



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

*BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY
INFORMATION AND INDEPENDENT
AUDITOR'S REPORT
(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)*

*AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2010*



*Hon. Isidro Negrón - Irizarry
Mayor*

*Mrs. Eli Eida Ortiz - Feliciano
Finance Director*

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

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INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Members of the
Municipal Assembly
Municipality of San Germán, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of San Germán, Puerto Rico**, as of and for the year ended June 30, 2010, which collectively comprise the Municipality of San Germán, Puerto Rico's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Municipality of San Germán, Puerto Rico's management. Our responsibility is to express opinions on these financial statements based on our audit.

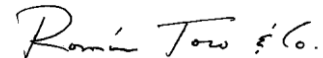
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and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

In our opinion, the financial statements referred to previously present fairly, in all material respects, financial position of the governmental activities and general fund of the Municipality of San Germán, Puerto Rico, as of June 30, 2010, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we also issued our report dated February 9, 2011, on our consideration of the Municipality of San Germán, Puerto Rico's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 14 and 52 through 54 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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



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Yauco, Puerto Rico
February 9, 2011

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

As management of the Municipality of San Germán (“the Municipality”), we offer readers of the Municipality’s financial statements this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2010. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our basic financial statements presented in this report.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

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

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2010 by \$44,739,505 (net assets).
- Revenues decreased by 0.4% and expenses decreased 5% in comparison with fiscal year 2009.
- Net change in net assets amounted to \$5,481,199, an increase of 25% with respect to prior fiscal year’s net change, as restated.

Highlights for Fund Financial Statements

Detailed information about the Municipality’s most significant funds is found in the funds financial statements, which use the current financial resources measurement focus and modified accrual basis of accounting:

- At June 30, 2010, a net change of (\$2,216,657) in the fund balances of the Municipality’s governmental funds resulted in a reported combined ending fund balances of \$4,761,665. Approximately (6%) of the total combined fund balances is unreserved.
- The General Fund reported an excess of expenditures and other financing uses over revenues and other financing sources of \$658,735 and an unreserved fund balance of (\$289,570). Unreserved fund balance decreased 273% from prior year.

General Financial Highlights

- The investment in capital assets as of June 30, 2010 was \$51,283,754 (net of depreciation).
- Long term debt decreased to \$14,681,169.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$321,221.

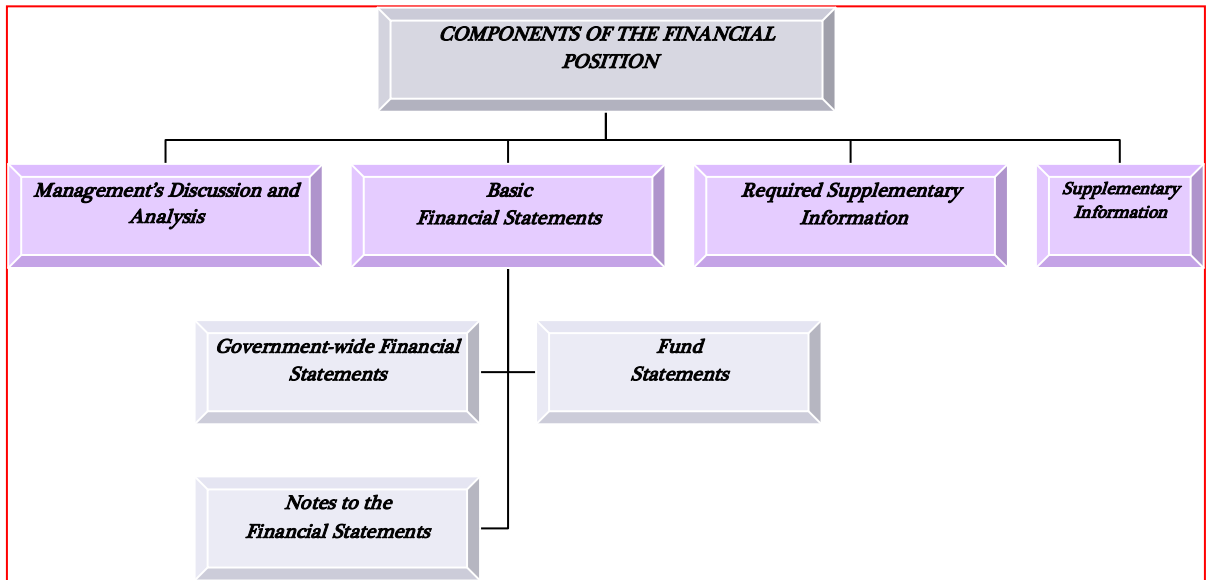
COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise four components: (1) management's discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information and (4) other supplementary information.



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

Basic Financial Statements

- *Government-Wide Financial Statements*

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the statement of net assets – presents information on all of the Municipality's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the Municipality's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's capital assets may need to be considered to assess the overall health of the Municipality. The second statement – the statement of activities – presents information showing how the net assets changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

The government-wide statements reports as governmental activities the Municipality's basic services such as public works, sanitation, public safety, culture and recreation, health, welfare, education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

- ***Fund Financial Statements***

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

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

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

- ***Notes to the financial statements***

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required supplementary information

The statements and notes are followed by the required supplementary information that contains the budgetary comparison schedule for the General Fund.

Supplementary information

The supplementary information includes a financial data schedule containing financial information of the Section 8 Housing Choice Voucher Program administered by the Municipality.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

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

TABLE 1

<i>Summary Statement of Net Assets As of June 30,</i>		
	Governmental Activities	
	2010	2009 (as restated)
Assets		
Current and other assets	\$ 14,266,273	\$ 14,419,167
Capital assets	51,283,754	45,367,946
Total assets	<u>\$ 65,550,027</u>	<u>\$ 59,787,113</u>
Liabilities		
Current and other liabilities	\$ 6,129,353	\$ 4,943,653
Long term liabilities	14,681,169	15,585,154
Total liabilities	<u>20,810,522</u>	<u>20,528,807</u>
Net assets		
Invested in capital assets, net of related debt	42,062,828	36,180,567
Restricted	5,815,686	6,062,794
Unrestricted (deficit)	(3,139,009)	(2,985,055)
Total net assets	<u>\$ 44,739,505</u>	<u>\$ 39,258,306</u>

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased 14% with respect to prior year.

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g. land, construction in progress, buildings, equipment, and infrastructure); less accumulated depreciation and less any related outstanding debt used to acquire those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt.

Restricted net assets represent resources that are subject to external restrictions on how they may be used. Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

As of June 30 2010, the Municipality presented an unrestricted net assets deficit. This deficit primarily arises from long term obligations such as compensated absences and debts to CRIM for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a "pay as you go" basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as invested in capital assets, net of related debt section of net assets. Therefore, are reported as part of the unrestricted net assets section.

Changes in net assets

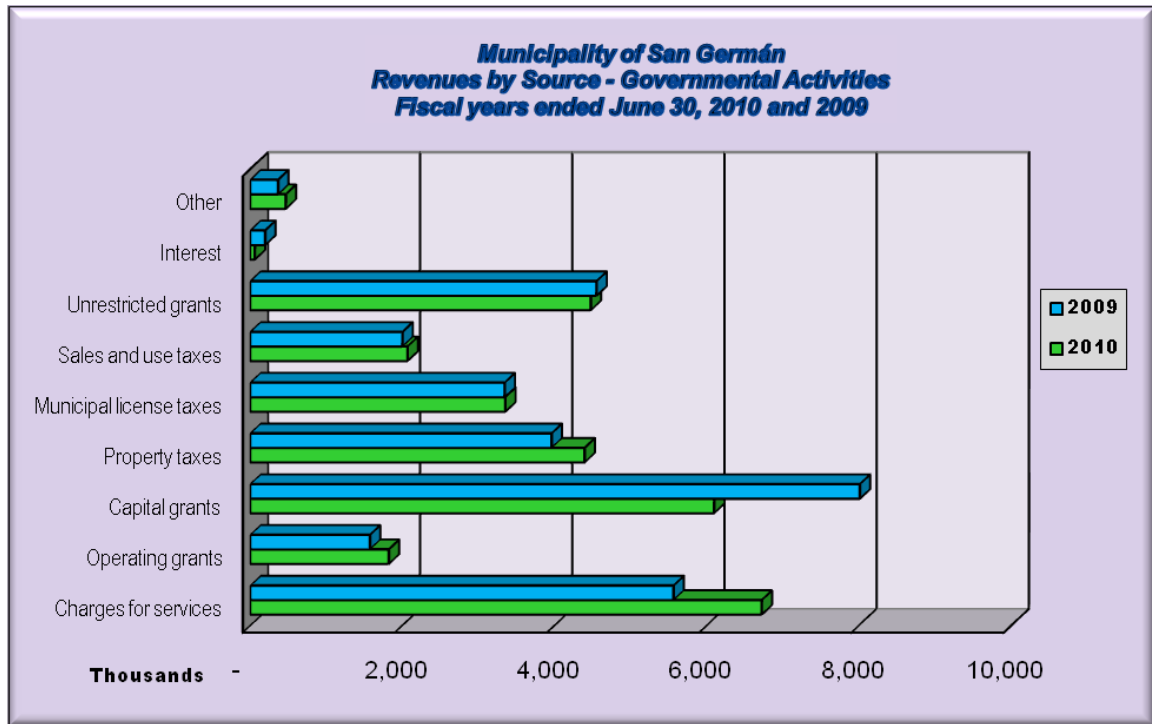
The following table summarizes the changes in net assets for the years ended June 30, 2010 and 2009:

TABLE 2

<i>Summary of Changes in Net Assets As of June 30,</i>		
	Governmental Activities	
	2010	2009 (as restated)
Program revenues:		
Fees, fines and charges for services	\$ 6,718,993	\$ 5,560,246
Operating grants and contributions	1,818,977	1,570,527
Capital grants and contributions	6,094,482	8,008,875
General revenues:		
Property taxes	4,391,517	3,957,513
Municipal license taxes	3,349,086	3,340,440
Sales and use taxes	2,064,239	1,997,928
Grants and contributions not restricted to specific programs	4,472,247	4,547,463
Interest	56,989	193,869
Other	463,495	306,265
Net gain on sale and disposition of capital assets	-	58,111
Total revenues	29,430,025	29,541,237
Expenses:		
General government	5,745,775	7,195,489
Public safety	1,594,494	1,720,820
Public works	9,867,565	10,074,722
Sanitation	1,828,497	1,368,000
Health	786,763	786,763
Welfare	2,977,240	2,641,776
Culture and recreation	644,181	565,656
Education	56,329	292,772
Interest on long term debt	447,982	509,371
Total expenses	23,948,826	25,155,369
Change in net assets	5,481,199	4,385,868
Net assets-beginning of year, as restated	39,258,306	34,872,438
Net assets-end of year	\$ 44,739,505	\$ 39,258,306

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2010**

FIGURE 1



Approximately 23% of the Municipality’s revenues came from fees and charges for services, 21% from capital grants, 15% unrestricted grants, 15% from property taxes, and 11% from municipal license tax. The Municipality’s expenses cover a range of services. The largest expenses are public works and sanitation representing approximately 45%, and general government with 28%.

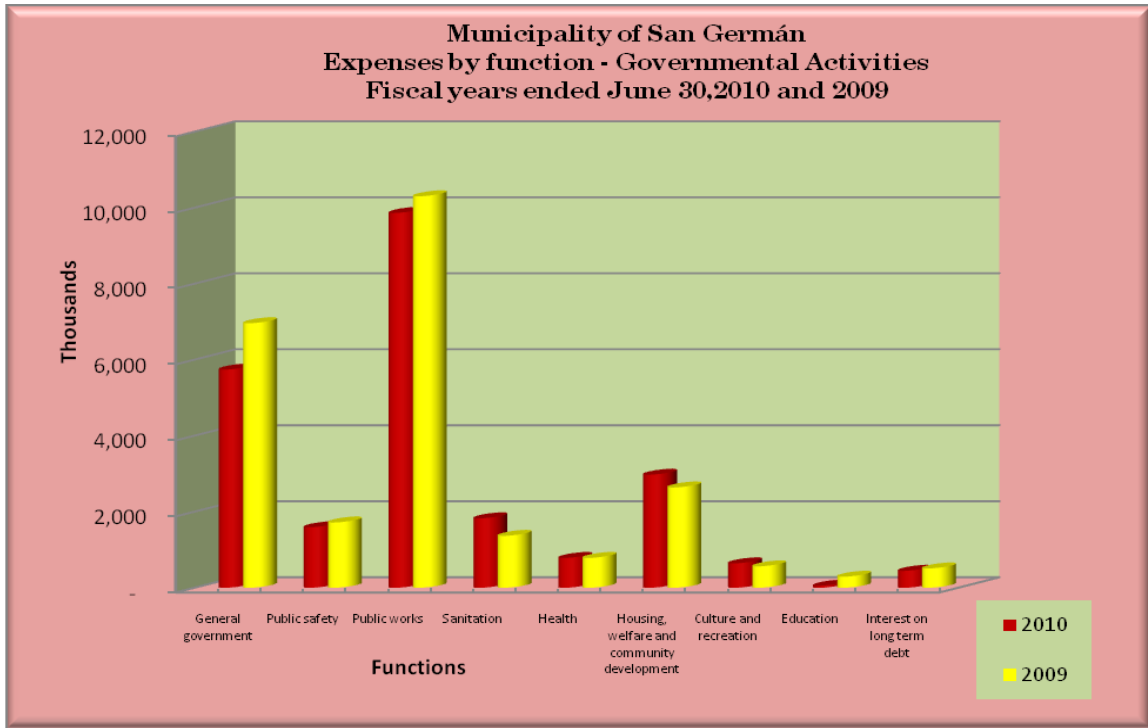
With respect to prior year, revenues reported a net decrease of approximately 0.4%. This net decrease is primarily the result of: (1) a 21% increase in fees and charges for services that resulted from a 45% increase in construction permits and an increase of 29% in the compensation in lieu of taxes received from the P.R. Electric Power Authority (P.R.E.P.A.); (2) a 24% decrease in capital grants that resulted from an 85% decrease in the funds provided by the P.R. Infrastructure Financing Authority for improvements to the Arquelio Torres Coliseum, which was offset by \$3,055,175 received from Law No. 2212 and PEC grants for the improvements of the downtown electric system and other capital projects; (3) 16% increase in operating grants due to the additional federal funds received under the American Reinvestment and Recovery Act (“ARRA”), including Early Head Start, Energy Efficiency, Capacity Building and Homelessness Prevention and Rapid Re-housing programs; (4) an 11% increase in property taxes that resulted from a 37% increase in the property tax collected for the debt service fund (“C.A.E.”); (5) a 71% decrease in interest due to a significant decrease in the interest rates earned on the certificates of deposit; and finally, (6) a 27% increase in other revenues due to a \$172,199 settlement of a legal claim filed by the Municipality against one of its contractors.

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MANAGEMENT’S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

FIGURE 2



Expenses decreased 5% in comparison with the 2009 year. The most significant decreases occurred in education with 81%, general government with 18%, public safety with 7% and in public works with 4%. These decreases were offset by a 13% increase in housing, welfare and community development. The significant decrease in education is due to transfer of the salaries, employee benefits and other costs incurred by the Municipality’s school bus drivers to the new transportation department created within the public works function. The \$1,219,355 decrease in general government is due to a 5% decrease in the accrued compensated absences that resulted from a 4% decrease in the total number of workers employed by the Municipality (due to the hiring of 20 sanitation employees by the private company in charge of the privatization of the waste removal services); and to a 39% decrease in the workmen’s compensation expense. The 7% decrease in public safety is the result of a 12% decrease in the salaries and employee benefits paid to the municipal police force (due to a reduction of policemen that transferred to the Commonwealth’s police force and others who retired during the year). The decrease in public works is due to a 96% decrease in noncapital outlays. The significant increase in housing, welfare and community development is due to a 27% increase in the operating costs of the two PRPHA’s low-income housing projects administered by the Municipality and to the expenses incurred by ARRA-funded programs including Capacity Building and Homelessness Prevention and Rapid Rehousing programs. As noted previously, the minimal net decrease in revenues and the reasonable net decrease in expenses caused an increase of 25% in the net change in net assets with respect to the prior year’s net change.

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

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

TABLE 3

<i>Net Cost of Municipality's Governmental Activities Fiscal years ended June 30,</i>				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2010	2009 (as restated)	2010	2009 (as restated)
General government	\$ 5,745,775	\$ 6,965,130	\$ (3,104,265)	\$ (4,605,185)
Public safety	1,594,494	1,720,820	(1,468,567)	(1,539,920)
Public works	9,867,565	10,305,081	(73,191)	521,021
Sanitation	1,828,497	1,368,000	(1,828,497)	(1,368,000)
Health	786,763	786,763	(786,763)	(786,763)
Housing, welfare and community development	2,977,240	2,641,776	(1,034,179)	(892,108)
Culture and Recreation	644,181	565,656	(582,031)	(550,622)
Education	56,329	292,772	9,101	(284,773)
Other	447,982	509,371	(447,982)	(509,371)
	<u>\$ 23,948,826</u>	<u>\$ 25,155,369</u>	<u>\$ (9,316,374)</u>	<u>\$ (10,015,721)</u>

The net cost of services was fully covered by other general revenues such as property and municipal license taxes among others.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2010, the governmental funds reported combined ending fund balances of \$4,761,665, a net decrease of \$2,216,659 in comparison with the prior year. This decrease was caused primarily by a net change in the general fund of (\$658,735); \$568,295 in the debt service fund; (\$408,527) in the Permanent Capital Improvements fund; and (\$1,623,334) in the other governmental funds. Of the total combined fund balances, (\$289,570) (-6%) constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. For the year ended June 30, 2010, the fund balance of the general fund decreased by \$658,735 when compared with the prior year. There was a net increase in revenues of \$628,665 due to: (1) an increase of \$644,223 in rental income and charges for services due to a 19% increase in the compensation in lieu of taxes received from the P.R. Electric Power Authority (P.R.E.P.A.); (2) a \$117,006 increase in intergovernmental revenue due to a 3% increase in the funds received from the municipal equalization fund; (3) a \$199,612 increase in other revenue due to the reimbursement from Public Order Code funds of salaries and employee benefits incurred by the municipal police force and of workmen's compensation costs incurred by various Commonwealth's and Federal programs; (4) a \$334,949 decrease in property taxes due to a non-recurrent receipt from the CRIM in fiscal year 2009 of prior years property taxes; (5) and finally, a \$85,967 decrease in interest revenue due to a decrease in the interest rates earned on the certificates of deposits owned by the Municipality.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

The net decrease in expenditures of \$71,616 is the result of an increase of \$479,017 in sanitation services; a \$92,953 increase in culture and recreation (due to a 15% increase in salaries and employee benefits); a \$287,294 decrease in education as a result of the transfer of the salaries, employee benefits and other costs incurred by the Municipality's school bus drivers to the new transportation department created within the public works function government; a \$169,322 decrease in capital outlays; a \$91,209 decrease in public safety (mainly due to a 12% decrease in the salaries and employee benefits paid to the municipal police force as a result of a reduction of policemen that transferred to the Commonwealth's police force and others who retired during the year); and finally, a \$70,235 decrease in public works as a result of a 14% decrease in repairs and maintenance and operating equipment leases expenditures.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2009-2010 presented a decrease of 6% with respect to prior year budget. Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year, budget revenues were increased by \$1,257,704 due to an increase in the estimate adjustment made by PREPA of the contribution in lieu of taxes ("CELI") for the fiscal year 2009-2010 and to an increase in the funds received from the municipal equalization fund. Budget expenditures were increased by \$1,628,249. Actual revenues were more than the revised budgeted revenues by \$91,471 (net). The most significant positive variances were in municipal license taxes (\$77,963), intergovernmental revenue (\$33,673), and other revenues (\$71,767), which were offset by a negative variance of \$96,795 in interest revenue and \$15,346 in sales and use taxes. The positive variance in intergovernmental revenue was due to an increase in the Christmas Bonus reimbursement received from the P.R. Department of Treasury. The \$71,767 positive variance in other revenues is mainly due to the reimbursement of workmen's compensation and Single Audit costs made by various state and federal programs and of salaries and employee benefits contributions of public works and sanitation employees used in clean-up projects subsidized by FEMA grants. The negative variance in the interest revenue is the result of a significant decrease in the interest rates earned on the certificates of deposits owned by the Municipality.

A positive variance of \$43,802 between revised budget and actual expenditures was due mainly to a net decrease of \$101,619 in general government, which was offset by a negative variance of \$59,230 in public works. The positive variance in general government expenditures is due mainly to legal claims, municipal legislators allowances, workmen's compensation, state unemployment tax and telephone charges that were less than the budget estimate. The negative variance in public works is due to electric service charges in excess of budgeted amounts. Actual expenditures exceeded actual revenues by \$321,221.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$51,283,754 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of approximately 13% over the prior year.

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

TABLE 4

<i>Capital Assets, net As of June 30,</i>		
	Governmental Activities	
	2010	2009 (as restated)
Non-depreciable assets:		
Land	\$ 7,224,602	\$ 5,961,346
Construction in progress	6,937,405	8,885,906
Depreciable assets:		
Buildings and Buildings Improvements	24,050,498	17,001,434
Equipment	3,614,438	3,608,290
Roads	4,359,526	4,676,742
Bridges	5,097,285	5,234,228
Total	\$ 51,283,754	\$ 45,367,946

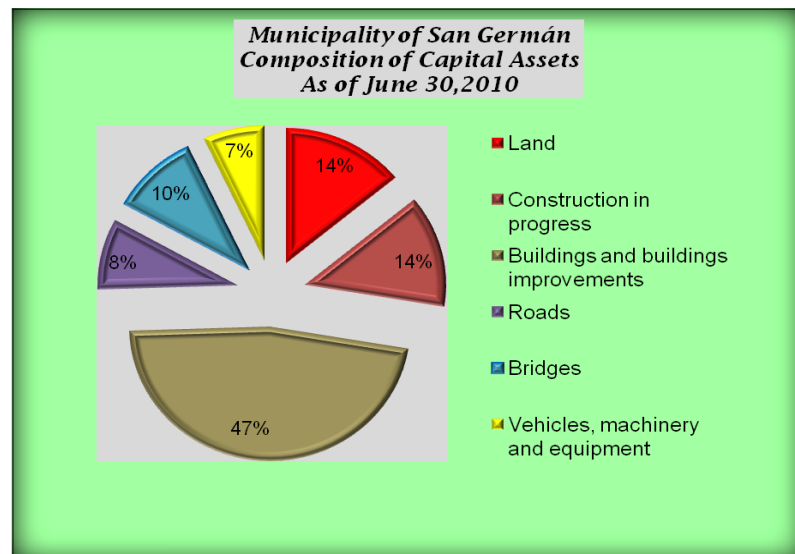
The Municipality's major capital projects that were still in construction as of June 30, 2010 are as follows:

- Construction of a sanitary sewer system Guamá Community - \$1,539,253
- Improvements to the downtown electrical infrastructure - \$3,208,219

These projects will be financed through Federal and Commonwealth grants, funds from the Commonwealth Legislature, general obligation bonds and Municipal funds.

In addition, the Municipality acquired equipment amounting to \$503,025, mainly vehicles for the municipal police force acquired with Public Order Code grant funds.

Capital assets composition as of June 30, 2010 follows:



**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT’S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

More detailed information about the Municipality’s capital assets is presented in Note G to the financial statements.

Long-term debt

At year-end, the Municipality maintains an outstanding balance of \$9,514,568 in general and special bonds and notes, a decrease of 10% with respect to prior year. The following is a summary of the Municipality’s outstanding debt as of June 30, 2010 and 2009:

TABLE 5

<i>Outstanding Long-term Debt As of June 30,</i>		
	Governmental Activities	
	2010	2009
General and special obligation bonds and notes	\$ 9,514,568	\$ 10,516,568
General obligation bond anticipation note	149,244	-
Note payable to CRIM – LIMS	102,413	165,852
Note payable to CRIM – prior years delinquent accounts	106,098	110,921
Compensated absences	3,489,953	3,692,679
Christmas Bonus	346,355	402,681
Claims and judgments	55,000	14,000
Payable to CRIM – property tax advances	122,226	84,788
Note Payable to SIFC	-	57,295
Note payable to PRASA	31,294	92,028
Liabilities expected to be refinanced	44,620	-
Note payable to ERS	-	62,105
Payable to PREPA	719,398	386,237
Total	<u>\$ 14,681,169</u>	<u>\$ 15,585,154</u>

During the year, a new bond anticipation note was issued in the amount of \$149,244 for the construction of a sanitary sewer system. The liabilities expected to be refinanced correspond to an outstanding matured debt of \$56,608 for unemployment benefits paid by the Commonwealth of Puerto Rico on behalf of the Municipality. Of this amount, the Municipality intends to refinance \$44,620 on a long term basis through the issuance of a \$44,620 non-interest bearing note actually issued on August 26, 2010. In addition, the increase in the notes payable with Puerto Rico Electric Power Authority (PREPA) is the result of an excess of the annual energy charges incurred by the Municipality over the contribution in lieu of taxes (“CELI”) for the fiscal year 2008-2009, which was recorded both a long term debt and an account receivable from the agency. Finally, the decrease in compensated absences is the result of a 4% decrease in the total number employees working for the Municipality as of June 30, 2010 due to the hiring of 20 sanitation employees by the private company in charge of the privatization of the waste removal services. More detailed information about the Municipality’s long-term liabilities is presented in Note I to the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2010-2011 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 17.7%, which compares with the Commonwealth rate of 16.6%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2010-2011 are \$17,128,566, an increase of approximately 7% with respect to prior year estimates. Budgeted expenditures are expected to be reduced accordingly to the decrease of budgeted revenues. In addition to the estimated budget for the general fund, the Municipality has submitted Federal and Commonwealth funds proposals for welfare as well as for capital improvements and public works funds.

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 demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Director of Finance at P.O. Box 85, San German, Puerto Rico 00683.

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**STATEMENT OF NET ASSETS
JUNE 30, 2010**

Assets	Governmental Activities
Cash and cash equivalents	\$ 1,290,692
Receivables (net of allowance for uncollectibles) (note C):	
Municipal license taxes	179,003
Sales and use taxes	127,682
Rents and construction permits	782,413
Due From (note D):	
Commonwealth Government	2,151,515
Federal Government	578,325
Restricted Assets:	
Cash and cash equivalents	4,265,384
Cash with fiscal agents	4,761,932
Deferred bond issuance costs, net of accumulated amortization of \$36,185	38,227
Capital assets (note G):	
Land and construction in progress	14,162,007
Other capital assets, net	37,121,747
Total capital assets, net	51,283,754
Other assets (note F)	91,100
 Total assets	 \$ 65,550,027
 Liabilities	
Accounts payable and accrued liabilities	\$ 2,478,419
Interest payable	210,080
Due to:	
Commonwealth Government (note D)	306,865
Federal Government	444,288
Deferred revenues	2,689,701
Long-term liabilities (note I):	
Due within one year	2,339,571
Due in more than one year	12,341,598
Total liabilities	20,810,522
 Net assets	
Invested in capital assets, net of related debt	42,062,828
Restricted for:	
Capital projects	619,964
Debt service	3,530,378
Other specified purposes	1,665,344
Unrestricted (deficit)	(3,139,009)
 Total net assets	 \$ 44,739,505

The accompanying notes are an integral part of these financial statements

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN
STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2010**

<u>Functions</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expenses) Revenues and Change in Net Asset</u>
		<u>Fees, Fines and Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
Governmental activities:					
General government	\$ 5,745,775	\$ 2,310,616	\$ 330,894	\$ -	\$ (3,104,265)
Public safety	1,594,494	-	125,927	-	(1,468,567)
Public works	9,867,565	3,413,831	286,061	6,094,482	(73,191)
Sanitation	1,828,497	-	-	-	(1,828,497)
Health	786,763	-	-	-	(786,763)
Welfare	2,977,240	994,546	948,515	-	(1,034,179)
Culture and recreation	644,181	-	62,150	-	(582,031)
Education	56,329	-	65,430	-	9,101
Interest on long-term debt	447,982	-	-	-	(447,982)
Total government activities	\$ 23,948,826	\$ 6,718,993	\$ 1,818,977	\$ 6,094,482	(9,316,374)

General Revenues:

Taxes:

Property taxes	4,391,517
Municipal license taxes	3,349,086
Sales and use taxes	2,064,239
Grants and contributions not restricted to specific programs	4,472,247
Interest	56,989
Other	463,495
Total general revenues	14,797,573

Change in net assets	5,481,199
Net assets beginning of year, as restated (note P)	39,258,306
Net assets end of year	\$ 44,739,505

The accompanying notes are an integral part of these financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2010

	Major Funds					Total Governmental Funds
	General	Debt Service	Commonwealth Legislative Resolutions	Permanent Capital Improvements	Other Governmental Funds	
Assets						
Cash and cash equivalents	\$ 1,290,692	\$ -	\$ -	\$ -	\$ -	\$ 1,290,692
Receivables (net of allowance for uncollectibles):						
Municipal license taxes	179,003	-	-	-	-	179,003
Sales and use taxes	127,682	-	-	-	-	127,682
Rents and construction permits	762,391	-	-	-	20,022	782,413
Due from:						
Commonwealth Government	1,009,497	77,519	-	-	1,064,499	2,151,515
Federal Government	-	-	-	-	578,325	578,325
Other funds (note E)	1,605,117	-	350	-	26,419	1,631,886
Advances to other funds (note E)	285,531	-	-	-	-	285,531
Restricted Assets:						
Cash and cash equivalents	-	-	1,066,042	859,546	2,339,796	4,265,384
Cash with fiscal agents	-	3,662,432	10,416	-	1,089,084	4,761,932
Total assets	<u>\$ 5,259,913</u>	<u>\$ 3,739,951</u>	<u>\$ 1,076,808</u>	<u>\$ 859,546</u>	<u>\$ 5,118,145</u>	<u>\$ 16,054,363</u>
Liabilities and fund balances						
Liabilities:						
Accounts payable and accrued liabilities	\$ 647,774	\$ -	\$ 24,208	\$ 121,490	\$ 1,684,949	\$ 2,478,421
Matured bonds and interest payable	-	982,353	-	-	-	982,353
Due to:						
Commonwealth Government	306,865	-	-	-	-	306,865
Federal Government	-	-	-	-	444,288	444,288
Other funds (note E)	26,419	-	29,781	350	1,575,336	1,631,886
Advances from other funds (note E)	-	-	56,091	-	229,440	285,531
Deferred revenues (note H)	4,176,762	-	-	-	986,592	5,163,354
Total liabilities	<u>5,157,820</u>	<u>982,353</u>	<u>110,080</u>	<u>121,840</u>	<u>4,920,605</u>	<u>11,292,698</u>
Fund balances:						
Reserved for:						
Encumbrances	106,132	-	-	-	-	106,132
Debt service	-	2,757,598	-	-	-	2,757,598
Capital projects	-	-	104,792	737,706	-	842,498
Other specified purposes	-	-	861,936	-	197,540	1,059,476
Advances	285,531	-	-	-	-	285,531
Unreserved	(289,570)	-	-	-	-	(289,570)
Total fund balances	<u>102,093</u>	<u>2,757,598</u>	<u>966,728</u>	<u>737,706</u>	<u>197,540</u>	<u>4,761,665</u>
Total liabilities and fund balances	<u>\$ 5,259,913</u>	<u>\$ 3,739,951</u>	<u>\$ 1,076,808</u>	<u>\$ 859,546</u>	<u>\$ 5,118,145</u>	<u>\$ 16,054,363</u>

The accompanying notes are an integral part of these financial statements

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET ASSETS
JUNE 30, 2010**

Total governmental fund balances:		\$ 4,761,665
Amounts reported for the governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds:		51,283,754
Other assets used in governmental activities are not financial resources and, therefore, are not reported in the funds:		
Deferred charges-bond issue costs	\$ 38,227	
Other assets	91,100	129,327
Other assets are not available to pay for current period expenditures and, therefore, are deferred in the funds:		
Receivables:		
Municipal license taxes	162,940	
Construction permits	226,520	
Rent - properties	154,783	
Rent - land lots	352,251	
P.R. Department of Family Law No. 105	16,459	
P.R. Department of Labor- Law No. 52 and 82	79,612	
P.R. Department of Labor- Law No. 9	46,560	
P.R. Department of Treasury - Christmas bonus reimbursement	160,871	
P.R. Electric Power Authority (PREPA)	719,397	
P.R. Office of Ombudsman for the Elderly	12,568	
OCAM - Public Order Code	211,267	
Federal Grants - CDBG	76,402	
Federal Grants - Public Housing Capital Fund	95,820	
Federal Grants - HOPWA	41,741	
Federal Grants - ESG	13,546	
Federal Grant - State and Community Highway Safety	95,350	
Federal Grants - EECBG	7,568	2,473,655
Interest liabilities are not due and payable in the current period and, therefore, are not reported in the funds:		(74,727)
Long-term liabilities are not due and payable in the current period and, therefore are not reported in the funds:		
General and special obligation bonds and notes	(8,667,568)	
Compensated absences	(3,489,952)	
Claims and judgments	(55,000)	
Note payable to CRIM - delinquent accounts	(106,098)	
Note payable to CRIM - LIMS	(102,413)	
Payable to PREPA	(719,398)	
Christmas bonus	(346,355)	
Payable to CRIM- Property taxes advances	(122,226)	
Note payable to P.R. Water and Sewer Authority	(31,294)	
Note payable to P.R. Department of Labor and Human Resources	(44,621)	
General obligation bond anticipation note	(149,244)	(13,834,169)
Net assets of governmental activities		\$ 44,739,505

The accompanying notes are an integral part of these financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES -
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2010

	Major Funds				Other Governmental Funds	Total Governmental Funds
	General	Debt Service	Commonwealth Legislative Resolutions	Permanent Capital Improvements		
Revenues:						
Taxes:						
Property taxes (note J)	\$ 2,818,302	\$ 1,610,653	\$ -	\$ -	\$ -	\$ 4,428,955
Municipal license taxes	3,305,076	-	-	-	-	3,305,076
Sales and use taxes	1,651,823	425,646	-	-	-	2,077,469
Intergovernmental:						
Commonwealth Government (note K)	4,558,849	-	52,999	-	3,852,277	8,464,125
Federal Government	-	-	-	-	3,153,173	3,153,173
Rental income and charges for services	4,957,789	-	-	-	1,006,376	5,964,165
Fines and forfeitures	78,146	-	-	-	-	78,146
Interest	42,050	2,905	10	9,104	2,920	56,989
Other	244,872	15,440	-	-	272,686	532,998
Total Revenues	<u>17,656,907</u>	<u>2,054,644</u>	<u>53,009</u>	<u>9,104</u>	<u>8,287,432</u>	<u>28,061,096</u>
Expenditures:						
Current:						
General government	5,784,988	-	-	-	358,702	6,143,690
Public safety	1,458,756	-	-	-	61,773	1,520,529
Public works	6,694,987	-	71,038	351	647,595	7,413,971
Sanitation	1,747,210	-	-	-	8,195	1,755,405
Health	786,763	-	-	-	-	786,763
Welfare	592,518	-	1,000	-	2,345,516	2,939,034
Culture and recreation	553,289	-	-	-	75,748	629,037
Education	-	-	-	-	56,329	56,329
Capital outlays	77,270	-	75,327	417,280	6,541,938	7,111,815
Debt service:						
Principal	-	1,053,000	-	-	-	1,053,000
Interest	-	431,289	-	-	-	431,289
Total expenditures	<u>17,695,781</u>	<u>1,484,289</u>	<u>147,365</u>	<u>417,631</u>	<u>10,095,796</u>	<u>29,840,862</u>
Excess (deficiency) of revenues over expenditures	(38,874)	570,355	(94,356)	(408,527)	(1,808,364)	(1,779,766)
Other financing sources (uses):						
Bond anticipation note issuance	-	-	-	-	149,244	149,244
Liability expected to be refinanced - unemployment tax	44,621	-	-	-	-	44,621
Payment of long-term debt - PREPA	(630,756)	-	-	-	-	(630,756)
Transfers - in	141,122	-	-	-	174,848	315,970
Transfers - (out)	(174,848)	(2,060)	-	-	(139,062)	(315,970)
Total other financing sources (uses)	<u>(619,861)</u>	<u>(2,060)</u>	<u>-</u>	<u>-</u>	<u>185,030</u>	<u>(436,891)</u>
Net change in fund balances (deficit)	(658,735)	568,295	(94,356)	(408,527)	(1,623,334)	(2,216,657)
Fund balance at beginning of year	<u>760,828</u>	<u>2,189,303</u>	<u>1,061,084</u>	<u>1,146,233</u>	<u>1,820,874</u>	<u>6,978,322</u>
Fund balance at end of year	<u>\$ 102,093</u>	<u>\$ 2,757,598</u>	<u>\$ 966,728</u>	<u>\$ 737,706</u>	<u>\$ 197,540</u>	<u>\$ 4,761,665</u>

The accompanying notes are an integral part of these financial statements

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2010**

Net change in fund balances - total governmental funds **\$ (2,216,657)**

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

Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:

Expenditures for capital assets:	\$ 7,111,815	
Less: current year depreciation	<u>(1,751,869)</u>	5,359,946

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset: (21,470)

Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds:

Municipal license tax (net change)	44,010	
Construction permits	226,520	
Rent (net change)	17,644	
Others	75,837	
P.R. Department of Treasury - Law No. 52	72,430	
P.R. Department of Treasury - Law No. 9	46,560	
P.R. Department of Treasury - Christmas bonus reimbursement	160,871	
P.R. Electric Power Authority (PREPA)	642,611	
OCAM - Public Order Code (current year)	182,372	
Federal Grants - Public Housing Capital Fund	95,820	
Federal Grants - CDBG	76,402	
Federal Grants - EECBG	7,568	
Federal Grant - State and Community Highway Safety	95,350	
Donated capital assets	<u>668,433</u>	2,412,428

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

CRIM - Property taxes (General Fund) (current year)	(52,643)	
CRIM - Property taxes (General Fund) (prior year)	15,205	
CRIM - Intergovernmental (prior year)	(60,440)	
Sales and use taxes (Debt Service Fund) (prior year)	(13,230)	
Sales and use taxes (General Fund) (prior year)	-	
Others	(55,619)	
P.R. Electric Power Authority (PREPA) (prior year)	(309,451)	
P.R. Department of Treasury - Christmas bonus reimbursement (prior year)	(187,033)	
OCAM - Public Order Code (prior year)	(120,135)	
P.R. Department of Treasury - Law No. 52	(92,689)	
Federal Grants - CDBG	(133,500)	
Federal Grants - Public Housing Capital Fund (prior year)	<u>(35,540)</u>	(1,045,075)

Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

Matured bonds principal payments (net change)		51,000
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Proceeds from other long term debt is an other financing source in the governmental funds, but increase long-term liabilities in the Statement of Net Assets: (193,865)

Repayment of long-term debt consumes the current financial resources of governmental funds, but has no effect on net assets of governmental activities:

General obligation bonds and notes	1,002,000	
Other long-term liabilities	<u>1,576,804</u>	2,578,804

Continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2010

Governmental funds report the effect of bond issuance costs as expenditure when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This amount is the net effect of these differences:

Amortization of bond issuance costs (6,153)

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds:

Claims and judgments	(41,000)	
Accrued interest (net change)	5,757	
Compensated absences	(92,244)	
P.R. Electric Power Authority (PREPA)	(963,917)	
Christmas bonus	<u>(346,355)</u>	<u>(1,437,759)</u>

Change in net assets of governmental activities

\$ 5,481,199

The accompanying notes are an integral part of these financial statements

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of San Germán (“the Municipality”) was founded in 1573. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of fourteen (14) members of the Municipal Legislature. The Municipality engages in a comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

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

1. *Financial reporting entity*

The financial reporting entity included in this report consists of the financial statements of the Municipality of San Germán (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government’s reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete. There are two methods of presentation of the component unit in the financial statements: (a) blending the financial data of the component units’ balances and transactions in a manner similar to the presentation of the Municipality’s balances and (b) discrete presentation of the component unit’s financial data in columns separate from the Municipality’s balances and transactions.

The basic criteria for deciding financial accountability are any one of the following:

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit’s governing body and,
 - 1) The primary government can impose its will on the potential component unit and/or,
 - 2) A financial benefit/ burden exist between the primary government and the potential component unit.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

In addition, a legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if *all* of the following criteria are met:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

Other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Professional judgment is applied in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

2. *Basis of presentation, measurement focus and basis of accounting*

The financial report of the Municipality consists of the Management's Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

Management's Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to the analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Government-wide statements

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long-lived) assets and receivables as well as long-term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed non-exchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes and sales and use taxes (derived tax revenues) when the underlying exchange has occurred. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants, revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

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. The Municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues or expenditures or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users (for Commonwealth Legislature Resolutions and Permanent Capital Improvement Funds).

The Municipality reports the following major governmental funds:

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.

Debt Service Fund: Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Commonwealth Legislature Resolutions Fund: The Commonwealth Legislative Resolutions Fund is used to account for grants from the Commonwealth's Legislature.

Permanent Capital Improvements Fund: The Permanent Improvement fund is used to account for the moneys received from the \$575,000,000 in 2006 Series A Public Improvement Bonds issued by Commonwealth Government. The financial resources received by this fund are used for the restoration of the downtown area and the construction of an educational park.

The governmental funds reported in the fund financial statements are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method of accounting, revenues are recognized when they are susceptible to accrual (i.e. 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 Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenues susceptible to accrual include property taxes (recognized as revenues in the year for which they are levied); municipal license taxes and sales and use taxes (recognized when the underlying exchange has occurred and time requirements are met) and interest. In applying the susceptible to accrual concept to intergovernmental revenues, revenues are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met and revenue becomes available. There are, however, essentially two types of these revenues. In the first case, on expenditure-driven grants, monies must be expended on the specific project or purpose (eligibility requirement), before any amounts are paid to the Municipality. Revenue is, therefore, recognized as expenditures are incurred to the extent available. In the other cases, monies are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. In these cases revenues are recognized as the time of receipt or earlier if the susceptible to accrual criteria is met. Licenses and permits, charges for services, rent, fines and miscellaneous revenues are generally recorded as revenues when received or are recognized earlier if the susceptible to accrual criteria is met.

The Municipality reports in the governmental funds statements deferred revenues which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred. Certain exceptions to this fundamental concept include the following: (1) payments of principal and interest on general long-term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) (2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, a reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Notes to Financial Statements

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

Required Supplementary Information:

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

3. *Deposits and investments*

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition. Nonnegotiable certificates of deposits with original maturity of more than three months are considered time deposits as required by current standards. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law.

The laws and regulations of the Commonwealth of Puerto Rico authorize the Municipality to invest only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by the Governmental Development Bank for Puerto Rico ("GDB").

4. *Restricted assets*

Restricted assets are liquid assets which have third-party limitations on their use. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law. Restricted cash with fiscal agent in the debt service fund consists of the undisbursed balance of property and sales tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of the other governmental funds represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB or a federal government agency.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. *Receivables and due from governmental entities*

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property and sales tax revenues of current fiscal year collected by the CRIM (property tax) and the Puerto Rico Department of Treasury (sales tax) on the subsequent fiscal year.

6. *Interfund receivables and payables*

Activity among funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due from/to 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 among funds are reported as "due from/to other funds".

7. *Inventories*

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

8. *Deferred bond issuance costs*

Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

9. *Capital assets*

Capital assets reported in the governmental activities in the Statements of Net Assets include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items). The Municipality defines capital assets (except for infrastructure assets) as assets that have an individual cost of \$50 or more and have a useful life of one or more years. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

All capital assets, other than land and construction in progress, are depreciated using the straight-line method over the following useful lives:

<u>Description</u>	<u>Years</u>
Buildings	40
Improvements	10-20
Vehicles, machinery and equipment	5-10
Infrastructure	2-50

In accordance with current accounting standards capital assets are reviewed for impairment. Impairment occurs when there is a significant decline in asset service utility due to the occurrence of a prominent event or change in circumstances affecting the asset. Current standards provide guidance for accounting and reporting for impairment and for insurance recoveries.

10. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities.

11. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness).

The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Pursuant to Law No. 152 of August 20, 1996 effective July 1, 1997 the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

12. Fund balances and Net Assets

In the fund financial statements, governmental funds report reserved and unreserved fund balances. Reservations of fund balance represent portions of the 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 balances:

Encumbrances:	Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.
Inventories	Represent the valuation amount assigned for the restriction and use of resources accounted in inventory on hand.
Debt Service:	Represent net assets available to finance future debt service payments.
Capital Projects:	Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed.
Other specified purposes:	Represent amounts to be used for future expenditures of Federal and Commonwealth's grants as well as funds reserved through enabling legislation passed by the government itself, to be used to finance activities other than construction or capital improvement commitments.
Advances:	Represent the non-current portion of interfund loans.

In the government-wide statements net assets are segregated into three categories:

Invested in capital assets, net of related debt:	Consist of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Restricted net assets:	Represent net assets (restricted assets net of related debt) that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).
Unrestricted net assets:	Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

13. *Interfund transactions*

The Municipality reports certain transactions as transfers, which are legally required transfers that are reported when incurred as "Transfers-in" by the recipient fund and as "Transfers-out" by the disbursing fund.

14. *Risk financing*

The Puerto Rico Department of Treasury (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of San Germán consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

15. *Use of estimates*

The preparation of the basic financial statements in accordance 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 basic financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE C – RECEIVABLES

1. *Municipal license taxes*

Municipal license taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15. During the Fiscal year ended June 30, 2010 the tax rates were as follows:

Financial business - 1.50% of gross revenues
Other organizations - .50% of gross revenues

Municipal license tax receivable and corresponding deferred revenues as of June 30, 2010 follows:

<u>Description</u>	<u>Amount</u>
Total municipal license tax receivable:	507,733
Less: allowance for uncollectibles	<u>(328,730)</u>
	<u>\$ 179,003</u>

As required by current standards, \$162,940 of the \$179,003 net balance is recorded as deferred revenue since there were not collected within the availability period.

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Resources are intended to finance the operations of the applicable fiscal year. At this moment the Municipality recognizes revenues on municipal license taxes. A discount of 5% is allowed when full payment is made on or before April 15. Since this time requirement, cash collected in advance, which totals \$2,400,000 is recorded as deferred revenue as of June 30.

2. *Sales and use taxes*

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE C – RECEIVABLES - Continued

The Municipal Legislature approved the imposition of the municipal sales and use tax on November 1, 2006 with Ordinance No. 36 Series 2006-2007, effective on November 15, 2006. On July 29, 2007 the Commonwealth Legislature approved Act No. 80 (“Act 80”) which amend Act No. 117 of July 4, 2006 to impose to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007, 1% of the 1.5% is collected by the Municipalities and the remaining .5% of the 1.5% is collected by the Puerto Rico Department of Treasury (PRDT). Act 80 also provides for restrictions on the use of the sales tax, which is required be invested in solid waste and recycling programs, capital improvements and health and public safety costs. Amount collected by the PRDT (the remaining .5% of the 1.5%) is deposited in accounts or special funds in the Governmental Development Bank for Puerto Rico (“GDB”), subject to restrictions imposed and distributed as follows:

- .2% of the .5% will be deposited in a “Municipal Development Fund” to finance costs as restricted by the Act,
- .2% of the .5% will be deposited in a “Municipal Redemption Fund” to finance loans to Municipalities subject to restrictions imposed by the Act and,
- .1% of the .5% will be deposited in a “Municipal Improvement Fund” to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth’s Legislature.

The Municipal Legislature approved a Municipal Ordinance to conform to dispositions of Act 80.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. The tax is due the 10th day of each month based on tax collected in the preceding month. Municipal sales and use tax receivable of \$127,682 represents the tax collected on June by individuals, organizations and entities but reported and paid to the Municipality on or before July 10, net of uncollectible accounts; \$15,718 and \$48,486 represents amounts of “Municipal Development Fund” and “Municipal Redemption Fund” respectively, represents the tax collected on June by individuals, organizations and entities but paid by the PRDT subsequent to June 30.

3. Rents and construction permits

A detail of rents and construction permits’ receivable as of June 30, 2010 follows:

Description	Amount
Rent-land lots	\$ 444,574
Rent-properties	212,666
Construction permits	226,520
Other	21,671
	905,431
Less: allowance for uncollectibles	(123,018)
	\$ 782,413

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE C – RECEIVABLES - Continued

Of the total amount of \$782,413 the Municipality recorded \$733,553 as deferred revenue in the governmental funds statements since they are not available as required by current standards.

NOTE D - DUE FROM (TO) GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2010 follows:

	Commonwealth Government	Federal Government
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 719,398	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	160,871	-
Municipal Revenue Collection Center (CRIM) – intergovernmental subsidy (general fund)	70,030	-
P.R. Department of Treasury – sales and use taxes – Municipal Development fund	15,718	-
Solid Waste Authority	43,480	-
<u>Major fund – Debt service fund:</u>		
Municipal Revenue Collection Center (CRIM) – property taxes	29,033	-
P.R. Department of Treasury – sales and use taxes- Municipal Redemption Fund	48,486	-
<u>Other governmental funds:</u>		
Office of Commissioner of Municipal Affairs – Public Order Code	211,267	-
P.R. Department of Labor – Law No. 9 and 52	118,989	-
P.R. Department of Treasury – Law No. 2212	698,036	-
U.S. Department of Housing and Urban Development – CDBG	-	230,859
P.R. Public Housing Administration (PRPHA) – Capital Fund Program	-	100,059
P.R. Traffic Safety Commission	-	95,350
P.R. Department of Health – HOPWA	-	67,388
U.S. Department of Health and Human Services – Early Head Start	-	60,104
Others	36,207	24,565
	\$ 2,151,515	\$ 578,325

See note H for detail of amounts due from Governmental Entities recorded as deferred revenue.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE D - DUE FROM (TO) GOVERNMENTAL ENTITIES - Continued

2. Amounts due to governmental entities as of June 30, 2010 follows:

Description	Commonwealth Government
Employees' Retirement System of the Government of P.R. (ERS)	\$ 269,237
P.R. Department of Labor – unemployment	21,933
P.R. Aqueduct and Sewer Authority (PRASA)	6,296
P.R. Industrial Development Company (PRIDCO)	6,208
Others	3,191
	\$ 306,865

NOTE E - INTERFUND TRANSACTIONS

1. Due from/to other funds:

Amounts due from/to other funds represent advances to other funds for payroll and payroll taxes expenditures, as follows:

Receivable Fund	Payable Fund	Amount
General Fund:	<u>Major fund:</u> Commonwealth Legislature Resolutions	\$ 29,781
	<u>Other governmental funds:</u> DTOP Public Order Code Law No. 9, 52 and 82 Public and Indian Housing Students boulevard HOPWA Traffic safety commission \$3,500,000 Bond issuance Early Head Start Others	402,571 209,756 163,892 161,510 152,809 67,396 56,990 51,141 50,715 258,556
		\$ 1,605,117
Commonwealth Legislature Resolutions:	<u>Major fund:</u> Permanent Improvements	\$ 350
Other governmental funds: \$1,695,000 Bond issuance \$2,100,000 Bond issuance	<u>Major fund:</u> General Fund General Fund	\$ 20,873 5,546
		\$ 26,419

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE E - INTERFUND TRANSACTIONS - Continued

2. Advances to(from) other funds:

Advances to (from) other funds represent long term advances to other funds by the general fund for payroll, payroll taxes and other expenditures, as follows:

Receivable Fund	Payable Fund	Amount
General Fund	<u>Major fund:</u>	
	Commonwealth Legislature Resolutions	\$ 56,091
	<u>Other governmental funds:</u>	
	OMEP	70,847
	Rural Development Corporation	29,425
	Special Communities	25,061
	Others	104,107
		\$ 285,531

3. Transfers in (out):

Transfers among individual funds were made for operational purposes. Transfers include (1) interest earned on restricted cash with fiscal agent in the debt service fund and operating and capital improvement loans in other governmental funds which are transferred to the general fund (2) interest in Commonwealth Legislature Resolutions funds which is transferred to the general fund and, (3) principal and interest payments of long-term debt transferred from the general fund to the debt service fund.

NOTE F- OTHER ASSETS

Other assets include cash deposits of \$91,100 held in custody of a Commonwealth's court of law for the acquisition of a parcel of land and improvements to infrastructure under litigation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE G - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2010 is as follows:

	Beginning balance July 1, 2009	Increases	Decreases	Ending balance June 30, 2010
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 5,961,346	\$ 1,263,256	\$ -	\$ 7,224,602
Construction in progress	8,885,906	5,668,559	7,617,060	6,937,405
Total capital assets not being depreciated:	14,847,252	6,931,815	7,617,060	14,162,007
Capital assets, being depreciated:				
Buildings and improvements	24,377,653	7,660,300	-	32,037,953
Equipment	9,605,606	503,025	107,702	10,000,929
Roads	12,716,028	169,859	-	12,885,887
Bridges	7,151,048	41,208	-	7,192,256
Total capital assets being depreciated	53,850,335	8,374,392	107,702	62,117,025
Less accumulated depreciation for:				
Buildings and improvements	7,376,219	611,236	-	7,987,455
Equipment	5,997,316	475,407	86,232	6,386,491
Roads	8,039,286	487,075	-	8,526,361
Bridges	1,916,820	178,151	-	2,094,971
Total accumulated depreciation	23,329,641	1,751,869	86,232	24,995,278
Total capital assets being depreciated, net	30,520,694	6,622,523	21,470	37,121,747
Governmental activities capital assets, net	<u>\$ 45,367,946</u>	<u>\$ 13,554,338</u>	<u>\$ 7,638,530</u>	<u>\$ 51,283,754</u>

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

Governmental activities:

General government	\$ 78,951
Public safety	73,965
Public works	1,487,333
Sanitation	73,092
Culture and recreation	15,144
Welfare	23,384
Total depreciation expense, governmental activities	<u>\$ 1,751,869</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE H - DEFERRED REVENUES – GOVERNMENTAL FUNDS

Deferred revenues - Intergovernmental Commonwealth Government represent revenues not available as required by current standards and for Federal Grants represent resources received before allowable expenditures are incurred or resources not available as required by current standards. A detail of these balances follows:

	General fund	Other governmental funds
<u>Major fund - General fund:</u>		
Municipal license taxes – cash received in advance	\$ 2,400,000	\$ -
Municipal license taxes – receivable	162,940	-
Rents and construction permits	733,553	-
P.R. Electric Power Authority (PREPA)	719,398	-
P.R. Department of Treasury – Christmas bonus reimbursement	160,871	-
<u>Other governmental funds:</u>		
Office of Commissioner of Municipal Affairs – Public Order Code	-	211,267
P.R. Department of Labor – Law No. 9 and 52	-	118,989
P.R. Traffic Safety Commission	-	95,350
P.R. Public Housing Administration (PRPHA) – Public and Indian Housing and Capital Fund Programs	-	160,770
Rural Development – Guama Sanitary Sewer System	-	102,785
P.R. Department of Justice – ARRA EBJAG	-	100,000
U.S. Department of Housing and Urban Development – CDBG and ARRA CDBG	-	76,402
P.R. Department of Health – HOPWA	-	41,741
U.S. Department of Housing and Urban Development – ARRA - Homeless Prevention and Rapid Re-Housing	-	19,451
Others	-	59,837
	\$ 4,176,762	\$ 986,592

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I – LONG-TERM DEBT

1. Summary of long-term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2010:

	<u>Balance at July 1, 2009</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2010</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 10,516,568	\$ -	\$ 1,002,000	\$ 9,514,568	\$ 1,066,341
General obligation bond anticipation note	-	149,244	-	149,244	-
Note payable to CRIM-LIMS	165,852	-	63,439	102,413	67,270
Note payable to CRIM-financing of delinquent accounts	110,921	-	4,823	106,098	4,823
Note payable to PRASA	92,028	-	60,734	31,294	31,294
Liabilities expected to be refinanced	-	44,620	-	44,620	44,620
Note payable to SIFC	57,295	-	57,295	-	-
Note payable to ERS	62,105	-	62,105	-	-
Compensated absences	3,692,679	92,245	294,971	3,489,953	311,193
Christmas Bonus	402,681	346,355	402,681	346,355	346,355
Claims and judgments	14,000	41,000	-	55,000	-
Payable to PREPA	386,237	963,917	630,756	719,398	398,092
Payable to CRIM-property tax advances	84,788	52,643	15,205	122,226	69,583
	<u>\$ 15,585,154</u>	<u>\$ 1,690,024</u>	<u>\$ 2,594,009</u>	<u>\$ 14,681,169</u>	<u>\$ 2,339,571</u>

2. General and special obligation bonds and notes payable

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2010 amount to \$9,514,568. All these bonds are serviced by the Governmental Development Bank for Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to collect property taxes for payment of principal and interest on bonds and notes. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by law. Debt service funds has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of special obligation notes of \$996,000 are made through the "Municipal Redemption Fund".

A detail of the general and special obligation bonds and notes as of June 30, 2010 follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I - LONG-TERM DEBT - Continued

	<u>Outstanding Amount</u>
1988 public improvement bonds of \$400,000 due in annual installments ranging from \$7,000 to \$32,000 through January 1, 2013; bearing interest at 6.13%	\$ 88,000
1989 public improvement bonds of \$765,000 due in annual installments ranging from \$16,000 to \$60,000 through January 1, 2011; bearing interest at 6.37%	60,341
1991 public improvement bonds of \$616,000 due in annual installments ranging from \$16,000 to \$45,000 through January 1, 2012; bearing interest at 5.00%	87,227
1996 public improvement bonds of \$3,500,000 due in annual installments ranging from \$70,000 to \$330,000 through July 1, 2015; bearing interest at rates ranging from 4.70% to 6.58% (6.30% at June 30, 2010)	1,650,000
2000 general obligation bonds of \$2,100,000 due in annual installments ranging from \$85,000 to \$235,000 through July 1, 2013; bearing interest at rates ranging from 2.70% to 7.81% (4.30% at June 30, 2010)	840,000
2002 general obligation bonds of \$130,000 due in annual installments ranging from \$5,000 to \$10,000 through July 1, 2026; bearing interest at rates ranging from 2.70% to 5.60% (4.30% at June 30, 2010)	90,000
2002 general obligation bonds of \$830,000 due in annual installments ranging from \$10,000 to \$75,000 through July 1, 2026; bearing interest at rates ranging from 2.70% to 5.60% (4.30% at June 30, 2010)	710,000
2003 general obligation bonds of \$320,000 due in annual installments ranging from \$9,000 to \$22,000 through January 1, 2030; bearing interest at 4.25%	302,000
2004 general obligation bonds of \$355,000 due in annual installments ranging from \$5,000 to \$30,000 through July 1, 2028; bearing interest at rates ranging from 2.36% to 5.28% (4.50% at June 30, 2010)	310,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I - LONG-TERM DEBT - Continued

2005 special obligation note of \$455,000 due in annual installments ranging from \$55,000 to \$75,000 through July 1, 2011; bearing interest at rates ranging from 3.27% to 4.62% (4.50% at June 30, 2010)	145,000
2006 general obligation bonds of \$3,000,000 due in annual installments ranging from \$67,000 to \$194,000 through January 1, 2031; bearing interest at 4.50%	2,712,000
2006 special obligation note of \$1,695,000 due in annual installments ranging from \$200,000 to \$285,000 through July 1, 2012; bearing interest at rates ranging from 4.23% to 5.32% (4.50% at June 30, 2010)	810,000
2008 special obligation bond of \$780,000 due in annual installments ranging from \$50,000 to \$105,000 through July 1, 2018; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2010)	730,000
2008 special obligation note of \$996,000 due in annual installments ranging from \$16,000 to \$86,000 through July 1, 2032; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2010)	980,000
	\$ 9,514,568

The annual requirement to amortize general and special obligation bonds and notes as of June 30, 2010 follows:

June 30,	Principal	Interest
2011	\$ 1,066,341	\$ 423,828
2012	1,081,227	363,569
2013	1,026,000	357,978
2014	759,000	313,875
2011	561,000	279,262
2016-2020	1,733,000	1,039,417
2021-2025	1,349,000	692,988
2026-2030	1,504,000	305,756
2031-2032	435,000	23,265
Totals	\$ 9,514,568	\$ 3,799,938

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I - LONG-TERM DEBT - Continued

3. Other long-term liabilities

	Outstanding Amount
<p>General obligation bond anticipation note – On June 22, 2010 the Municipality issued a \$149,244 general obligation bond anticipation note to Rural Development (“RD”). This represents the first note of a total note of \$457,000 to be issued to finance the construction of a sanitary sewer system financed by RD. The note bears interest at 2.3750% and is due the date of the final payment issued by RD to the Municipality, but not exceeding 10 years from the date of the first note. The Municipality intends to refinance this note on a long term basis through a \$457,000 general obligation bond issuance approved by the Municipal Legislature and the Governmental Development Bank for Puerto Rico, payable from sales and used taxes deposited in the Municipal Redemption Fund. Issuance will occur after the construction project is finished.</p>	<p>\$ 149,244</p>
<p>Note payable to CRIM (LIMS) – On July 3, 2001 the Municipality entered into a financing agreement with the CRIM in the amount of \$539,645 for the payment of the Municipality’s share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer’s properties located in Puerto Rico. The note is payable in semiannual installments of \$36,188, including interest of 5.95% and is due on November 28, 2011. The amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of the municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:</p>	<p>\$ 102,413</p>

June 30,	Principal	Interest
2011	\$ 67,270	\$ 4,774
2012	35,143	872
Totals	\$ 102,413	\$ 5,646

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I - LONG-TERM DEBT – Continued

Note payable to CRIM (Financing of delinquent accounts)– On March 26, 2002, the Municipality entered into a financing agreement with the CRIM in the amount of \$470,818, to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a non-revolving line of credit bearing interest of 6.5% for the first five years and variable for the next twenty-five years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first five years were financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico’s general fund. Also, during the first five years any collection from those delinquent accounts was credited to the loan principal. After the five year period the loan outstanding balance was restructured for a twenty-five years period. Debt service requirements in future years are as follows:

\$ 106,098

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2011	\$ 4,823	\$ 11,422
2012	4,823	11,122
2013	4,823	10,822
2014	4,823	10,522
2015	4,823	10,222
2016-2020	24,113	46,611
2021-2025	24,113	39,112
2026-2030	24,113	31,613
2031-2032	9,644	10,545
Totals	<u>\$ 106,098</u>	<u>\$ 181,991</u>

Note payable to Puerto Rico Aqueduct and Sewer Authority (PRASA) – On June 23, 2009 the Municipality entered into a financing agreement with PRASA to refinance through a long term (non-interest) obligation a \$120,801 debt for water and sewer services as of May 31, 2009. The Municipality paid a down payment of \$25,801 and issued a note for the remaining balance. The note has an imputed interest rate of 4.06% and was originally recorded at its present value of \$92,028, net of an unamortized discount of \$2,972 at inception. This note is payable in annual installments of \$5,278 (including interest), is due on December 24, 2010 and will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:

\$ 31,294

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I - LONG-TERM DEBT – Continued

June 30	Principal	Interest
2011	\$ 31,294	\$ 372
Totals	\$ 31,294	\$ 372

<p>Liabilities expected to be refinanced – As of June 30, 2010 the Municipality has an outstanding matured debt of \$56,608 for unemployment benefits paid by the Commonwealth of Puerto Rico in behalf of the Municipality. Of this amount, the Municipality intends to refinance \$44,620 on a long term basis through the issuance of a \$44,620 non-interest bearing note (imputed interest of 3.98%) actually issued on August 26, 2010 and due on November 5, 2010. Amount will be totally repaid in fiscal year 2010-2011 with unrestricted funds through withholdings from the advances of property tax and amounts of the municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center.</p>	<p>\$ 44,620</p>
<p>Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time; represents the Municipality’s commitment to fund such costs from future operations. Amount is paid with unrestricted funds.</p>	<p>\$ 3,489,953</p>
<p>Christmas Bonus - represents the accrued portion corresponding to fiscal year 2010 of the Christmas bonus to be paid in December 2010.</p>	<p>\$ 346,355</p>
<p>Claims and judgments - represents the estimated loss of a legal case to be paid subsequent to June 30, 2010. The awarded amount, if any, will be paid with unrestricted funds.</p>	<p>\$ 55,000</p>
<p>Payable to PREPA - As required by Act No. 83 of May 2, 1941 the Puerto Rico Electric Power Authority (“PREPA”) should annually pay to the Municipalities of Puerto Rico a contribution in lieu of tax (“CELI”) based on certain requirements as specified by the mentioned Act. The amount of CELI obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. For fiscal year 2009 the Municipality’s annual energy charges amounted to \$2,423,712 but the CELI obligation amounted to \$1,459,795. The excess amount of \$963,917 was recorded as a payable and a receivable for the same amount and will be amortized over a three-year period. As of June 30, 2010 the outstanding amount of \$719,398 includes a balance of \$76,786 from fiscal year 2008 and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:</p>	<p>\$ 719,398</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I - LONG-TERM DEBT – Continued

June 30	Principal
2011	\$ 398,092
2012-2015	321,306
Totals	\$ 719,398

Payable to CRIM, property tax advances – represent the amount reported by CRIM of the final settlement of excess of advances over actual collections of property taxes applicable to fiscal 2009 and the preliminary settlement applicable to fiscal year 2010. (See related note J)

\$ 122,226

NOTE J - PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2010 are 7.03% for personal property and 9.03% for real property. The distribution of these rates follows:

Description	Personal Property	Real Property
Basic property tax rate, which is appropriated for general purposes and accounted in the Municipality's general fund:	4.00%	6.00%
Percent that belongs to the Commonwealth's debt service fund:	1.03%	1.03%
Percent that belongs to the Municipality's debt service fund:	2.00%	2.50%
Total tax rate:	7.03%	9.53%
Discount granted by law to the taxpayers but reimbursed to the Municipality by the P.R. Treasury Department:	(.20%)	(.20%)
Total percent to be paid by taxpayers:	6.83%	9.33%

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE J - PROPERTY TAXES - Continued

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government.

The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. This amount is recorded as long term debt. The Municipality has a net payable of \$122,226 resulting from the final settlement of fiscal year 2009 and the preliminary settlement of fiscal year 2010 which is recorded as long-term debt.

NOTE K - INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of Christmas bonus reimbursement of \$287,173 and revenues for municipal equalization fund of \$4,271,676 received from the Commonwealth of Puerto Rico. Amount recorded in other governmental funds consists of Federal and Commonwealth governmental grants.

NOTE L - RETIREMENT PLAN

1. Plan description

Regular employees of the Municipality contribute to a cost-sharing multiple employer defined benefit retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico an its Instrumentalities (ERS). ERS covers all regular full-time public employees working for the central government, the municipalities and certain public corporations not having their own retirement systems. The system provides retirement pensions, death and disability benefits.

Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and no occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE L - RETIREMENT PLAN - Continued

Law No. 305 of September 24, 1999 amended the Act No. 447 of 1951 and was enacted with the purpose of establishing a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subjected to the total accumulated balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If the savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

Disability pensions are not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

2. Funding policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.275% of gross salary.

The Municipality's actual contribution for the current and the previous three fiscal years, which is equal to the required contribution, follows:

Fiscal year ended:	Law No. 447	System 2000
2010	\$ 205,386	\$ 284,535
2009	\$ 241,234	\$ 298,133
2008	\$ 225,548	\$ 223,491

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE M – POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note L, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas bonus and death benefits. For the fiscal year 2010, costs related to these post employment benefits amounted to \$168,999. These benefits are recorded as expenditures in the general fund.

NOTE N - COMMITMENTS

1. *Operating leases*

The Municipality leases office space and office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted to \$150,833. Management believes that the summary of the future minimum rental commitments under non-cancellable equipment leases with terms exceeding one year is not significant.

2. *Construction*

The Municipality has commitments at June 30, 2010 of \$2,258,266 for construction, improvements or renovation of certain municipal facilities.

NOTE O - CONTINGENCIES

1. *Federal and State grants*

Projects financed by Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine that the expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. *Litigations*

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. As a result of one legal case as of June 30, 2010 and not to be covered by insurance, the Municipality accrued an estimated loss of \$55,000 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsels that based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE P – NET ASSETS RESTATEMENT

The following table disclosed the change of net assets balance at beginning of year as previously reported in the government wide statements. The change resulted from the correction of an understatement construction in progress for an infrastructure project not recorded in prior year. The beginning balances have been restated as follows:

	Net assets
Balance at beginning of year, as previously reported:	\$ 38,819,658
Correction of error, understatement of capital assets – construction in progress, infrastructure project	438,648
Balance at beginning of year, as restated:	\$ 39,258,306

NOTE Q – FUND BALANCE DEFICITS

Certain special funds included as other governmental funds in the fund statements disclosed fund balance deficits as follows:

	Amount
Capital Fund	\$ 97,051
Emergency Shelter Grant	\$ 13,546
OGAVE - Alzheimer	\$ 12,768
CDBG Entitlement	\$ 26,353
CDBG - ARRA	\$ 40,307
Law 43 Permanent Improvements	\$ 62,993
HOPWA	\$ 41,749
Guama Sanitary Sewer System	\$ 215,789
Traffic Safety Commission	\$ 95,350
PINI Fund	\$ 47,521
Law No. 52 and 82	\$ 79,611
Law No. 105	\$ 16,577

The deficits results from the accrual of expenditures without accruing intergovernmental revenues. As required by current standards, the Municipality recorded intergovernmental revenues for grants on fund statements when all applicable eligibility requirements have been met and the resources are available.

**.COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE R – SUBSEQUENT EVENT

On September 1, 2010 the Governmental Development Bank for Puerto Rico (GDB) issued a \$1,585,000 interim loan to finance the construction of a capital asset. The loan will bear interest at variable rates (Prime + 1.50%) until a general obligation bond is finally issued at a fixed interest rate.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2010**

	Budgeted amounts		Actual amounts (Budgetary basis)	Variance with final budget Positive (Negative)
	Original	Final		
Revenues:				
Taxes:				
Property taxes	\$ 4,068,213	\$ 4,068,213	\$ 4,068,213	\$ -
Municipal license taxes	3,333,691	3,333,691	3,411,654	77,963
Sales and use taxes	1,661,322	1,661,322	1,645,976	(15,346)
Intergovernmental	2,604,237	3,205,235	3,238,908	33,673
Rental income and charges for services	3,757,399	4,646,140	4,655,572	9,432
Fines and forfeitures	55,000	55,000	65,777	10,777
Interest	140,500	140,500	43,705	(96,795)
Other	335,131	103,099	174,866	71,767
Total Revenues	<u>15,955,493</u>	<u>17,213,200</u>	<u>17,304,671</u>	<u>91,471</u>
Expenditures:				
Current:				
General government	5,827,165	5,765,117	5,663,498	101,619
Public safety	1,545,377	1,458,968	1,458,756	212
Public works	6,255,755	6,673,438	6,732,668	(59,230)
Sanitation	217,453	1,749,638	1,748,475	1,163
Health	837,755	786,763	786,763	-
Welfare	645,943	593,902	593,894	8
Culture and recreation	626,045	555,916	555,886	30
Total expenditures	<u>15,955,493</u>	<u>17,583,742</u>	<u>17,539,940</u>	<u>43,802</u>
Excess (deficiency) of revenues over expenditures	<u>\$ -</u>	<u>(370,542)</u>	<u>(235,269)</u>	<u>135,273</u>
Other financing sources (uses)				
Transfers - in		88,896	88,896	-
Transfers - out		(174,848)	(174,848)	-
Total other financing sources (uses)		<u>(85,952)</u>	<u>(85,952)</u>	<u>-</u>
Readjustment from prior year fund balance (note B)		(456,494)	-	(456,494)
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses		<u>\$ -</u>	<u>\$ (321,221)</u>	<u>\$ (321,221)</u>

The accompanying notes to required supplemental information are an integral part of this schedule

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

June 30, 2010

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1981, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared.

Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The budget comparison schedule provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. On a GAAP basis, encumbrances outstanding at year-end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of the current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year-end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level.

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.

NOTE B - BUDGET READJUSTMENT

During the year the approved operational budget was increased by \$456,494 from previous year excess fund balance. The purpose of this readjustment was to increase the amount assigned to certain expenditures in the general fund.

NOTE C - BUDGET TO GAAP RECONCILIATION

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION-
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
June 30, 2010**

NOTE C - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ (321,221)
Budget to GAAP differences:	
Entity differences:	
Non-budgeted funds recorded as expenditures for financial reporting:	(23,850)
Basis of accounting differences:	
Revenues recorded for financial reporting purposes but not in budgetary basis:	1,017,324
Revenues recorded in budgetary basis purposes but not in financial reporting:	(568,241)
Expenditures recorded in budgetary basis but not for financial reporting purposes:	231,892
Expenditures recorded for financial reporting purposes but not in budgetary basis:	(694,398)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	106,132
Prior year encumbrances recorded as expenditures for financial reporting purposes:	(406,373)
Net change in fund balance (GAAP basis):	<u>\$ (658,735)</u>

SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2010**

Line Item No.	Description	14.871 Housing Choice Vouchers
Balance Sheet		
111	Cash - unrestricted	\$ 41,044
113	Cash - other restricted	\$ 67,072
115	Cash - restricted for payment of current liability	\$ 7,545
100	Total cash	\$ 115,661
121	Accounts receivable - PHA projects	\$ 2,035
122	Accounts receivable - HUD other projects	\$ 866
125	Accounts receivable - miscellaneous	\$ 4,889
126.2	Allowance for doubtful accounts - other	\$ -
128	Fraud recovery	\$ 9,261
128.1	Allowance for doubtful accounts - fraud	\$ (4,235)
120	Total receivables, net of allowance for doubtful accounts	\$ 12,816
144	Inter program - due from	\$ -
150	Total Current Assets	\$ 128,477
164	Furniture, equipment and machinery - administration	\$ 47,511
166	Accumulated depreciation	\$ (36,439)
160	Total capital assets, net of accumulated depreciation	\$ 11,072
180	Total Non-current Assets	\$ 11,072
190	Total Assets	\$ 139,549
312	Accounts payable <= 90 days	\$ 35
313	Accounts payable > 90 days past due	\$ -
321	Accrued wage/payroll taxes payable	\$ -
322	Accrued compensated absences - current portion	\$ 2,989
331 - 030	Accounts payable - HUD PHA programs - Other	\$ -
332	Accounts Payable - PHA Projects	\$ -
333	Accounts payable - other government	\$ -
341	Tenant security deposits	\$ -
342	Deferred revenue	\$ -
345	Other current liabilities	\$ 7,545
347	Inter-program - due to	\$ 3,101
348	Loan Liability - current	\$ -
310	Total Current Liabilities	\$ 13,670
353	Non-current liabilities - other	\$ 13,384
354	Accrued compensated absences - non current	\$ 7,469
350	Total Non-current Liabilities	\$ 20,853
300	Total Liabilities	\$ 34,523
508.1	Invested in Capital Assets, Net of Related Debt	\$ 11,072
511.1	Restricted Net Assets	\$ 62,978
512.1	Unrestricted Net Assets	\$ 30,976
513	Total Equity/Net Assets	\$ 105,026
600	Total Liabilities and Equity/Net Assets	\$ 139,549

Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2010**

Line Item No.	Description	14,871 Housing Choice Vouchers
Income Statement		
70600-010	Housing assistance payments	\$ 335,749
70600-020	Ongoing administrative fees earned	\$ 62,604
70600-031	FSS Coordinator	\$ 8,708
70600-070	Admin fee calculation description	
70600	HUD PHA operating grants	\$ 407,061
71100-010	Housing Assistance Payment	\$ -
71100-020	Administrative Fee	\$ -
71100	Investment income - unrestricted	\$ -
71400-010	Housing Assistance Payment	\$ 100
71400-020	Administrative Fee	\$ 100
71400	Fraud recovery	\$ 200
71500	Other revenue	\$ 43,319
71600	Gain or loss on the sale of capital assets	\$ -
72000-010	Housing Assistance Payment	\$ -
72000-020	Administrative Fee	\$ -
72000	Investment income - restricted	\$ -
700	Total Revenue	\$ 450,580
91100	Administrative salaries	\$ 13,025
91200	Auditing fees	\$ -
91500	Employee benefit contributions- administrative	\$ 7,187
91600	Office expenses	\$ 2,515
91800	Travel	\$ 100
91000	Total Operating - Administrative	\$ 22,827
92100	Tenant services - salaries	\$ 13,188
92300	Employee benefit contributions- tenant services	\$ 4,224
92400	Tenant services - other	\$ 5,806
96000	Total Tenant Services	\$ 23,218

Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2010**

Line Item No.	Description	14.871 Housing Choice Vouchers
96200	Other general expenses	\$ -
96210	Compensated absences	\$ -
96600	Bad debt - other	\$ 4,235
96000	Total Other General Expenses	\$ 4,235
96900	Total Operating Expenses	\$ 50,280
97000	Excess Revenue Over Operating Expenses	\$ 400,300
977300-020	Home-Ownership	\$ -
97300-050	All Other	\$ 343,645
97300	Housing assistance payments	\$ 343,645
97350	HAP Portability-in	\$ 37,740
97400	Depreciation expense	\$ 1,846
97500	Fraud losses	\$ -
900	Total Expenses	\$ 433,511
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$ 17,069
11030	Beginning equity	\$ 87,957
11040-010	Prior period adjustments and correction of errors - Editable	\$ -
11040	Prior period adjustments, equity transfers, and correction of errors	\$ -

Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2010**

Line Item No.	Description	14.871 Housing Choice Vouchers
Balance Sheet		
11770-001	Administrative Fee Equity - Beginning Balance	\$ 18,431
11170-010	Administrative Fee Revenue	\$ 62,604
11170-020	Hard to House Fee Revenue	\$ -
11170-021	FSS Coordinator Grant	\$ 8,708
11170-030	Audit Costs	\$ -
11170-040	Investment Income	\$ -
11170-045	Fraud Recovery Revenue	\$ 100
11170-050	Other Revenue	\$ 42,071
11170-051	Comment For Other Revenue	This amount corresponds to the administrative fees earned on the portability-in vouchers administered by the Municipality (\$5,871) plus the reimbursement received from the initial PHAs of the HAP rent payments made on behalf of the portability-in units during 09-10 (\$37,740) less the correction of accounts receivable fraud recovery that was erroneously recorded in previous years (\$1,450).
11170-060	Total Admin Fee Revenues	\$ 113,483
11170-080	Total Operating Expenses	\$ 50,280
11170-090	Depreciation	\$ 1,846
11170-095	Housing Assistance Portability In	\$ 37,740
11170-100	Other Expenses	\$ -
11170-101	Comment For Other Expense	
11170-110	Total Expenses	\$ 89,866
11170-002	Net Administrative Fee	\$ 23,617
11170-003	Administrative Fee Equity - Ending Balance	\$ 42,048
11170	Administrative Fee Equity	\$ 42,048

Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2010**

Line Item No.	Description	14.871
		Housing Choice Vouchers
11180-001	Housing Assistance Payments Equity - Beginning Balance	\$ 69,526
11180-010	Housing Assistance Payments Revenues	\$ 335,749
11180-015	Fraud Recovery Revenue	\$ 100
11180-020	Other Revenue	\$ 1,248
		This amount corresponds to the elimination of rent & utilities allowance checks that were outstanding for more than one year (\$2,698) less the correction of Accts Receiv Fraud Recovery that was erroneously recorded in previous years (\$1,450).
11180-021	Comment For Other Revenue	
11180-025	Investment Income	\$ -
11180-030	Total HAP Revenues	\$ 337,097
11180-080	Housing Assistance Payments	\$ 343,645
11180-090	Other Expenses	\$ -
11180-091	Comment For Other Expense	
11180-100	Total Housing Assistance Payments Expenses	\$ 343,645
11180-002	Net Housing Assistance Payments	\$ (6,548)
11180-003	Housing Assistance Payments Equity - Ending Balance	\$ 62,978
11180	Housing Assistance Payments Equity	\$ 62,978
11190-210	Total ACC HCV Units	1,056
11190-220	Unfunded Units	-
11190-230	Other Adjustments	-
11190	Unit Months Available	1,056
11210	Unit Months Leased	1,049

The accompanying notes are an integral part of this schedule

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTE TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE

June 30, 2010

NOTE A – BASIS OF PRESENTATION

The accompanying financial data schedule (FDS) is a trial balance of the Section 8 Housing Choice Voucher Program, administered by the Municipality. The FDS was created in order to standardize the financial information reported by Public Housing Authorities (PHA) to the Real Estate Assessment Center (REAC), as required by the Uniform Financial Reporting Standards (UFRS). REAC is the US Department of Housing and Urban Development (HUD) national management center created to assess the condition of HUD owned and assisted properties. The UFRS are rules to implement requirements of 24 CFR, Part 5, Subpart H, for the electronic filing of financial information to HUD.

In accordance with the guidelines for reporting and attestation requirements of UFRS, the accompanying FDS is included as information supplementary to the financial statements. It was prepared using the accrual basis of accounting, as required by REAC regulations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

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

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>Federal CFDA Number (note B)</u>	<u>Pass-Through Entity Identifying Number (note B)</u>	<u>Federal Expenditures (notes A and B)</u>
<u>U.S. Department of Agriculture</u>			
Direct programs:			
Water and Waste Disposal Systems for Rural Communities	10.760	N/A	\$ 1,149,250
<u>U.S. Department of Housing and Urban Development</u>			
Direct programs:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	407,061
CDBG - Entitlement Grants Cluster:			
Community Development Block Grants / Entitlement Grants	14.218	N/A	1,116,676
Community Development Block Grant ARRA Entitlement Grants (CDBG-R) (Recovery Act Funded)	14.253	N/A	278,861
Total CDBG - Entitlement Grants Cluster:			1,395,537
Shelter Plus Care	14.238	N/A	56,641
Passed-through program from:			
Office of Commissioner of Municipal Affairs:			
Community Development Block Grant / State's Program (State-Administered Small Cities Program)	14.228	FD-57 AB-57, FC-57	144,525
<u>P.R. Department of Family:</u>			
Emergency Shelter Grants Program	14.231	S08DC720001, S09DC720001	37,175
ARRA - Homeless Prevention and Rapid Re-Housing Program Technical Assistance	14.262	S08DC720001	29,301
<u>P.R. Department of Health:</u>			
Housing Opportunities for Persons with AIDS (HOPWA)	14.241	2008-DS 0618	36,742
<u>P.R. Department of Housing - (Puerto Rico Public Housing Administration "PRPHA"):</u>			
Public and Indian Housing	14.850	RQ003091, RQ005145	766,385
Public Housing Capital Fund	14.872	RQ005008026	216,743
Subtotal U.S. Department of Housing and Urban Development			3,090,110

Continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

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

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Entity Identifying Number (note B)	Federal Expenditures (notes A and B)
<u>U.S. Department of Transportation</u>			
Passed-through program from:			
<u>P.R. Traffic Safety Commission</u>			
State and Community Highway Safety	20.600	10-06-28, 10-03-76	100,169
<u>Environmental Protection Agency</u>			
Direct programs:			
Brownfields Assessment and Cleanup Cooperative Agreements	66.818	N/A	20,918
<u>U.S. Department of Energy</u>			
Direct programs:			
ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	N/A	17,000
<u>U.S. Department of Health and Human Services</u>			
Direct programs:			
ARRA - Early Head Start	93.709	N/A	60,104
ARRA - Strengthening Communities Fund	93.711	N/A	152,072
Passed-through programs from:			
<u>P. R. Office of the Ombudsman for the Elderly:</u>			
Special Programs for the Aging, Title III, Part C_Nutrition Services	93.045	N/AV	143,637
Subtotal U.S. Department of Health and Human Services:			<u>355,813</u>
<u>U.S. Department of Homeland Security</u>			
Passed-through programs from:			
<u>P. R. Governor's Office - Governor's Authorized Representative (GAR):</u>			
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	125-99-125	48,082
<u>P.R. Governor Office - Office of Public Safety Affairs:</u>			
State Homeland Security Program (SHSP)	97.073	2007-GE-T7-0043	23,999
Subtotal U.S. Department of Homeland Security:			<u>72,081</u>
Total Expenditures of Federal Awards			<u><u>\$ 4,805,341</u></u>

The accompanying notes are an integral part of this schedule

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2010

NOTE A – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality under programs of the federal government for the year ended June 30, 2010. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements. Because the schedule presents only a selected portion of the operations of the Municipality, it is not intended to and does not present the financial position and changes in net assets of the Municipality.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized when the related liability is incurred following the cost principles contained in OMB Circular A-87 *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

State or local government redistributions of federal awards to the Municipality, known as “pass-through awards”, should be treated by the Municipality as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for the federal awards received as a subrecipient. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2010

NOTE C – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

CFDA No. / Description	Other Governmental Funds
10.760	\$ 1,149,250
14.871	407,061
14.218	1,116,676
ARRA – 14.253	278,861
14.238	56,641
14.228	144,525
14.231	37,175
ARRA – 14.262	29,301
14.241	36,742
14.850	766,385
14.872	216,743
20.600	100,169
66.818	20,918
ARRA – 81.128	17,000
ARRA – 93.709	60,104
ARRA – 93.711	152,072
93.045	143,637
97.036	48,082
97.073	23,999
Total federal awards expenditures:	4,805,341
Total non-federal awards expenditures:	5,290,455
Total expenditures, fund statements:	\$ 10,095,796

**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**

Honorable Mayor and Member of the
Municipal Assembly
Municipality of San Germán, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Municipality of San Germán, Puerto Rico as of and for the year ended June 30, 2010, which collectively comprise Municipality of San Germán, Puerto Rico's basic financial statements and have issued our report thereon dated February 9, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

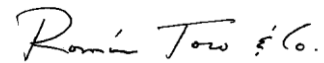
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of San Germán, Puerto Rico's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards*.

This report is intended solely for the information and use of management, the Municipal Assembly, 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.



ROMAN TORO & CO., CSP
LICENSE #35 - IN FORCE

Yauco, Puerto Rico
February 9, 2011

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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

Honorable Mayor and Member of the
Municipal Assembly
Municipality of San Germán, Puerto Rico

Compliance

We have audited Municipality of San Germán, Puerto Rico's compliance, with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Municipality of San Germán, Puerto Rico's major federal programs for the year ended June 30, 2010. Municipality of San Germán, Puerto Rico's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality of San Germán's management. Our responsibility is to express an opinion on Municipality of San Germán's compliance based on our audit.

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

In our opinion, Municipality of San Germán, Puerto Rico, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

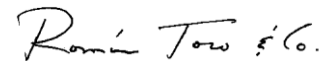
Internal Control Over Compliance

Management of Municipality of San Germán, Puerto Rico, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of San Germán, Puerto Rico's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Municipality of San Germán, Puerto Rico's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

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



ROMAN TORO & CO., CSP
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Yauco, Puerto Rico
February 9, 2011

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2010**

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditor's report issued: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

Internal control over financial reporting:

- Control deficiency identified? Yes None reported
- Significant deficiency identified? Yes None reported
- Material weakness (es) identified? Yes No

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

- Control deficiency identified? Yes None reported
- Significant deficiency identified? Yes None reported
- Material weakness (es) identified? Yes No

Type of auditor's report issued on compliance for Major Programs: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

Any audit finding disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? Yes No

Identification of Major Programs:

CFDA Number	Name of Federal Program or Cluster
14.218	Community Development Block Grant – Entitlement Grants
14.871	Section 8 – Rental Housing Choice Vouchers
14.850	Public and Indian Housing
10.760	Water and Waste Disposal for Rural Development

Dollar threshold used to distinguish between Type A and Type B Programs: \$300,000

Auditee qualified as low-risk auditee? Yes No

SECTION II – FINANCIAL STATEMENTS FINDINGS

No findings are reported.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No findings are reported.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN, PUERTO RICO
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010**

Year	Finding Number	Finding	CFDA Number	Questioned Cost(s)	Comments
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(1) Prior Audit Findings, fully corrected or not noted during our audit:

None.

(2) Prior Audit Findings, not corrected or partially corrected:

None.

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

None.

(4) Prior Audit Findings, are no longer valid:

None.

END OF SCHEDULE
