality of Yauco**' internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulation, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion of 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 important for assessing the results of my audit.

The management's discussion and analysis and budgetary comparison information on pages 3 through 9 and 35 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 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. Such information has been subjected to the auditing procedures applies in the audit of the basic financial statements and, in my opinion, is fairly stated, in all material respects, in relations to the basic financial statements taken as a whole.

October 26, 2007  
Aguas Buenas, Puerto Rico

License No. 1339  
Expire December 1, 2007



The stamp No. 2297330 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'S DISCUSSION AND ANALYSIS (UNAUDITED)  
FOR THE YEAR ENDED JUNE 30, 2007**

**MANAGEMENT AND DISCUSSION ANALYSIS**

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, 2007. Please read it in conjunction with the financial statements, which begin on page 10.

**FINANCIAL HIGHLIGHTS**

- The Net Investment in Capital Assets reflected in the Statement of Net Assets increased by \$5.1 millions in comparison with the prior year financial statements. The increase in capital assets came up mainly from capital projects developed by the Municipality and donated land lots received by the Municipality for recreational and sport purposes.
- A construction loan for \$4.1 millions was obtained from the Government Development Bank for the construction of a project consisting of 70 low-income housing units. There is a need of residential units for very low and low families that are safe, decent and affordable. Because the National Poverty Level evidences that Puerto Rico has three times more poverty rate than the national rate over any State in the United States, the Municipality is committed to alleviate the disadvantaged living conditions among the citizens of Yauco. This project is in the initial stage of permits and drawings. A cash balance for 3.9 millions and an interim note payable for \$4.1 are included in the Statement of Net Assets as of June 30, 2007.
- The Statement of Activities shows a favorable change in net assets by \$4 millions, when we compared the current with the former year, including a favorable result of operations for 1.9 millions and a prior period adjustment for donated capital assets amounted to \$2.1 millions.
- The Municipality ended its operations as of June 30, 2007, as reflected in the General Fund of the Statement of Revenues, Expenditures and Changes in Fund Balance with a deficit of \$131,613, in comparison with a deficit of \$401,270 in the prior year. 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 reduced its controllable costs for purposes of matching its operational expenditures with the reality its revenues. 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'S DISCUSSION AND ANALYSIS (UNAUDITED)**  
**FOR THE YEAR ENDED JUNE 30, 2007**

**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 public safety (the municipal police), public works, garbage disposal, public energy and health services, education, culture and recreation, and general administration. Property taxes, sale 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 16 of this report.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
FOR THE YEAR ENDED JUNE 30, 2007**

**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, 2007 and 2006:

<b>Table 1</b>		<b>Year Ended</b>	<b>Year Ended</b>	<b>Net Change</b>
<b>Statement in Net Assets</b>		<b>June 30, 2007</b>	<b>June 30, 2006</b>	<b>Favorable</b>
<b>(In Millions)</b>			<b>(As restated)</b>	<b>(Unfavorable)</b>
Cash and other current assets			\$ .2	\$ (.2)
Cash restricted	\$ 6.5		2.6	3.9
Accounts receivable	3.8		3.1	.7
Capital assets-net	<u>37.1</u>		<u>32.0</u>	<u>5.1</u>
 Total assets		<u>47.4</u>	<u>37.9</u>	<u>9.5</u>
 Short-term debt		17.3	10.1	(7.2)
Long-term debt		<u>17.5</u>	<u>17.2</u>	<u>(.3)</u>
 Total liabilities		<u>34.8</u>	<u>27.3</u>	<u>(7.5)</u>
 Net Assets:				
Invested in capital assets, net of related debt	24.8		19.3	5.5
Restricted for:				
Debt service	1.3		1.3	
State and federal programs			.8	(.8)
Unrestricted	<u>(13.5)</u>		<u>(10.8)</u>	<u>(2.7)</u>
 Total net assets		<u>\$12.6</u>	<u>\$10.6</u>	<u>\$ 2.0</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**  
**FOR THE YEAR ENDED JUNE 30, 2007**

**THE MUNICIPALITY AS A WHOLE (CONTINUED)**

<b>Table 2</b>			
<b>Changes in Net Assets</b>	<b>Year Ended</b>	<b>Year Ended</b>	<b>Net Change</b>
<b>(In Millions)</b>	<b>June 30, 2007</b>	<b>June 30, 2006</b>	<b>Favorable</b>
			<b>(Unfavorable)</b>
<b>Revenues</b>			
Program revenues:			
Charge for services	\$ .1	\$ .6	\$ (.5)
Operating grants	.6	.8	(.2)
Capital grants	6.8	2.5	4.3
General revenues:			
Property taxes	5.7	6.4	(.7)
Municipal license tax	2.1	2.2	(.1)
Sales tax	2.6	.5	2.1
Grants and entitlements	5.0	4.5	.5
Donated assets		8.0	(8.0)
Other income	<u>2.1</u>	<u>1.6</u>	<u>.5</u>
<b>Total Revenues</b>	<u>25.0</u>	<u>27.1</u>	<u>(2.1)</u>
<b>Program Expenses:</b>			
General administration	9.0	7.7	(1.3)
Public safety	2.0	1.9	(.1)
Education	2.7	1.4	(1.3)
Public works	7.5	5.1	(2.4)
Health and welfare	1.0	1.7	.7
Other	<u>.9</u>	<u>.8</u>	<u>(.1)</u>
<b>Total Expenses:</b>	<u>23.1</u>	<u>18.6</u>	<u>(4.5)</u>
<b>Increase (Decrease) in Net Assets</b>	<b>\$ 1.9</b>	<b>\$ 8.5</b>	<b>\$ (6.6)</b>

It is very important to notice that the increase in net assets for the year ended June 30, 2007 resulted in \$1.9 millions. *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'S DISCUSSION AND ANALYSIS (UNAUDITED)**  
**FOR THE YEAR ENDED JUNE 30, 2007**

**Governmental Activities**

The principal revenues of the Municipality are composed of property taxes, sales tax, municipal license taxes and grant contributions. Table 2 shows that the Municipality ended its operations for the current year with an increase in net assets for \$1.9 millions. The above table presents an increase in sale taxes, grant contributions and other income for \$7.4 millions. The aforementioned increase was accompanied with a decrease in donated capital for \$8 millions and other local revenues for \$1.5 millions in comparison with prior year. However, during the current year the Municipality had an increase in program expenses for \$4.5 millions, mainly in general administration, education and public works in comparison with prior year.

**General Fund Budgetary Highlights**

Once the Municipality's budget for the fiscal year 2006-2007 was approved on June 2006, 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, 2007, 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, 2007, the Municipality of Yauco had \$37.1 millions invested in a broad range of capital assets, including land, land improvements, buildings, parks, roads, bridges and equipment.

<b>Table 3</b> <b>Capital Assets</b> <b>(Net of depreciation, in Millions)</b>	<b>Year Ended</b> <b>June 30, 2007</b>	<b>Year Ended</b> <b>June 30, 2006</b>	<b>Net Change</b> <b>Favorable</b> <b>(Unfavorable)</b>
Land and works of art	\$ 2.8	\$ 2.8	
Land improvements	.2	.3	\$ (.1)
Buildings and improvements	6.1	6.3	(.2)
Equipment	2.6	2.5	.1
Infrastructure	<u>25.4</u>	<u>20.1</u>	<u>5.3</u>
Totals	\$37.1	\$32.0	\$ 5.1

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**  
**FOR THE YEAR ENDED JUNE 30, 2007**

**CAPITAL ASSET AND DEBT ADMINISTRATION (CONTINUED)**

As we can note in Table 3, the Municipality increased its capital assets in \$7.2 millions in comparison with prior year financial statements. The main portion of the increase in capital assets came up from capital projects developed by the Municipality and donated land lots received by the Municipality for recreational and sport purposes, as shown in Note 9 to the financial statements.

The Municipality recognized during the current year an amount for \$476,042, consisting of the infrastructure capital assets existent prior to the year ended June 30, 2003, according to the provisions the GASB No. 34. Therefore and as reported previously, all those capital assets were accounted for and included in the financial statements of the Municipality.

**Long-Term Debt**

As of June 30, 2007, the Municipality had \$22.6 millions, in bonds, notes and other outstanding debts as shown in Table 4, including \$4.1 millions in notes payable utilized as interim loan during the construction of a low-income housing units project. The outstanding balance of long-term debts was mainly utilized to finance capital projects, including infrastructure, acquisitions of land and construction projects.

<b>Table 4</b>			
<b>Outstanding Debt</b>	<b>Year Ended</b>	<b>Year Ended</b>	<b>Change</b>
<b>(in Millions)</b>	<b>June 30, 2007</b>	<b>June 30, 2006</b>	<b>Favorable</b>
			<b>(Unfavorable)</b>
Bonds and Note Payable	\$20.0	\$15.1	\$(4.9)
Other	<u>2.6</u>	<u>2.8</u>	<u>.2</u>
Totals	\$22.6	\$17.9	\$(4.7)

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The Municipality's elected and appointed officials considered many factors when setting the fiscal year 2007 budget. The most significant goal in the next year's budget in comparison with the amounts included for the year ended June 30, 2007, is to continue with the aggressive collection procedure to increase the municipal construction and city taxes, 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, 2007.

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'S DISCUSSION AND ANALYSIS (UNAUDITED)  
FOR THE YEAR ENDED JUNE 30, 2007**

**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, 2007**

<b>ASSETS</b>	<b><u>PRIMARY GOVERNMENT</u></b>
Cash and cash equivalents	\$ 21,515
Receivable other agencies	736,338
Other receivable net allowance for bad debts	
Property tax	2,796,746
Sale tax	253,831
Capital assets, net	37,115,404
Restricted assets:	
Cash with fiscal agent	<u>6,471,158</u>
<b>Total Assets</b>	<u>47,394,992</u>
<b>LIABILITIES AND NET ASSETS</b>	
<b>Liabilities:</b>	
Accounts payable	5,715,862
Due to other agencies	3,839,018
Accrued interest	523,722
Deferred revenue	2,130,832
Note payable	4,155,000
Non-current liabilities:	
Due within one year	957,683
Due in more than one year	<u>17,496,145</u>
<b>Total Liabilities</b>	<u>34,818,262</u>
<b>Net Assets:</b>	
Invested in capital assets, net of related debt	24,834,404
Restricted for Debt service	1,306,459
Unrestricted (deficit)	<u>(13,564,133)</u>
<b>Total Net Assets</b>	<u>\$12,576,730</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, 2007**

<b><u>FUNCTIONS AND PROGRAMS</u></b>	<b><u>EXPENSES</u></b>	<b>PROGRAMS REVENUES</b>			<b><u>NET (EXPENSES) REVENUES AND CHANGES IN NET ASSETS</u></b>
		<b><u>CHARGE FOR SERVICES</u></b>	<b><u>OPERATING GRANTS AND CONTRIBUTIONS</u></b>	<b><u>CAPITAL GRANTS AND CONTRIBUTIONS</u></b>	<b><u>PRIMARY GOVERNMENT</u></b>
<b>Primary government:</b>					
General administration	\$ 8,978,984		\$392,725		\$ (8,586,259)
Public safety	2,048,085		10,880		(2,037,205)
Education, culture and recreational	2,738,922		68,908		(2,670,014)
Public works and sanitation	7,498,856	\$75,000		\$6,753,586	(670,270)
Health and welfare	965,461		139,719		(825,742)
Interest	<u>884,091</u>				<u>(884,091)</u>
Total expenditures	<u>\$23,114,399</u>	\$75,000	\$612,232	\$6,753,586	<u>(15,673,581)</u>
<b>General revenues:</b>					
Taxes:					
Property taxes					5,725,133
Municipal tax					2,141,705
Sales tax					2,565,215
Grants and entitlements					5,036,147
Licenses and permits					824,697
Interest					250,522
Other income					<u>1,069,415</u>
Total general revenues					<u>17,612,834</u>
<b>Changes in net assets</b>					<u>1,939,253</u>
<b>Net assets at beginning of the   year as previously reported</b>					8,482,351
<b>Prior period adjustments</b>					<u>2,155,126</u>
<b>Net asset beginning of year   as restated</b>					<u>10,637,477</u>
<b>Net assets at end of the year</b>					<u>\$ 12,576,730</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, 2007**

	<u>MAJOR FUNDS</u>				<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>\$4,155,000 NOTE FUND</u>	<u>SALE TAX FUND</u>		
<b>Assets:</b>						
<b>Cash:</b>						
Cash in commercial bank					\$ 21.515	\$ 21.515
Cash with fiscal agent		\$1,790.256	\$3,971.722		709.180	6,471.158
<b>Receivables:</b>						
Due from governmental agencies	\$ 268.439				467.899	736.338
Due from other funds	358.174				806.910	1,165.084
Property tax	2,072.828	723.918				2,796.746
Sale tax				<u>\$ 253.831</u>		<u>253.831</u>
<b>Total assets</b>	<u>\$ 2,699.441</u>	<u>\$2,514.174</u>	<u>\$3,971.722</u>	<u>\$ 253.831</u>	<u>\$2,005.504</u>	<u>\$11,444.672</u>
<b>Liabilities and other credits</b>						
<b>Liabilities:</b>						
Accounts payable and accrued expenses	\$ 1,894.429			\$ 1,367.681	\$1,853.419	\$ 5,115.529
Deferred revenues	3,682.065	\$ 692.287		253.831	177.194	4,805.377
Deposits	120.506					120.506
Due to governmental agencies	3,839.018					3,839.018
Due to other fund	<u>593.763</u>			<u>471.321</u>	<u>100.000</u>	<u>1,165.084</u>
<b>Total liabilities</b>	<u>10,129.781</u>	<u>692.287</u>		<u>2,092.833</u>	<u>2,130.613</u>	<u>15,045.514</u>
<b>Fund balance (deficiency):</b>						
Reserved for:						
Debt service		1,821.887				1,821.887
State and federal programs			\$3,971.722	(1,839.002)	(125.109)	2,007.611
Undesignated deficit	<u>(7,430.340)</u>					<u>(7,430.340)</u>
<b>Total fund balance (deficiency)</b>	<u>(7,430.340)</u>	<u>1,821.887</u>	<u>3,971.722</u>	<u>(1,839.002)</u>	<u>(125.109)</u>	<u>(3,600.842)</u>
<b>Total liabilities and fund balance</b>	<u>\$ 2,699.441</u>	<u>\$2,514.174</u>	<u>\$3,971.722</u>	<u>\$ 253.831</u>	<u>\$2,005.504</u>	<u>\$11,444.672</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, 2007**

Fund Balances in Governmental Funds	\$ (3,600,842)
<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.	37,115,404
Deferred property tax recorded as revenue in the governmental activities	2,674,545
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	(20,043,000)
Accrued interest	(523,722)
Landfill	(201,716)
Capital lease	(44,375)
Accrued vacation	(1,887,695)
Claims and judgements	(479,827)
Intergovernmental payable to ASES	<u>(432,042)</u>
<i>Net Assets of Governmental Activities</i>	<u>\$12,576,730</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, 2007**

	<u>MAJOR FUNDS</u>					
	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>\$4,155,000 NOTE FUND</u>	<u>SALE TAX FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
<b>Revenues:</b>						
Taxes:						
Property taxes	\$ 4,011.954	\$1,695.119				\$ 5,707.073
Municipal tax	2,141.705					2,141.705
Safe tax				\$ 2,565.215		2,565.215
Grants and entitlements	4,972.648				\$ 7,478.146	12,450.794
Rental income	166.296					166.296
Licenses and permits	824.697					824.697
Solid waste disposal	75.000					75.000
Interest	201.094	49.428				250.522
Other	<u>768.324</u>			<u>601</u>	<u>134.194</u>	<u>903.119</u>
Total Revenues	<u>13,161.718</u>	<u>1,744,547</u>		<u>2,565.816</u>	<u>7,612.340</u>	<u>25,084.421</u>
<b>Expenditures:</b>						
General administration	7,153.220		\$ 16.242	786.596	1,122.162	9,078.220
Public safety	1,950.070			29.592		1,979.662
Education, culture and recreational	2,446.454				139.662	2,586.116
Public works and sanitation	1,915.037		167.036	3,710.944	7,048.959	12,841.976
Health and welfare	854.476			20.000	354.065	1,228.541
Debt service:						
Principal		851.000				851.000
Interest		<u>691.326</u>				<u>691.326</u>
Total Expenditures	<u>14,319.257</u>	<u>1,542.326</u>	<u>183.278</u>	<u>4,547.132</u>	<u>8,664.848</u>	<u>29,256.841</u>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<b>\$ (1,157.539)</b>	<b>\$ 202.221</b>	<b>\$(183.278)</b>	<b>\$(1,981.316)</b>	<b>\$(1,052.508)</b>	<b>\$(4,172.420)</b>

(continue)

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
STATEMENT OF REVENUES, EXPENDITURES  
AND CHANGES IN FUND BALANCE-GOVERNMENTAL FUNDS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2007**

	<u>MAYOR FUNDS</u>					
	<u>GENERAL FUND</u>	<u>DEBT SERVICE FUND</u>	<u>\$4,155,000 NOTE FUND</u>	<u>SALE TAX FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
<b>Excess (deficiency) of revenues over (under)</b>						
Expenditures	<u>\$(1,157,539)</u>	<u>\$ 202,221</u>	<u>\$ (183,278)</u>	<u>\$(1,981,316)</u>	<u>\$(1,052,508)</u>	<u>\$(4,172,420)</u>
<b>Other financing sources (uses):</b>						
Operating transfer in	1,384,803	358,877				1,743,680
Operating transfer out	(358,877)	(45,670)		(100.00)	(1,239,133)	(1,743,680)
Proceed from loans			<u>4,155,000</u>		<u>1,597,000</u>	<u>5,752,000</u>
Total other financing sources (uses)	<u>1,025,926</u>	<u>313,207</u>	<u>4,155,000</u>	<u>(100,000)</u>	<u>357,867</u>	<u>5,752,000</u>
<b>Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses</b>	(131,613)	515,428	3,971,722	(2,081,316)	(694,641)	1,579,580
<b>Fund balance (deficit) at beginning of year</b>	<u>(7,298,727)</u>	<u>1,306,459</u>		<u>242,314</u>	<u>569,532</u>	<u>(5,180,422)</u>
<b>Fund balance (deficit) at end of year</b>	<u>\$(7,430,340)</u>	<u>\$1,821,887</u>	<u>\$3,971,722</u>	<u>\$(1,839,002)</u>	<u>\$ (125,109)</u>	<u>\$(3,600,842)</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, 2007**

<b>Net change in fund balances – total governmental funds</b>	<b>\$ 1,579,580</b>
 <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.	7,187,929
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.	851,000
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.	16,419
Change in accrued expenses which do not require the use of current financial resources:	
Deffered	(30,769)
Interest	(192,765)
Compensating absences	(674)
Landfill postclosure expenses	(100,000)
Claims and judgements	206,357
Amount due to PR Health Insurance Administration	285,866
Governmental funds report proceed from notes and bonds as other financial resources, whereas the proceed is recorded as long-term debt on the statement of activities	(5,752,000)
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>(2,111,690)</u>
<b><i>Changes in Net Assets of Governmental Activities</i></b>	<b><u>\$ 1,939,253</u></b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

**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, 2007**

**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, 2007**

**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.

3) \$4,155,000 Note Fund

The fund accounts the proceed from a note and expenditures for the construction of a low income housing project.

4) Sale tax

The fund accounts for proceed and expenditures of the Sale tax.

**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 revenue 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.

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, 2007**

**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, 2007**

**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
Other improvements	\$25,000
Equipment	\$ 2,000
Library books (collections)	Capitalized all
Works of Arts	Capitalized all
Leasehold improvements	\$10,000
Vehicles and Machinery	Capitalized all

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2007**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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, 2007 amounted to approximately \$305,864. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$280,723 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.

**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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2007**

**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 \$21,515 in other governmentall funds were fully collateralized at June 30, 2007. The deposits at GDB of approximately \$4.7 millions that are restricted principally for capital projects, and the \$1.8 millions 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 estimed 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.

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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2007**

**4. PROPERTY TAX (CONTINUED)**

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 2007 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.

Total property tax receivable, net of an allowance for uncollectible accounts of \$4,520,351 amounted to \$2,796,746 at June 30, 2006. The composition of property taxes receivable and the related deferred revenue is as follows at June 30, 2007:

	<u>General Fund</u>	<u>Debt service Fund</u>	<u>Total</u>
Gross property taxes receivable	\$ 5,414,651	\$ 1,902,446	\$ 7,317,097
Less:			
Allowance for uncollectible accounts	<u>(3,341,823)</u>	<u>(1,178,528)</u>	<u>(4,520,746)</u>
Net property taxes receivable	<u>\$ 2,072,828</u>	<u>\$ 723,918</u>	<u>\$ 2,796,746</u>
Deffered (unavailable) property Tax revenues in GFFS	\$ 1,982,258	\$ 692,287	\$ 2,674,545

**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 1<sup>st</sup> and January 1<sup>st</sup> 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, 2007, \$1,699,807 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, 2007**

**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 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 Property and Sale Tax

Deferred revenues amounting to \$1,699,807 in the general fund related to the municipal license tax collected in the fiscal year 2005-2006 that will be earned in fiscal year 2007-2008 and \$2,674,545 and \$253,831 related to property taxes and city tax receivable that were not available to pay current liabilities. Deferred property tax is recorded as revenue in the governmental wide financial statements.

Federal Government

The deferred revenues of \$177,194 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, 2007, 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2007**

**9. CAPITAL ASSETS**

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

<u>Primary government</u>	<u>Balance June 30, 2006 as restated</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2007</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 2,599,247			\$ 2,599,247
Work of art	<u>156,000</u>			<u>156,000</u>
Total capital assets , not being depreciated	<u>2,755,247</u>			<u>2,755,247</u>
Capital assets being depreciated:				
Land improvements	800,308			800,308
Buildings and building improvements	8,060,361			8,060,361
Machinery and equipment	4,916,698	\$ 278,038		5,194,736
Infrastructure	<u>22,473,295</u>	<u>6,909,891</u>		<u>29,383,186</u>
Total capital assets being depreciated	<u>36,250,662</u>	<u>7,187,929</u>		<u>43,438,591</u>
Less accumulated depreciation for:				
Land improvements	538,720	8,733		547,453
Buildings and building improvements	1,761,426	147,904		1,909,330
Machinery and equipments	2,360,147	316,400		2,676,547
Infrastructure	<u>2,306,451</u>	<u>1,638,653</u>		<u>3,945,104</u>
Total accumulated depreciation	<u>6,966,744</u>	<u>2,111,690</u>		<u>9,078,434</u>
Total capital assets being depreciated, net	<u>29,283,918</u>	<u>5,076,239</u>		<u>34,360,157</u>
Governmental activities capital assets, net	<u>\$32,039,165</u>	<u>\$5,076,239</u>		<u>\$37,115,404</u>

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

General administration	\$ 122,866
Public safety	68,423
Public works	1,744,809
Education, culture and recreation	152,806
Health and welfare	<u>22,786</u>
Total depreciation expense	<u>\$2,111,690</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2007**

**10. GENERAL LONG-TERM DEBT**

Long-term liability activity for the year ended June 30, 2007 was as follows:

<b>Primary Government Governmental Activities</b>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Due within one year</b>
Bonds and note payable	\$15,142,000	\$1,597,000	\$851,000	\$15,888,000	\$658,000
Capital leases	60,794		16,419	44,375	19,683
Accrued vacation	1,887,021	674		1,887,695	
Amount due to PR Health Insurance Administration	717,908		285,866	432,042	280,000
Accrued for landfill postclosure expense	<u>101,716</u>	<u>100,000</u>		<u>201,716</u>	
<b>Total Non-Current Liabilities</b>	<b><u>\$17,909,439</u></b>	<b><u>\$1,697,674</u></b>	<b><u>\$1,153,285</u></b>	<b><u>\$18,453,828</u></b>	<b><u>\$957,683</u></b>

**A. Bonds and notes payable:**

1984 - \$171,000 bond due in one annual principal installment of \$12,000 on January 1, 2008, plus interest at 5%.	\$ 12,000
1996 - \$4,585,000 bond due in annual principal installments ranging from \$235,000 to \$435,000 through July 1, 2015, plus interest ranging from 4.70% to 6.58%.	2,925,000
2002 - \$2,015,000 bond due in annual principal installments ranging from \$45,000 to \$165,000 through July 1, 2026, plus interest at 7%.	1,835,000
2003 - \$1,385,000 bond due in annual principal installments ranging from \$30,000 to \$105,000 through July 1, 2027, plus interest at 5%.	1,285,000
2003 - \$1,005,000 bond due in annual principal installments ranging from \$25,000 to \$75,000 through July 1, 2029, plus interest at 6%.	925,000
2004 - \$975,000 bond due in annual principal installments ranging from \$95,000 to \$120,000 through July 1, 2013, plus interest at 5%.	645,000
2004 - \$495,000 bond due in annual principal installments ranging from \$10,000 to \$35,000 through July 1, 2028, plus interest at 5%.	465,000
2007 - \$615,000 bond due in annual principal installments ranging from \$35,000 to \$60,000 through July 1, 2020, plus interest at 1.25% over LIBOR rate.	555,000

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2007**

**10. GENERAL LONG-TERM DEBT (CONTINUED)**

**A. Bonds and notes payable: (continued)**

2007 - \$185,000 bond due in annual principal installments ranging from \$15,000 to \$25,000 through July 1, 2014, plus interest at 1.25% over LIBOR rate.	\$ 155,000
\$857,000 general obligation note of 1999, due in annual principal installments ranging from \$21,000 to \$57,000 through January 1, 2029 plus interest at 4.75%	799,000
\$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%.	610,000
\$505,000 general obligation note of 2002, due in annual principal installments ranging from \$75,000 to \$90,000 through July 1, 2009 plus interest at 6.50%.	245,000
\$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%.	675,000
\$1,000,000 general obligation note of 2004, due in annual principal installments ranging from \$25,000 to \$75,000 through July 1, 2027 plus interest at 6.50%.	920,000
\$240,000 general obligation note of 2004, due in annual principal installments ranging from \$35,000 to \$40,000 through July 1, 2010 plus interest at 6.00%	115,000
\$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%	380,000
\$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%	358,000
\$1,191,000 general obligation note due in annual principal installments ranging from \$29,000 to \$69,000 through January 1, 2029 plus interest at 4.25%	1,012,000
\$130,000 general obligation note due in annual principal installments of \$20,000 through July 1, 2011 plus interest at 1.25% over LIBOR rate.	100,000
\$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.	75,000

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2007**

**10. GENERAL LONG-TERM DEBT (CONTINUED)**

**A. Bonds and notes payable: (continued)**

\$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.	\$ 200,000
\$155,000 general obligation bond due in annual principal installments ranging from \$10,000 to \$20,000 through July 1, 2016 plus interests at 7%	155,000
\$135,000 general obligation bond due in annual principal installments ranging from \$5,000 to \$10,000 through July 1, 2031 plus interest at 7%	135,000
\$1,307,000 general obligation bonds due in annual principal instalments ranging from \$52,000 to \$134,000 through July 1, 2021 plus interest at 7.5%	<u>1,307,000</u>
Total bonds and note payable	<u>\$15,888,000</u>

The annual debt service requirements to maturity notes and bonds payable as of June 30, 2007 are as follows:

<u>Bonds and Notes Payable</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 658,000	\$ 781,872
2009	858,000	814,040
2010	924,000	793,168
2011	888,000	741,104
2012	909,000	687,851
2013-2017	4,429,000	2,688,069
2018-2022	3,193,000	1,555,715
2023-2027	3,124,000	961,686
2028-2032	<u>905,000</u>	<u>54,025</u>
	<u>\$15,888,000</u>	<u>\$9,077,530</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
JUNE 30, 2007**

**10. GENERAL LONG-TERM DEBT (CONTINUED)**

**B. 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, 2007, 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, 2007 reported in the accompanying government-wide statement of net assets is as follows:

Year ending <u>June 30</u>	
2008	\$20,720
2009	17,760
2010	<u>7,400</u>
Total future minimum lease payments	45,880
Less amount representing interest	<u>(1,505)</u>
Present value of capital lease obligations	<u>\$44,375</u>

**C. 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. NOTE PAYABLE:**

Note payable consist of an interim construction loan. The note will be paid with the proceed of the sale of low-income Housing Units.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2007**

**12. RETIREMENT SYSTEM**

**DEFINED BENEFIT PENSION PLAN**

The Employees' Retirement System of the Commonwealth of Puerto Rico 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 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2007**

**12. RETIREMENT SYSTEM (CONTINUED)**

**DEFINED CONTRIBUTION PLAN (CONTINUED)**

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, 2007 approximately \$326,628 and \$375,226, respectively. As of June 30, 2007, the Municipality due to the plans \$1,572,329 of the required contributions.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2007, 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, 2007**

**13. 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 \$201,716 as of June 30, 2007, 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 cost 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, 2007. 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.

**14. RESTATEMENT OF FUND BALANCE**

The fund balance of governmental activities as presented in 2007 statement of net assets has been adjusted because certain capital assets, mostly donated recreational facilities, were unrecorded. The corrections has no effect on the results of current year's activities, however, the cumulative effect increase the beginning net assets by \$2,155,126.

**15. AMOUNT DUE TO OTHER AGENCY:**

Amount due to other agencies as of June 30, 2007 consist of the following:

PR Department of Labor	\$ 784,814
PR Water and Sewer Authority	226,111
Employees' Retirement System of Commonwealth of Puerto Rico	1,572,329
PR Department of Treasury	1,189,881
US Internal Revenue Service	49,734
PR General Service Administration	<u>16,149</u>
	\$3,839,018

**REQUIRED SUPPLEMENTARY INFORMATION**

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**SCHEDULE OF BUDGETARY COMPARISON**  
**GENERAL FUND**  
**FOR THE YEAR ENDED JUNE 30, 2007**

	<u>ORIGINAL BUDGET</u>	<u>FINAL BUDGET</u>	<u>ACTUAL AMOUNT AT BUDGETARY BASIS</u>	<u>VARIANCE WITH FINAL BUDGET POSITIVE (NEGATIVE)</u>
<b>Revenues:</b>				
Taxes:				
Property taxes	\$ 3,696,177	\$3,696,177	\$ 4,011,954	\$ 315,777
Municipal tax	2,150,000	2,150,000	2,141,705	(8,295)
Grants and entitlements	4,716,934	4,716,934	4,972,648	255,714
Rental income	55,000	55,000	166,296	111,296
Licenses and permits	488,198	488,198	824,697	336,499
Solid waste disposal	72,000	72,000	75,000	3,000
Interest	100,000	100,000	201,094	101,094
Other	<u>1,922,000</u>	<u>1,922,000</u>	<u>768,324</u>	<u>(1,153,676)</u>
 Total Revenues	 <u>13,200,309</u>	 <u>13,200,309</u>	 <u>13,161,718</u>	 <u>(38,591)</u>
<b>Expenditures:</b>				
General administration	6,016,782	6,189,823	7,153,220	(963,397)
Public safety	2,218,543	1,896,857	1,950,070	(53,213)
Education, culture and recreational	1,777,904	2,200,957	2,446,454	(245,497)
Public works and sanitation	2,053,435	1,855,616	1,915,037	(59,421)
Health and welfare	810,070	853,905	854,476	(571)
Debt service	<u>323,575</u>	<u>323,575</u>	<u>358,877</u>	<u>(35,302)</u>
 Total Expenditures	 <u>13,200,309</u>	 <u>13,320,733</u>	 <u>14,678,134</u>	 <u>(1,357,401)</u>
 <b>Excess (deficiency) of revenues over (under) expenditures</b>	  <b>\$</b>	  <b>\$(120,424)</b>	  <b>\$(1,516,416)</b>	  <b>\$(1,395,992)</b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO SCHEDULE OF BUDGETARY COMPARISON**  
**JUNE 30, 2007**

**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. The general fund is the only fund required to adopt a budget.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO SCHEDULE OF BUDGETARY COMPARISON (CONTINUED)**  
**JUNE 30, 2007**

**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>EXPENDITURES</u>
Generally accepted accounting principles (GAAP) basis	\$13,161,718	\$14,319,257
Transferout included as expense in budgetary basis	<u>                    </u>	<u>    358,877</u>
Budgetary basis	<u>\$13,161,718</u>	<u>\$14,678,134</u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2007**

	<u>NUMBER</u>	<u>EXPENDITURES</u>
<b><u>US Department of Housing and Urban Development</u></b>		
Passed through:		
Municipal Service Administration:		
Community Development Block Grant/ State Program	14.228	\$ 102,627
Direct programs:		
Section 8- Housing Choice Vouchers	14.871	140,647
Community Development Block Grant/ Entitlement Grant	14.118	1,777,701
<b><u>US Department of Health and Human Services</u></b>		
Passed through:		
PR Department of Family:		
Child Care and Development Block Grant	93.575	121,119
<b><u>US Department of Agriculture</u></b>		
Direct program:		
Water and Waste Disposal Systems for Rural Communities	10.760	896,381
Passed through:		
Puerto Rico Department of Education Child and and Adult Food Program	10.558	18,564
<b><u>US Department of Home and Security</u></b>		
Passed through:		
PR Office of Management and Budget (GAR) Public Assistance Grant	97.036	412,211
<b><u>US Department of Transportation</u></b>		
Passed through:		
PR Department of Transportation Federal Transit investment Grant	20.500	<u>15,597</u>
		<b>\$3,484,847</b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF YAUCO**  
**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**JUNE 30, 2007**

**1. BASIS OF PRESENTATION:**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Municipality of Yauco and is prepared on the modified accrual basis of accounting. Accordingly, amounts presented in the accompanying schedule agree to amounts presented in the basic financial statements.

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

*Carlos R. Diaz Negrón*

Certified Public Accountant

MEMBER:

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

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**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, each major fund, and the aggregate remaining fund information of the **Municipality of Yauco** as of and for the year ended June 30, 2007, which collectively comprise the Municipality of Yauco's basic financial statements, and have issued my report thereon dated October 26, 2007. 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 Financing Reporting**

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

My consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, I identified a deficiency in internal control over financial reporting that I consider to be a significant deficiency.

## REPORT ON COMPLIANCE AND ON INTERNAL CONTROL (CONTINUED):

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Municipality of Yauco's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Municipality of Yauco's financial statements that is more than inconsequential will not be prevented or detected by the Municipality of Yauco's internal control. I consider the deficiency described in the accompanying schedule of findings and questioned costs as Finding 01-07 to be significant deficiencies in internal control over financial reporting.

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

My consideration of internal control over financial reporting was form the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, I believe that the significant deficiency described above is not a material weakness.

### Compliance and Other Material

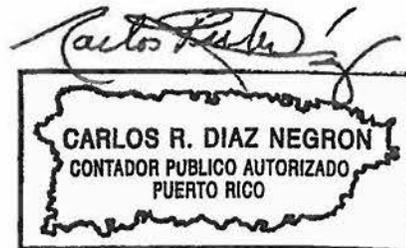
A part of obtaining reasonable assurance about whether the Municipality of Yauco's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the accompanying schedule of findings and questioned costs as Findings 01-07 and 02-07.

The Municipality of Yauco's response to the findings in my audit is described in the accompanying schedule of findings and questioned costs. I did not audit the Municipality of Yauco's response and accordingly, I express no opinion on it.

This report is intended solely for the information and use of management, Municipal Legislative Body, others within the entity, and 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.

Octubre 26, 2007  
Aguas Buenas, Puerto Rico

License No. 1339  
Expires December 1, 2010



The stamp No. 2297331 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**

*Carlos R. Diaz Negrón*

Certified Public Accountant

MEMBER:

American Institute of Certified Public Accountants  
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**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** with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2007. The Municipality of Yauco's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirement of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality of Yauco's management. My responsibility is to express an opinion on the Municipality of Yauco'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 noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Municipality of Yauco's compliance with those requirements and performing such other procedures as I considered necessary in the circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination of the Municipality of Yauco's compliance with those requirements.

In my opinion, the Municipality of Yauco 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, 2007. However, the results of my auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedules of findings and questioned costs as Findings 01-07 and 02-07.

## REPORT ON COMPLIANCE WITH REQUIREMENT APPLICABLE (CONTINUED):

### Internal Control Over Compliance

The management of the Municipality of Yauco 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's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of the Municipality of Yauco's internal control over compliance.

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

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

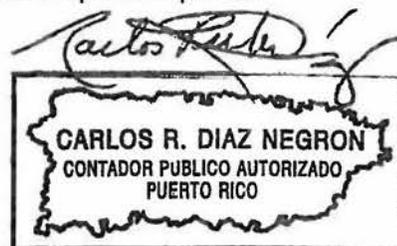
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Municipality of Yauco's internal control.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

The Municipality of Yauco's response to the findings in my audit is described in the accompanying schedule of findings and questioned costs. I did not audit the Municipality of Yauco's response and accordingly, I express no opinion on it.

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.

Octubre 26, 2007  
Aguas Buenas, Puerto Rico

License No. 1339  
Expire December 1, 2010



The stamp No. 2297332 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, 2007**

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

**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 is 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**

14.228

Community Development  
Block Grants/State's Program  
Public Assistance Grants

97.036

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

\$300,000

Audit qualified as low-risk audited?

\_\_\_yes    X\_no

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

**SECTION II – FINANCIAL STATEMENT FINDING**

NONE

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

**SECTION III - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**Finding No. 01-07 – Activities Allowed or Unallowed – Allowable Cost/Cost Principle**

**Federal Program**

CFDA – 97.036 Public Assistance Grants

**Compliance requirement:**

Activities Allowed or Unallowed  
Allowable Cost/Cost Principles

**Category:**

Compliance

**Condition:**

In testing compliance and internal controls over allowability and procurement and suspension and debarment requirements, I selected 19 disbursements from the Public Assistance Grants program. During the disbursement test no supporting documents were available for examination for one (1) out of the 19 disbursements (5%) selected for testing.

**Criteria:**

44 CFR section 13.20(b) (2) establishes that grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Additionally, 44 CFR section 13.20(b) (6) establishes that accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.

**Effect:**

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

**Questioned cost:**

\$10,000

**Recommendation:**

I recommend the Municipality to establish an adequate internal control system to ascertain compliance with the Allowable Cost/Cost Principles requirements.

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

**SECTION III - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**Finding No. 02-07 – Davis-Bacon Act**

**Federal Program**

CFDA – 97.036 Public Assistance Grants

**Compliance requirement:**

Davis-Bacon Act

**Category:**

Compliance

**Condition:**

As part of my audit procedures I tested 19 disbursements to determine compliance with the Davis-Bacon Act. During the disbursement test, the certified payrolls amounting to \$176,688 and the related statements of compliance required to be submitted by the contractors were not available for examination.

**Criteria:**

The Davis-Bacon Act requires that all construction contracts in excess of \$2,000 financed by federal assistance funds must be paid wages not less than those established for the locality of the project. Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (29 CFR sections 5.5 and 5.6). This reporting is often done using Optional Form WH-347, which includes the required statement of compliance (*OMB No. 121501-49*).

**Effect:**

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

**Questioned cost:**

None

**Recommendation:**

I recommend the Municipality to establish an adequate internal control system to ascertain compliance with the Davis-Bacon Act requirements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF YAUCO**

**EXHIBIT - I**

**STATUS OF PRIOR YEAR AUDIT FINDINGS**

**AND QUESTIONED COSTS**

**FOR THE YEAR ENDED JUNE 30, 2007**



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*

November 5, 2007

## ***Status of Prior 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 accumulated deficit.*

### ***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 and improve the deficiencies that it had before.*

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

*We gave instructions to correct and complete the findings.*

*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, 2007**



*Abel Nazario Quiñones*  
Alcalde

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



March 25, 2008

## **Corrective Action Plan**

Municipality of Yauco respectfully submits the following corrective plan for the year ended June 30, 2007.

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, 2007  
Yauco City Mayor: Hon Abel Nazario Quiñones  
Person Designated: Magaly Rodriguez Caraballo  
Internal Auditor  
Number of contact: (787) 856-3566 ext. 253

The findings from the June 30, 2007 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, 2007**

**Finding No. 01-07 – Activities Allowed or Unallowed – Allowable Cost/Cost  
Principle:**

We are in the process of reviewing the billing reimbursement control system. We have had establish internal monitoring control to assure that this situation will not happened again, however is very important to clarify that the disbursements in reference were done in accordance with the applicable rules and regulations of the Federal State and Local Government.

**Finding No. 02-07 – Davis Bacon Act:**

By an involuntary mistake the Municipality of Yauco failed to request the correspondent weekly payroll from the contractors. The Municipality has had establish internal controls to require that all contractors who finishes any projects financed with Federal Funds, to submit along with the certification of the project all the weekly payrolls of the employees working in the projects. In addition we will continue to enforce that the Municipality of Yauco will comply with the Federal Minimum Wages Law.

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

Sincerely yours,

  
Hon. Abel Nazario Quiñones  
Yauco City Mayor