COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANOVANAS

SINGLE AUDIT REPORT
Fiscal Year Ended
June 30, 2008

BASIC FINANCIAL STATEMENTS AND SUPPLEMENTAL SCHEDULE

With Independent Auditors' Report Thereon
June 30, 2008

15

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Table of Contents
Fiscal Year Ended June 30, 2008

Independent Auditors' Report 1-2
Required Supplementary Information (Part I):
Management's Discussion and Analysis 3-19
Basic Financial Statements:
Government-wide Financial Statements:
Statement of Net Assets 20-21
Statement of Activities 22
Governmental Fund Financial Statements:
Balance Sheet – Governmental Funds 23
Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets 24
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds 25
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds to the Statement of Activities 26
Notes to Basic Financial Statements 27-74
Required Supplementary Information (Part II):
Budgetary Comparison Schedule - General Fund 75
Schedule of Expenditures of Federal Awards 76
Notes to Schedule of Expenditures of Federal Awards 77
Internal Control and Compliance (Part III):
Report on Compliance and on Internal Control over Financial Reporting based on an audit of Financial Statements performed in accordance with Government Auditing Standards 78-79
Report on Compliance with requirements applicable to each major program and on Internal Control over compliance in accordance with OMB Circular A-133 80-82
Audit Findings and Questioned Costs (Part IV):
Schedule of Findings and Questioned Costs 83-106
Client's response to Schedule of Findings and Questioned Costs 107
Summary Schedule of Prior Audit Findings 108-113

BENITEZ-JAIME, CPA-PSC
Certified Public Accountants and Business Consultants

Independent Auditors' Report on Basic Financial Statements and Supplementary Schedule of Expenditures of Federal Awards

The Honorable Mayor, Members of the
Municipal Legislature and People of
the Municipality of Canovanas
Canovanas, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Canovanas of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2008, which collectively comprise the Municipality's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Canovanas of the Commonwealth of Puerto Rico, as of June 30, 2008, and the respective 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 have also issued our report dated October 31, 2008, on our consideration of the Municipality of Canovanas of the Commonwealth of Puerto Rico internal control over financial reporting and on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements. 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and importance for assessing the results of our audit.

The accompanying Management's Discussion and Analysis and the Budgetary Comparison Schedule are not required parts of the basic financial statements referred to above, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

P.O. Box 191503, San Juan, Puerto Rico 00919-1503 TEL. 787-603-1600

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

October 31, 2008
Toa Alta, Puerto Rico

Stamp No. 2235775 was affixed to the original report.

CPA - PSC

As management of the Municipality of Canóvanas (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements for the fiscal year ended June 30, 2008. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the Municipality's financial statements, which follow this narrative.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's assets exceeded its liabilities (net assets) by $18,228,840 at June 30, 2008. The Municipality's net assets increased by $245,895 (1 percent) during the fiscal year ended June 30, 2008.

- The Municipality's assets decreased from $46,876,854 at June 30, 2007 to $46,264,049 at June 30, 2008, for a decrease of $612,805 (1 percent).

- The liabilities of the Municipality decreased from $28,893,909 at June 30, 2007 to $28,035,209 at June 30, 2008, for a decrease of $858,700 (3 percent).

- The revenues of the Municipality decreased from $24,996,063 for the fiscal year ended June 30, 2007 to $21,427,559 for the fiscal year ended June 30, 2008, for a decrease of $3,568,504 (14 percent).

- The Municipality's expenses decreased from $22,365,928 for the fiscal year ended June 30, 2007 to $21,196,995 for the fiscal year ended June 30, 2008, for a decrease of $1,168,933 (5 percent).

Governmental Funds' Highlights:

- The total fund balances of governmental funds amounted to $3,826,640 at June 30, 2008, which decreased by $723,557 (16 percent) during fiscal year ended June 30, 2008.

- The total assets of governmental funds decreased from $18,287,883 at June 30, 2007 to $17,102,690 at June 30, 2008, for a decrease of $1,185,193 (6 percent).

- The governmental fund's total liabilities decreased from $13,737,686 at June 30, 2007 to $13,276,050 at June 30, 2008, for a decrease of $461,636 (3 percent).

- The total revenues of governmental funds decreased from $24,463,535 for the fiscal year ended June 30, 2007 to $22,919,241 for the fiscal year ended June 30, 2008, for a decrease of $1,544,294 (6 percent).

- The governmental fund's total expenditures decreased from $26,032,568 for the fiscal year ended June 30, 2007 to $23,658,127 for the fiscal year ended June 30, 2008, for a decrease of $2,374,441 (9 percent).

- Other financing sources (uses), net, of governmental funds decreased from $1,560,000 for the fiscal year ended June 30, 2007 to zero for the fiscal year ended June 30, 2008.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2008. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

The Municipality's basic financial statements include three components: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), and (3) notes to the basic financial statements (NBFS). This report also contains additional required and other supplementary information in addition to the basic financial statements themselves. These components are described below.

The basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental funds. Both perspectives allow the users to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

a) Government-wide Financial Statements

The GWFS are composed of: (1) the statements of net assets (SNA) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2008. The GWFS are prepared using methods that are similar to those used by most private businesses.

1. Statement of Net Assets

The purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality.

On the other hand, the Municipality reports liabilities, such as claims and judgments, even though these liabilities might not be paid until several fiscal years into the future.

The difference between the Municipality's total assets and total liabilities reported in SNA is presented as *net assets,* which is similar to the total owners' equity reported by a commercial enterprise in its financial statements. Although the purpose of the Municipality is not to accumulate net assets, as this amount increases or decreases over time, such amount represents a useful indicator of whether the financial position of the Municipality is either improving or deteriorating, respectively.

2. Statement of Activities

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2008, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

Although SA looks different from a commercial enterprise's income statement, the difference is only in format, not substance. Whereas the bottom line in a commercial enterprise represents its net income, the Municipality reports an amount described as *net change in net assets*, which is essentially the same concept.

The focus of SA is on the *net cost* of various activities provided by the Municipality. The statement begins with a column that identifies the cost of each of the Municipality's major functions. Another column identifies the revenues that are specifically related to the classified governmental functions. The difference between the expenses and revenues related to specific functions/programs identifies the extent to which each function of the Municipality draws from general revenues or is self-financing through fees, intergovernmental aid, and other sources of resources.

This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

GWFS and GFFS present all of the Municipality's governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions). All services normally associated with the Municipality fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; public housing and welfare; and economic and urban development.

b) Governmental Fund Financial Statements

The Municipality's GFFS consist of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds,. These financial statements report the financial position and results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

Governmental funds are used to account for all of the services provided by the Municipality. These funds are used to account for essentially the same functions reported as governmental activities in the GWFS. Unlike GWFS, the focus of GFFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, GFFS report the Municipality's operations in more detail than the GWFS.

GFFS provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) general fund, (2) debt service fund, (3) special revenue funds, and (4) capital projects funds.

GFFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. In general, GFFS focus on near-term inflows and outflows of expendable financial resources, consequently, generally measure and account for cash and other assets that can easily be converted to cash. For example, amounts reported on the balance sheet include capital assets within a very short period of time, but do not include capital assets such as land and buildings. Governmental fund liabilities generally include amounts that normally are going to be paid within a very short period after the end of the fiscal year. The difference between a fund's total assets and total liabilities is reported as the fund balance, and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for governmental funds reports only those revenues and expenditures that were collected in cash or paid with cash, respectively, during the current fiscal year or very shortly after the end of the fiscal year.

Because the focus of GFFS is narrower than that of the GWFS, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the GWFS. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions. Both the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and the governmental activities reported in the government-wide financial statements.

The Municipality has two major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The two major governmental funds are: (1) general fund and (2) debt service fund.

c) *Notes to Basic Financial Statements*

The NBFS provide additional information that is essential for a full understanding of the data provided in the GWFS and GFFS. The NBFS can be found immediately following the basic financial statements.

d) Other Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of: (1) Budgetary Comparison Schedule - General Fund and (2) the Schedule of Expenditures of Federal Awards, as detailed in the accompanying table of contents.

FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Municipality's overall financial position for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS:

Comparative Statement of Net Assets
Governmental Activities (Condensed)
June 30, 2008 and 2007

	2008	2007
Assets:		
Current assets	$ 15,453,970	$ 16,419,488
Non-current assets:		
Capital assets, net	30,772,021	30,411,672
Other non-current assets	38,058	45,694
Total assets	$ 46,264,049	$ 46,876,854
Liabilities:		
Current liabilities	$ 10,126,964	$ 9,111,481
Long-term obligations due within one year	911,658	887,094
Long-term obligations due after one year	16,996,587	18,895,334
Total liabilities	$ 28,035,209	28,893,909
Net assets:		
Invested in capital assets, net of related debt	$ 30,667,510	$ 22,237,536
Restricted for debt service and others	1,909,207	1,825,264
Unrestricted	(14,347,877)	(6,079,855)
Total net assets	$ 18,228,840	$ 17,982,945

At June 30, 2008, the Municipality's current assets, amounting to $15,453,970, are mainly composed of cash and cash equivalents ($10,846,136) of which $6,827,128 are restricted, property taxes receivable of $3,204,690, net of allowance for doubtful accounts of $16,811,694, municipal license taxes receivable ($347,995) and intergovernmental receivables ($640,852).

The restricted cash of $6,827,128 represents resources legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded programs. Restricted cash also consists of unspent proceeds of bonds issued to pay accounts payable and certain specific commitments. A portion of property taxes receivable, amounting to $545,401, net of allowance for doubtful accounts of $2,861,154, represents restricted resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's non-current assets, amounting to $30,810,079 at June 30, 2008, are substantially composed of capital assets, with an aggregate cost basis of $47,822,110, which are reported net of accumulated depreciation and amortization of $17,050,110.

During the fiscal year ended June 30, 2008, the assets of the Municipality decreased by $612,805 (1 percent) in comparison with the prior fiscal year, principally for the following facts:

- Property taxes receivable decreased by $1,352,213. At the same time, the decrease in this receivable was caused principally by the decrease of $1,661,193 in property tax revenues during the current fiscal year.

- Capital assets increased by $360,349 due to the excess of current year additions ($1,784,700) over depreciation/amortization expense ($1,424,351) for the fiscal year ended June 30, 2008. The principal additions to capital assets for the current fiscal year were related to construction in progress ($1,494,315) and furniture, fixtures, machinery and equipment ($227,964).

At June 30, 2008, the Municipality's current liabilities amounting to $10,126,964 are mainly composed of unearned revenues ($6,180,432), accounts payable and accrued liabilities ($1,962,994), intergovernmental payables ($598,538), and the portions due within one year of compensated absences ($316,698) and bonds payable ($1,385,000). Deferred revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded programs. As noted in the condensed statement of net assets, the Municipality's current assets exceeded current liabilities by $5,327,006, for a current ratio (current assets to current liabilities) of 1.53 to 1.00.

The Municipality's non-current liabilities, amounting to $16,996,587 at June 30, 2008, are mainly composed of portions due after one year of bonds payable ($10,160,000), notes payable ($3,797,095), and compensated absences ($2,857,282).

At June 30, 2008, the liabilities of the Municipality decreased by $858,700 (3 percent) in comparison with the prior fiscal year, principally for the net effect of the following facts:

- Bonds payable decreased by $1,305,000 due to the effect of the debt service principal payments made during the current fiscal year for such amounts.

- Notes payable decreased by $570,360 due to the net effect of the debt service principal payments made during the current fiscal year amounting to $621,000, which were partially offsetted by the current year amortization of $50,640 in the discount on notes payable, which were charged to interest expense.

- Unearned revenues increased by $515,850. The increase in unearned revenues was caused principally by the increase of $701,277 in unearned municipal license taxes.

- Accounts payable and accrued liabilities decreased by $277,268 mainly due to the decrease of $1,168,933 in total expenses during the current fiscal year.

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial statement position. The assets of the Municipality exceeded liabilities by $18,228,840 at June 30, 2008. The most significant portion of net assets ($30,667,510), reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses the capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, as capital assets cannot be used to liquidate these liabilities.

Another significant portion of net assets at June 30, 2008, represents resources that are restricted for debt service payments ($1,801,340) and the operations of state and federally funded programs ($107,867). The remaining component of total net assets consists of unrestricted negative net assets amounting to ($14,347,877) at June 30, 2008. These unrestricted negative net assets are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds payable, notes payable compensated absences, claims and judgments, obligations under capital leases, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality increased by $245,895 for the fiscal year ended June 30, 2008. Such increase is principally due to the excess of total revenues ($21,427,559) over expenses ($21,196,995) for the fiscal year ended June 30, 2008.

The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS:

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Comparative Statement of Activities
Governmental Activities (Condensed)
Fiscal Years Ended June 30, 2008 and 2007

	2008	2007
Program revenues:		
Program-specific operating grants and contributions	$ 1,488,457	$ 1,416,217
Program-specific capital grants and contributions	2,621,421	3,333,033
Charges for services	1,153,391	832,048
Total program revenues	5,263,269	5,581,298
General revenues:		
Property taxes	8,292,199	9,953,392
Municipal license taxes	3,686,478	2,504,882
Construction excise taxes	1,604,571	2,425,005
Sales and use taxes	221,026	572,759
Unrestricted grants and contributions	1,783,557	1,766,381
Interests on deposits and miscellaneous revenues	576,459	2,192,346
Total general revenues	16,164,290	19,414,765
Total revenues	21,427,559	24,996,063
Program expenses:		
General government	6,456,306	7,892,095
Urban and economic development	5,229,614	5,736,361
Public safety	966,775	787,252
Health and sanitation	4,198,402	3,843,453
Culture, recreation and education	1,177,288	1,018,258
Public housing and welfare	2,275,539	2,210,644
Interest on long-term obligations	893,071	877,865
Total expenses	21,196,995	22,365,928
Net increase in net assets	230,564	2,630,135
Net assets, at beginning of fiscal year	17,982,945	15,352,810
Prior-period adjustments (note 14)	15,331	-
Net assets, at end of fiscal year	$ 18,228,840	$ 17,982,945

As previously mentioned, the Municipality's net assets increased by $245,895 or 1 percent during the current fiscal year. Approximately 64 percent ($13,804,274) of the Municipality's total revenues for the current fiscal year came from taxes (property taxes, municipal license taxes, construction excise taxes and sales and use taxes), while 28 percent ($5,893,435) resulted from restricted and unrestricted capital and operating grants and contributions.

There was a decrease of $2,399,571 (91 percent) in the net increase in net assets when the operating results for the fiscal current year are compared to those of the prior fiscal year. This occurred because total revenues decreased $3,568,504 (14 percent) while total expenses decreased $1,168,933 (5 percent) during the current fiscal year. The most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

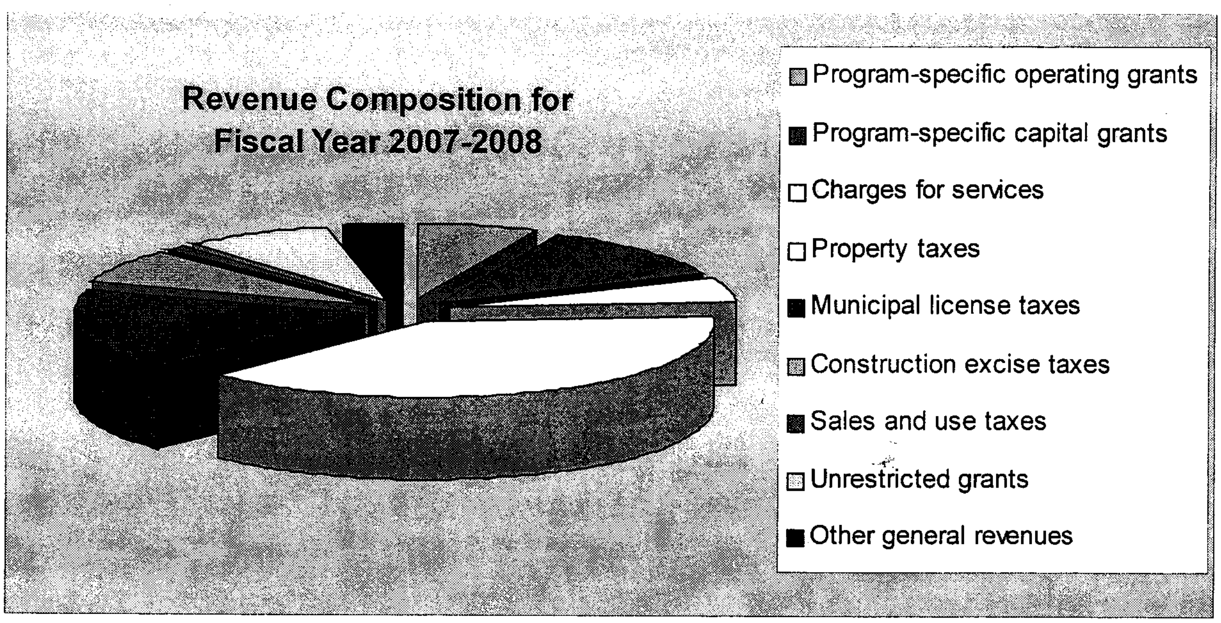
- Property taxes revenues decreased $1,661,193 (17 percent) because the current year property assessments and collections were lower that in the prior year due to the deteriorating economic conditions of the Commonwealth of Puerto Rico, which resulted in a decrease of $1,352,213 in property taxes receivable.

- Municipal license revenues increased $1,181,596 (41 percent) because during the fiscal year the Municipality made significant collection efforts.

- Grants and contributions decreased by $622,196 (10 percent) primarily due to a reduction in the grant awards of the Community Development Block Grant during the current fiscal year and the further reductions of various other grants from federal and state agencies.

- Miscellaneous revenues decreased $1,550,716 (84 percent) due to the non-recurring nature of these items which were collected in prior year but not in current year.

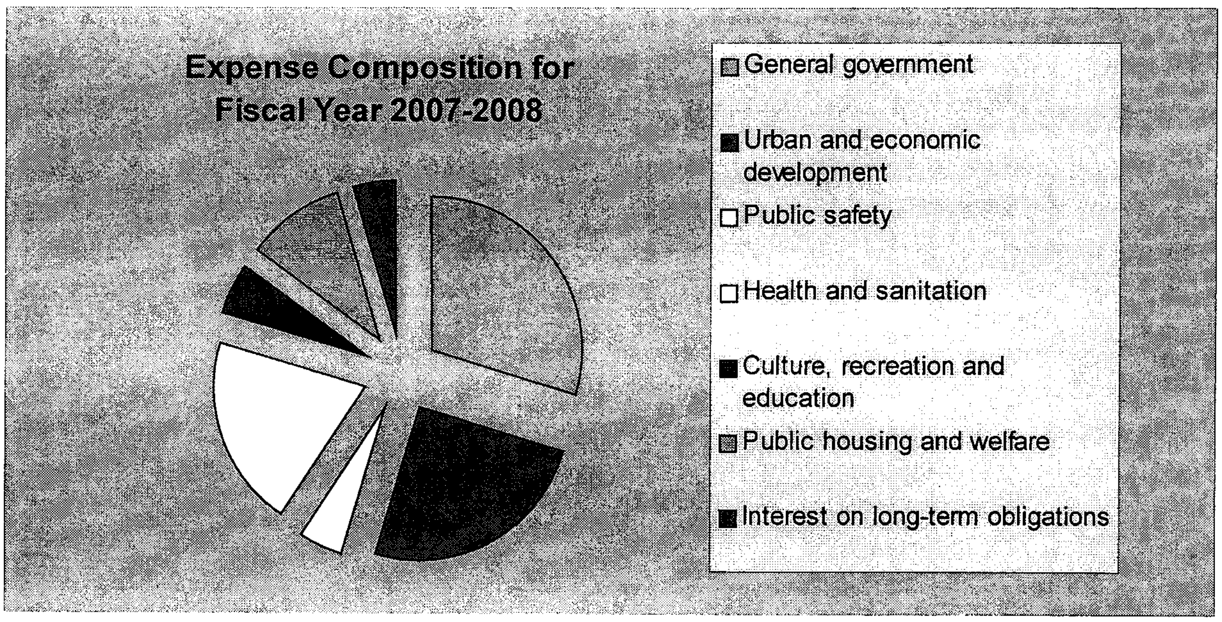
The following chart presents the composition of revenues for the fiscal year ended June 30, 2008:



The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2008 were related to: (1) general administrating and operating costs ($6,456,306), which were classified as "general government" and accounted for 30 percent of total expenses, (2) culture, recreation and education ($1,177,288), which accounted for 6 percent of total expenses, (3) health and sanitation ($4,198,402), which accounted for 20 percent of total expenses, (4) urban and economic development ($5,229,614), which accounted for 25 percent of total expenses and (5) public housing and welfare ($2,275,539), which accounted for 11 percent of total expenses.

As previously mentioned, the Municipality's expenses decreased from $22,365,928 for the fiscal year ended June 30, 2007 to $21,196,995 for the fiscal year ended June 30, 2008, for a decrease of $1,168,933 (5 percent). The most significant fluctuation between the current fiscal year's expenses and those of the prior fiscal year occurred in the general government expenses, which decreased $1,435,789 (18 percent) mainly due to the implementation of cost reduction strategies by management during the current fiscal year.

The following chart presents the composition of expenses for the fiscal year ended June 30, 2008:



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Condensed Balance Sheet - Governmental Funds
June 30, 2008 and 2007

	2008	2007
Assets:		
Total assets - major governmental funds	$ 13,178,810	$ 14,239,968
Total assets - other governmental funds	3,923,880	4,047,915
Combined total assets	17,102,690	18,287,883
Liabilities:		
Total liabilities - major governmental funds	$ 9,808,167	$ 10,146,242
Total liabilities - other governmental funds	3,467,883	3,591,444
Combined total liabilities	13,276,050	13,737,686
Fund balances:		
Reserved - major governmental funds	3,342,921	2,133,336
Reserved - other governmental funds	535,004	1,759,911
Unreserved – other governmental funds	(79,007)	(79,007)
Unreserved - major governmental funds	27,722	735,957
Combined total fund balances	3,826,640	4,550,197
Total liabilities and fund balances	$ 17,102,690	$ 18,287,883

FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS

Analysis of Financial Position of Governmental Funds

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's compliance with finance-related legal requirements. Specifically, unreserved fund balance may serve as a useful measure of the Municipality's net resources available for spending at the end of the fiscal year.

At June 30, 2008, the total assets of governmental funds decreased $1,185,193 (6 percent) in comparison with the prior fiscal year principally for the decrease of $1,352,213 in property taxes receivable. At June 30, 2008, the total liabilities of governmental funds decreased $461,636 (3 percent) in comparison with the prior fiscal year principally for: (1) the decrease of $975,834 in deferred revenues.

For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most of these fluctuations has been made.

At the end of the current fiscal year, total unreserved fund balances of governmental funds amounted to $51,285 (negative balance), while total fund balance reached $3,826,640. The total fund balances decreased by $723,557 during the current fiscal year. The following is a detailed financial analysis of the Municipality's governmental funds:

General fund (GF) - The GF is the main operating fund used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund due to legal requirements, GAAP requirements or the demands of sound financial administration requiring the use of a governmental fund other than the general fund. The GF is the principal operating fund of the Municipality. The GF's total assets amounted to $9,689,855 at June 30, 2008. Such assets consist principally of: (1) unrestricted and restricted cash and cash equivalents ($5,134,250), (2) tax receivables ($3,313,816), and (3) short-term and long-term amounts due from other funds ($1,058,670).

The GF's total liabilities amounted to $7,851,908 at June 30, 2008. Such liabilities are composed mainly of: (1) deferred revenues ($5,602,880), and (2) accounts payable and accrued liabilities, including amounts due to other governments ($1,666,056).

At the end of the current fiscal year, unreserved fund balance of the GF's amounted to $27,722, while total fund balance reached $1,837,947. As a measure of the GF's liquidity it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 0.2 percent of the total GF's expenditures, while total fund balance represents 11 percent of that same amount.

Debt service fund (DSF)- The DSF is a major governmental fund used to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. Consistently with the prior fiscal years' financial statement presentation, during the fiscal year ended June 30, 2008, the financial activity accounted for in the debt service fund was specifically related to bonds payable. The DSF's total assets amounted to $3,488,955 at June 30, 2008, which consists mainly of restricted cash in fiscal agent ($2,365,465) and restricted property taxes receivable ($545,401). The DSF's total liabilities amounted to $1,956,259 at June 30, 2008, which are mainly composed of: (1) matured bonds due and payable ($1,385,000), (2) matured interest due and payable ($300,776) and (3) deferred revenues ($268,644). At the end of the current fiscal year, DSF's total and reserved fund balance reached $1,532,696.

Other governmental funds (OGF)- The OGF is a combination of non-major major capital project and special revenue funds principally used to account for the financial resources arising from program-specific capital and operating grants and contributions awarded by state and federal agencies. The OGF's total assets amounted to $3,923,880 at June 30, 2008, which consist mainly of restricted cash ($3,346,421) and receivables from intergovernmental grants and contributions ($493,643). The OGF's total liabilities amounted to $3,467,883 at June 30, 2008, which are mainly composed of deferred revenues ($2,034,626) and short-term and long-term amounts due to other funds ($1,132,649). At the end of the current fiscal year, OGF's total and reserved fund balance reached $455,997 and negative $79,007, respectively

Condensed Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds (Condensed) Fiscal Years Ended June 30, 2008 and 2007

	2008	2007
Revenues:		
Total revenues - major governmental funds	$ 18,783,004	$ 19,688,310
Total revenues - other governmental funds	4,136,237	4,775,225
Combined total revenues	22,919,241	24,463,535
Expenditures:		
Total expenditures - major governmental funds	19,038,461	20,703,209
Total expenditures - other governmental funds	4,619,666	5,329,359
Combined total expenditures	23,658,127	26,032,568
Excess of expenditures over revenues	(738,886)	(1,569,033)
Other financing sources, net:		
Other financing sources (uses), net - major governmental funds	(467,626)	1,462,760
Other financing sources, net – other governmental funds	467,626	213.387
Combined other financing sources (uses), net	-	1,560,000
Deficiency of revenues and other financing sources under expenditures and other financing uses	(738,886)	(9,033)
Fund balances, at beginning of fiscal year	4,550,195	4,559,228
Prior-period adjustments (note 14)	15,331	-
Fund balances, at end of fiscal year	$ 3,826,640	$ 4,550,195

Analysis of Operating Results of Governmental Funds

General fund – The total fund balance of the GF decreased $1,031,346 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to $17,041,895, $17,044,728 and $1,028,513, respectively, for the fiscal year ended June 30, 2008.

Approximately 80 percent ($13,606,202) of the GF's total revenues for the current fiscal year came from taxes, while 10 percent ($1,776,793) resulted from intergovernmental grants and contributions.

During the current fiscal year, there was a deficiency of revenues and other financing sources under expenditures and other financing uses of $549,796 in the general fund, while in prior fiscal year there was an excess of revenues and other financing sources over expenditures and other financing uses of $1,168,262.

The GF's most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

- Miscellaneous revenues decreased $1,550,548 due to the non-recurring nature of these items which were collected in prior year but not in current year.

- Municipal license revenues decreased $1,370,857 principally due to the increase of $701,277 in deferred municipal license tax revenues.

- Property taxes revenues increased $137,823 mainly due to a decrease of $1,159,844 in deferred revenues while at the same time the current year property assessments and collections were lower that in the prior year, which resulted in a decrease of $1,114,352 in property taxes receivable.

The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the general government expenditures, which increased by $2,321,579.

Debt service fund (DSF) – The total fund balance of the DSF increased $308,263 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to $1,741,109, $1,993,733 and $560,887, respectively, for the fiscal year ended June 30, 2008.

Approximately 97 percent ($1,696,518) of DSF's total revenues for the current fiscal year came from restricted property taxes. There was an increase of $1,144,811 in the DSF's net change in fund balance when operations for the current fiscal year are compared to those of the prior fiscal year. This occurred because other financing uses decreased $1,234,982 during the current year for the effect of non-recurring transfers of $1,200,000 that were made in the prior fiscal year and were not done in current fiscal year.

Other governmental funds (OGF) – The total fund balance of the OGF decreased by $15,803 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to $4,136,237, $4,619,666 and $467,626, respectively, for the fiscal year ended June 30, 2008.

Approximately 99 percent ($4,109,878) of OGF's total revenues for the current fiscal year came from intergovernmental grants. There was a decrease of $638,988 in the OGF's total revenues (mainly on intergovernmental grants), while total expenditures decreased by $709,693 mainly on capital outlays, which decreased $1,218,557. Other financing sources (net) increased by $254,239.

BUDGETARY HIGHLIGHTS OF GENERAL FUND

The original budget of the general fund for the fiscal year ended June 30, 2008 amounted to $18,879,677, while the final approved budget for the general fund amounted to $19,032,036. Accordingly, there were no significant changes between the original and the final approved budgets for the fiscal year ended June 30, 2008.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2008 were $17,628,876, which is 7 percent ($1,335,881) less than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2008 were $17,466,363, which is 3 percent ($467,699) more than the budgeted expenditures. The most significant fluctuations in actual revenues (budgetary basis) occurred with construction excise tax revenues which were $1,720,383 less than their respective budgeted amounts. The most significant fluctuations in actual disbursements (budgetary basis) occurred with general government and the health and sanitation costs which were $2,303,031 less and $725,134 more than their respective budgeted amounts, respectively.

The unfavorable variance in construction excise tax revenues was caused by several construction projects that were scheduled by the respective developers to be started during the fiscal year 2007-2008. However, due to the current economic outlook in Puerto Rico, these projects were rescheduled for fiscal year 2008-2009 and, consequently, the respective excise taxes were not collected at June 30, 2008. The favorable variance of $2,303,031 in general government expenditures were mainly due to the implementation of cost reduction strategies by management during the current fiscal year as a result of the reduction of $1,335,881 in revenues collected for the current fiscal year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has invested $47,822,131 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of $17,050,110 at June 30, 2008. Capital assets increased $360,349 during the current fiscal year due to the excess of current year additions ($1,784,700) over depreciation/amortization expense ($1,424,351) for the fiscal year ended June 30, 2008. The principal additions to capital assets for the current fiscal year were related to construction in progress ($1,494,315) and furniture, fixtures, machinery and equipment ($227,964). The capital additions to construction in progress were principally related to improvements of streets and roads, the construction of the sports complex at San Isidro, improvements to the municipal library at Campo Rico and water pipes at Castro Sector.

We encourage readers to consider the information presented here in conjunction with more detailed capital assets information furnished in the accompanying notes to the financial statements.

Debt Administration

The Municipality finances a significant portion of its construction activities through bond and note issuances, and through state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

At June 30, 2008, the Municipality's total bonded debt amounted to $11,545,000, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality.

The following is a summary of the debt activity for the fiscal year ended June 30, 2008:

- Bonds payable decreased by $1,305,000 due to the effect of the debt service principal payments made during the current fiscal year for such amounts.

- Notes payable decreased by $570,360 due to the net effect of the debt service principal payments made during the current fiscal year amounting to $621,000, which were partially offsetted by the current year amortization of $50,640 in the discount on notes payable, which were charged to interest expense.

The total property assessed value the Municipality amounted to $193,315,481 at June 30, 2008. The Municipality's legal debt margin amounted to $1,764,805 at the current fiscal year-end.

We encourage readers to consider the information presented here in conjunction with more detailed long-term debt information furnished in the accompanying notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The territory of Canóvanas covers an area of approximately 28 square miles. Canóvanas is a municipality with a population density of 1,546 habitants per square mile. Canóvanas is characterized by being the economic integration center of the Region since it is considered the principal source of jobs and services of commercial, educational and health nature in the Region.

From the industrial perspective, Canóvanas accounts for 17 percent of the manufacturing jobs, 25 percent of the finance-related jobs and 21 percent of the service-related jobs in the Region.

Of the total population of the Municipality, 54 percent or approximately 25,200 persons are considered to live under the poverty level. This rate is higher than the overall rate for Puerto Rico (48 percent). Approximately 30 percent of the population of the Municipality receives public financial assistance as their principal source of income.

The economy of the Municipality is closely linked to the economy of the Commonwealth of Puerto Rico, which ultimately is greatly affected by the condition of the United States of America. Direct investment, exports, transfer payments, interest rates, inflation, and tourist expenditures are exogenous variables that are affected by the economy of the United States of America.

Puerto Rico, including the Municipality, has a diversified economy with manufacturing and services industries comprising its principal sectors. Manufacturing is the largest economic sector in terms of gross domestic product. Manufacturing in Puerto Rico is now more diversified than during the early phases of its industrial development between 1950 and 1980, and includes several industries less prone to business cycles. In the last three decades, industrial development in the Municipality has tended to be more capital intensive and more dependent on skilled labor.

Tourism makes a significant contribution to economic activity of the Municipality and the north coast of Puerto Rico. An estimated $3.4 billion were spent by visitors in Puerto Rico during the fiscal year 2007-2008. During the fiscal year ended June 30, 2008, the number of visitors increased 0.8% compared to fiscal year 2006-2007. The construction sector has been an integral part of the economic activity throughout the years. The Municipality is heavily dependent on oil imports for the production of electricity; however, as a result of the construction of two cogeneration plants in other regions of Puerto Rico, one of which is fueled by liquefied natural gas and the other by coal, the Municipality's dependence on oil imports for the production of electricity has been reduced from 99% to 74%. Currently, as part of the capital improvement plan of the Puerto Rico Electric Power Authority (a component unit of the Commonwealth of Puerto Rico), the construction of an additional cogeneration power plant fueled by liquefied natural gas is being currently evaluated to continue reducing the dependence on oil imports in Puerto Rico.

The preliminary reports issued by the Puerto Rico Planning Board (a governmental agency of the Commonwealth of Puerto Rico) about the performance of the economy of the Municipality indicate that the economy decreased 1.8% in terms of total real gross product during the fiscal year ended June 30, 2008.

According to the Puerto Rico Department of Labor and Human Resources, the labor force decreased from 1.42 million in 2007 to 1.41 million in 2008 for Puerto Rico as a whole. In addition, the average unemployment rate decreased from 11.7% in 2007 to 10.4% in 2008.

The Municipality has established policies and programs directed at developing the manufacturing and services industries. Selective tax exemptions and other incentives have stimulated domestic and foreign investment. Infrastructure expansion and modernization have been, to a large extent, financed by bonds issued by the Municipality and certain grants from the U.S. Department of Housing and Urban Development and the Federal Emergency Management Agency. Economic progress has been aided by significant increases in the levels of education and occupational skills of the population of the Municipality.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Canóvanas, Department of Finance and Budget, P.O. Box 945, Canóvanas, Puerto Rico, 00681.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Statement of Net Assets
June 30, 2008

Assets		Governmental activities
Current assets:		
Cash in commercial banks, including cash equivalents of $3,800,000		$ 4,019,008
Accounts receivable, net of allowance for doubtful accounts of $13,950,540:		
Taxes:		
Property taxes	$ 2,659,289	
Municipal license taxes	347,995	
Construction excise taxes	130,450	
Sales and use taxes	176,082	
Accrued interests on deposits	13,922	
Intergovernmental grants and contributions	147,209	
Miscellaneous receivables	25,103	
Total accounts receivable, net		3,500,050
Inventories and other current assets		68,740
Restricted assets:		
Cash in commercial banks	2,712,352	
Cash in fiscal agent	4,114,776	
Accounts receivable:		
Property taxes, net of allowance for doubtful accounts of $2,861,154	545,401	
Intergovernmental grants and contributions	493,643	
Total restricted assets		7,866,172
Total current assets		15,453,970
Capital assets, at cost:		
Depreciable capital assets	45,517,133	
Non-depreciable capital assets	2,304,998	
Total capital assets, at cost	47,822,131	
Less: accumulated depreciation and amortization	(17,050,110)	
Total capital assets, net of accumulated depreciation and amortization		30,772,021
Deferred charges, net of accumulated amortization of $97,744		38,058
Total non-current assets		30,810,079
Total assets		$ 46,264,049

The accompanying notes to the basic financial statements are an integral part of this statement.

Liabilities and net assets (liabilities)

		Governmental activities
Current liabilities:		
Accounts payable, including excess of checks drawn over bank balance of $314,328		$ 1,067,518
Accrued liabilities		294,092
Intergovernmental payables		598,538
Unearned revenues		4,145,806
Liabilities related to restricted assets:		
Accounts payable and accrued liabilities, including accrued interests on bonds payable of $300,776	$ 601,384	
Unearned revenues	2,034,626	
Current portion of bonds payable	1,385,000	4,021,010
Current portion of other long-term obligations (due within one year):		
Notes payable	594,960	
Compensated absences	316,698	
Total current portion of other long-term obligations		911,658
Total current liabilities		11,038,622
Non-current liabilities (due in more than one year):		
Liabilities related to restricted assets - bonds payable		10,160,000
Notes payable		3,797,095
Compensated absences		2,857,282
Reserve for federal cost disallowances		182,210
Total non-current liabilities		16,996,587
Total liabilities		28,035,209
Net assets:		
Invested in capital assets, net of related debt		30,667,510
Restricted for:		
Debt service		1,801,340
Federal and state funded programs		107,867
Unrestricted		(14,347,877)
Total net assets		$ 18,228,840

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Statement of Activities
Fiscal Year Ended June 30, 2008

Functions/programs	Expenses, including depreciation expense of $1,424,351	Program revenues: Charges for services	Program revenues: Program – specific operating grants and contributions	Program revenues: Program – specific capital grants and contributions	Net (expenses) and changes in net assets
Governmental activities:					
General government	$ 6,456,306	1,139,330	-	-	$ (5,316,976)
Urban and economic development	5,229,614	-	349,627	2,595,454	(2,284,533)
Public safety	966,775	-	1,398	-	(965,377)
Health and sanitation	4,198,402	-	-	-	(4,198,402)
Culture, recreation and education	1,177,288	-	-	-	(1,177,288)
Public housing and welfare	2,275,539	14,061	1,137,432	25,967	(1,098,079)
Interest on long-term obligations	893,071	-	-	-	(893,071)
Total governmental activities	$ 21,196,995	1,153,391	1,488,457	2,621,421	$ (15,933,726)

General revenues:	
Taxes:	
Property taxes	$ 8,292,199
Municipal license taxes	3,686,478
Construction excise taxes	1,604,571
Sales and use taxes	221,026
Total tax revenues	13,804,274
Intergovernmental grants and contributions, not restricted to specific programs	1,783,557
Interests on deposits	281,669
Miscellaneous	294,790
Total general revenues	16,164,290
Net increase in net assets	230,564
Net assets at beginning of fiscal year, as restated	17,998,276
Net assets at end of fiscal year	$ 18,228,840

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Balance Sheet – Governmental Funds
June 30, 2008

	Major governmental funds		Other	Total
Assets	General fund	Debt service fund	governmental funds	governmental funds
Cash and cash equivalents in commercial banks	$ 4,019,008	-	-	$ 4,019,008
Accounts receivable, net of allowance for doubtful accounts of $13,950,540:				
Taxes:				
Property taxes	2,659,289	-	-	2,659,289
Municipal license taxes	347,995	-	-	347,995
Construction excise taxes	130,450	-	-	130,450
Sales and use taxes	176,082	-	-	176,082
Accrued interest on deposits	10,807	1,839	1,276	13,922
Intergovernmental grants and contributions	147,209	-	-	147,209
Due and advances from other funds	1,058,670	-	-	1,058,670
Miscellaneous receivables	25,103	-	-	25,103
Restricted assets:				
Cash in commercial banks	-	-	2,712,352	2,712,352
Cash in fiscal agent	1,115,242	2,365,465	634,069	4,114,776
Accounts receivable:				
Property taxes, net of allowance for doubtful accounts of $2,861,154	-	545,401	-	545,401
Intergovernmental grants and contributions	-	-	493,643	493,643
Due and advances from other funds	-	576,250	82,540	658,790
Total assets	9,689,855	3,488,955	3,923,880	17,102,690
Liabilities				
Excess of checks drawn over bank balance	314,328	-	-	314,328
Accounts payable and accrued liabilities	753,190	-	-	753,190
Intergovernmental payables	598,538	-	-	598,538
Deferred revenues	5,602,880	-	-	5,602,880
Liabilities related to restricted assets:				
Accounts payable and accrued liabilities	-	300,776	300,608	601,384
Due and advances to other funds	582,972	1,839	1,132,649	1,717,460
Deferred revenues	-	268,644	2,034,626	2,303,270
Matured bonds due and payable	-	1,385,000	-	1,385,000
Total liabilities	7,851,908	1,956,259	3,467,883	13,276,050
Fund balances				
Reserved for:				
Encumbrances	507,215	-	-	507,215
Debt service	576,250	1,532,696	-	2,108,946
Capital assets and projects	538,292	-	344,597	882,889
Advances from other funds	188,468	-	82,540	271,008
Federal and state funded programs	-	-	107,867	107,867
Unreserved, including deficit of $79,007 in non-major capital project funds	27,722	-	(79,007)	(51,285)
Total fund balances	1,837,947	1,532,696	455,997	3,826,640
Total liabilities and fund balances	$ 9,689,855	3,488,955	3,923,880	$ 17,102,690

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Reconciliation of the Balance Sheet – Governmental Funds
to the Statement of Net Assets
June 30, 2008

The amounts of governmental activities reported in the statement of net assets and the balance sheet – governmental funds, are different for the following reasons:

Total combined fund balances reported in the balance sheet – governmental funds	$	3,826,640
Add (Deduct):		
Inventories and other current assets are not available to pay the current fiscal year expenditures, therefore, are not reported in the governmental funds.		68,740
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds. This is the carrying amount of capital assets, net of accumulated depreciation and amortization of $17,050,110 at June 30, 2008.		30,772,021
Certain deferred revenues in the governmental funds are recognized as revenues in the statement of activities. This is the amount of revenues that are measurable but not available at June 30, 2008.		1,725,718
Debt issued by the Municipality has associated costs (debt issue costs) that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets and reported net of accumulated amortization of $97,744 at June 30, 2008.		38,058
The following liabilities are not due (mature) in the current fiscal year, therefore, are not reported in the governmental funds at June 30, 2008:		
Bonds payable		(10,160,000)
Notes payable		(4,392,055)
Compensated absences		(3,173,980)
Reserve for federal cost disallowances		(182,210)
Accrued employees' christmas bonuses		(294,092)
Net assets – governmental activities, as reported in the statement of net assets	$	18,228,840

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Statement of Revenues, Expenditures and
Changes in Fund Balances -- Governmental Funds
Fiscal Year Ended June 30, 2008

	Major governmental Funds			
	General fund	Debt service fund	Other governmental funds	Total governmental funds
Revenues:				
Taxes:				
Property taxes	$ 7,999,497	1,696,518	-	$ 9,696,015
Municipal license taxes	3,781,108	-	-	3,781,108
Construction excise taxes	1,604,571	-	-	1,604,571
Sales and use taxes	221,026	-	-	221,026
Charges for services	1,139,330	-	14,061	1,153,391
Intergovernmental grants and contributions	1,776,793	-	4,109,878	5,886,671
Interests on deposits	224,780	44,591	12,298	281,669
Miscellaneous	294,790	-	-	294,790
Total revenues	17,041,895	1,741,109	4,136,237	22,919,241
Expenditures:				
Current:				
General government	6,575,638	-	-	6,575,638
Urban and economic development	2,920,282	-	1,373,415	4,293,697
Public safety	900,412	-	6,273	906,685
Health and sanitation	4,131,092	-	-	4,131,092
Culture, recreation and education	864,227	-	-	864,227
Public housing and welfare	1,072,491	-	1,181,126	2,253,617
Debt service:				
Principal	285,396	1,385,000	285,000	1,955,396
Interest	87,750	608,733	196,592	893,075
Capital outlays	207,440	-	1,577,260	1,784,700
Total expenditures	17,044,728	1,993,733	4,619,666	23,658,127
Excess of expenditures over revenues	(2,833)	(252,624)	(483,429)	(738,886)
Other financing sources (uses):				
Transfers-in from other funds	67,279	612,990	501,174	1,181,443
Transfers-out to other funds	(1,095,792)	(52,103)	(33,548)	(1,181,443)
Total other financing sources (uses), net	(1,028,513)	560,887	467,626	-
Net increase (decrease) in fund balances	(1,031,346)	308,263	(15,803)	(738,886)
Fund balances at beginning of fiscal year, as restated	2,869,293	1,224,433	471,800	4,565,526
Fund balances at end of fiscal year	$ 1,837,947	1,532,696	455,997	$ 3,826,640

The accompanying notes to the basic financial statements are an integral part of this statement

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds to the Statement of Activities
Fiscal Year Ended June 30, 2008

The amounts of governmental activities reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances - governmental funds, are different for the following reasons:

Deficiency of revenues and other financing sources under expenditures and other financing uses reported in the statement of revenues, expenditures and changes in fund balances – governmental funds	$ (738,886)
Add (Deduct):	
The following revenues recorded in the statement of activities do not provide current financial resources, therefore, are deferred in the governmental funds. This is the net change in deferred revenues of the following revenue items, which are measurable but not available at fiscal year end:	
Property taxes	(1,403,816)
Municipal license taxes	(94,630)
Intergovernmental grants and contributions	6,764
Governmental funds report capital outlays as expenditures. However in the statement of activities the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expense. This is the amount by which capital outlay expenditures ($1,784,700) exceeded depreciation and amortization expense of capital assets ($1,424,351) for the fiscal year ended June 30, 2008.	360,349
Repayment of principal of long-term obligations is reported as expenditure in the governmental funds, however, the repayment reduces long-term liabilities in the statement of net assets.	1,955,396
Amortization of deferred charges reported in the statement of activities does not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	(7,636)
Other reconciling items, net of certain expenses recorded in the statement of activities that do not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.	153,023
Net increase in net assets, as reported in statement of activities	$ 230,564

The accompanying notes to the basic financial statements are an integral part to this statement.

I. Background Information and Summary of Significant Accounting Policies

The Municipality of Canóvanas (the Municipality) is a local municipal government constituted in 1970 in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

The Commonwealth's Constitution provides for the separation of powers of the executive, legislative and judicial branches of the Commonwealth and the municipalities. However, the Municipality's governmental system consists of executive and legislative branches only. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power of the Municipality is exercised by the Municipal Legislature, whose members are also elected every four years. The judiciary power is exercised by the General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality.

The Municipality assumes either partial or full responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, education, urban development, economic development, and many other fiscal, general and administrative services.

a) *Financial Reporting Model*

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the fiscal year ended June 30, 2008, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

According to the financial reporting model established by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34), the required basic financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

RSI, consisting of a Management's Discussion and Analysis (MD&A), is information presented along with, but separate from, Municipality's basic financial statements.

MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2008, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

Other supplementary information presented in this report for purposes of additional analysis consist of: (1) combining and individual non-major governmental fund financial statements, (2) budgetary comparison schedule – debt service fund, and (3) schedules of capital assets used in the operations of governmental funds, as listed in the accompanying table of contents.

On July 1, 2005, the Municipality adopted the provisions of Statement No. 44, *Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement 1* (GASB No. 44). This statement amended the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* which provides guidance for the preparation of the statistical section of the Municipality's Comprehensive Annual Financial Report (CAFR). Accordingly, the statistical section of this Comprehensive Annual Financial Report has been modified to present more detailed information, typically in ten-year trends, that assists users in utilizing: (1) the basic financial statements, (2) the notes to basic financial statements, and (3) the required supplementary information, to assess the economic condition of a government.

b) Financial Reporting Entity

The accompanying basic financial statements include all departments, agencies and municipal operational units that are under the legal and administrative control of the Mayor, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Act No. 81.

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14), as amended, has set forth criteria to be considered in determining financial accountability for financial reporting purposes. These criteria include appointing a voting majority of an organization's governing body and: (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

According to GASB No. 39, a legally separate, tax-exempt organization should be reported as a discretely presented component unit of a reporting entity if all of the following criteria are met:

- 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.
- 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.

- 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 that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2008.

*c) **Government-wide Financial Statements***

The accompanying GWFS are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements report information of all governmental activities of the Municipality as a whole. These statements are aimed at presenting a broad overview of the Municipality's finances by reporting its financial position and results of operations using methods that are similar to those used by most private businesses.

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity) and or net liabilities. This statement assists management in assessing the level of services that can be provided by the Municipality in the future and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets and discloses legal and contractual restrictions on resources.

Net assets are classified in the accompanying statement of net assets within the following three categories:

- **Invested in capital assets, net of related debt** – This net asset category consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvement of those assets (capital-related debt). For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.

  In addition, for the purposes of determining the outstanding debt attributed to capital assets, the following items are excluded from the calculation: (1) bond issuance costs, (2) interest payable, (3) accrued interest on deep discount debt and non-capital accrued liabilities (e.g. compensated absences, claims and judgments, etc.), and (5) debt used to finance capital acquisitions by parties outside the Municipality. Furthermore, the computation of net assets invested in capital assets, net of related debt, excludes inter-fund loans and other financial assets.

- **Restricted net assets** – This net asset category consists of net resources restricted by external parties (such as debt covenants, creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

  On July 1, 2005, the Municipality adopted the provisions of Statement No. 46, *Net Assets Restricted by Enabling Legislation* (GASB No. 46). This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This Statement clarified that a legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. This Statement states that the legal enforceability of an enabling legislation should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration. Although the determination that a particular restriction is not legally enforceable may cause the Municipality to review the enforceability of other restrictions, it should not necessarily lead the Municipality to the same conclusion for all enabling legislation restrictions.

  The classification of restricted net assets identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

  Internally imposed designations of resources, including earmarking, are not reported as restricted net assets. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

The Municipality has reported the following types of restricted net assets in the accompanying statement of net assets as of June 30, 2008:

(1) **Debt service** – Represent net resources available to cover future debt service payments of bonds payable.

(2) **Federal and state funded programs** – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs.

- **Unrestricted net assets** – Generally, this category consists of the excess of assets over related liabilities that are neither externally nor legally restricted, neither invested in capital assets. However, at June 30, 2008, this category has a negative balance of $14,347,877 because liabilities exceeded the related assets. Generally, the assets recorded within this category are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints that are imposed by management but can be removed or modified.

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

The accompanying statement of activities presents the Municipality's results of operations by showing, how the Municipality's net assets changed during the fiscal year ended June 30, 2008, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education and (6) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General government:

Municipal legislature
Mayor's office
Department of finance and budget
Department of human resources
Department of municipal secretary
Department of internal audit
Department of general services
Department of public relations

Urban and economic development:

Department of public works
Department of transportation and mechanics
Department of urban development
Department of conservation and ornate

Public safety:

Department of emergency management
Department of municipal police

Health and sanitation:

Department of health
Department of recycling

Culture, recreation and education:

Department of recreation and sports

Public housing and welfare:

Department of community affairs
Department of service to citizens
Department of elderly services

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at: (1) the net cost of the function/program that must be financed from the Municipality's general revenues or (2) the net program revenue that contributes to the Municipality's general revenues. The accompanying statement of activities reports the following categories of program revenues for the fiscal year ended June 30, 2008:

- **Charges for services** – These revenues generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.

- **Program-specific operating and capital grants and contributions** – These revenues consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Capital grants and contributions consist of revenues or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes, sales and use taxes and construction excise taxes are reported as general revenues. All other non-tax revenues (including unrestricted interest on deposits, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

The general government function/program reported in the accompanying statement of activities includes expenses that are, in essence, indirect or costs of other functions/programs of the Municipality. Even though some of these costs have been charged to certain funds in the GFFS as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect costs as direct expenses of the general government function. Accordingly, the Municipality generally does not allocate general government (indirect) costs to other functions.

The effects of all inter-fund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets and activities.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the GFFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is financed primarily through user charges; or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

d) Governmental Fund Financial Statements

A fund is a fiscal and accounting entity consisting of a self-balancing set of accounts used to record assets, liabilities and residual equities, deficits or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with GAAP and/or special regulations, restrictions or limitations.

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental.

These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major governmental funds, as defined below, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current fiscal year have complied with public decisions concerning the raising and spending of public moneys in the short term (generally one fiscal year).

The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

- ***General fund*** – The general fund is the Municipality's main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.

- ***Debt service fund*** – The debt service fund is a major governmental fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. Consistently with the prior fiscal years' financial statement presentation, during the fiscal year ended June 30, 2008, the financial activity accounted for in the debt service fund was specifically related to bonds payable.

  The outstanding balance of general long-term debts for which debt service payments do not involve the advance accumulation of resources (such as notes payable and obligations under capital leases) are only accounted for in the accompanying statement of net assets. The debt service payments of such debts are generally accounted for as debt service – principal and debt service – interest expenditures in the general fund, except for certain notes payable to HUD, which are accounted for in the HUD Section 108 capital projects fund, a non-major governmental fund.

  Special revenue funds - The special revenue funds are non-major governmental funds, as defined below, used by the Municipality to account for revenues derived from grants, contributions or other revenue sources that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in major capital projects which are accounted for in the capital projects fund). The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditures for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

- ***Capital projects funds*** – Capital projects funds are non-major governmental funds, as defined below, used to account for the financial resources used for the acquisition, construction or improvement of major capital facilities and other assets. Significant capital outlays financed from proceeds of general obligation, public improvement or special obligation bonds accounted for also in the capital projects funds.

  The use of the capital projects funds has been reserved only for major capital acquisitions, construction or improvement activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capitalizable assets (such as furniture, office equipment, vehicles and other minor capital assets or improvements) have been reported in the governmental fund from which financial resources were used for the payment.

The focus of the GFFS is on major governmental funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds between major and non-major categories within the GFFS. Major individual governmental funds are reported individually as separate columns in the GFFS, while data from all non-major governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund would be classified as a major governmental fund in the GFFS if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and non-operating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are: (1) the general fund and (2) the debt service fund.

The Municipality periodically undertake a comprehensive evaluation of its fund structure to ensure that complies with all aspects that are of importance to users of general purpose external financial reports. Consequently, all superfluous funds and some internal funds currently used by Municipality in the day-to-day accounting procedures have not been reported as individual governmental funds in the accompanying fund financial statements. Accordingly, the accompanying fund financial statements include only the minimum number of funds consistent with legal and operating requirements

The accompanying GFFS are accompanied by the following schedules required by GAAP: (1) the reconciliation of the balance sheet – governmental funds to the statement of net assets, and (2) the reconciliation of the statement of revenues, expenditures and changes in fund balances – governmental funds to the statement of activities.

e) Measurement Focus and Basis of Accounting

Government-wide financial statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest on deposits and investments) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* (GASB No. 33). GASB No. 33 established accounting and reporting standards for non-exchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a non-exchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its non-exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions.

In the case of derived tax revenue transactions, which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

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

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to the Municipality and the provider government requires the Municipality to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary non-exchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, willingly entered into by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above. Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

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

According to GASB No. 34, all general capital assets and the unmatured long-term liabilities are recorded only in the accompanying statement of net assets. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the GFFS.

Governmental fund financial statements – The accompanying GFFS are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues (municipal licenses taxes, construction excise taxes, sales and use taxes, interests on deposit, intergovernmental grants and contributions and certain charges for services) to be available if collected within 90 days after June 30, 2008, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2008.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, interest on deposits, and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues (see note 8).

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred for expenditure-driven grants). Interest on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2008.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. GASBI No. 6 modified the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting prior to GASB No. 34, and clarified a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities. Therefore, the accompanying balance sheet – governmental funds generally reflects only assets that will be converted into cash to satisfy current liabilities. Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds.

Modifications to the accrual basis of accounting in accordance with GASBI No. 6 include:

- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest of bonds due on July 1, 2008, which are recorded as governmental fund liabilities at June 30, 2008 which is the date when resources were available in the debt service fund.

- Obligations under capital leases, compensated absences, and the reserve for federal cost disallowances are recorded only when they mature (when payment is due).

- Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (unmatured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.

- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

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

f) Stewardship, Compliance and Accountability

Budgetary Control

According to Act No. 81, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budgets are prepared.

The Mayor must submit, for the fiscal year commencing on the next July 1, an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of the Commonwealth (the Commissioner) and the Municipal Legislature no later than May 10 and May 15, respectively. The Commissioner preliminary verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before June 13.

The Municipal Legislature has 10 business days, up to the immediately preceding June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This permits the Municipality to continue doing payments for its operations and other purposes until the new budgets are approved.

The annual budgets may be updated for any estimate revisions as well as fiscal year-end encumbrances, and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare, capital outlays, principal expenditures, interest expenditures, etc.) within the general and debt service funds, respectively.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

Budgetary Accounting

The Municipality's annual budgets are prepared using the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

According to the budgetary basis of accounting, revenue is generally recorded when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one fiscal year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at fiscal year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying Budgetary Comparison Schedule – general fund, provides information about the general fund's original budget, its amendments, and the actual results of operations of such governmental fund under the budgetary basis of accounting for the fiscal year ended June 30, 2008. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2008, which is prepared by the Municipality's Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget at P.O. Box 1612, Canóvanas, Puerto Rico 00729-1612.

Because accounting principles applied for the purposes of the developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the general fund's budgetary basis and GAAP actual amounts is presented as follows:

Deficiency of revenues and other financing sources under expenditures and other financing uses – budgetary basis – general fund	$ (868,182)
Timing differences:	
Net effect of current year encumbrances recorded as expenditures for budgetary purposes versus prior year encumbrances recorded as current year expenditures for GAAP purposes	995,429
Entity differences – non-budgeted expenditures	(78,710)
Basis of accounting differences:	
Net decrease in property taxes receivable	(1,114,352)
Net decrease in municipal license taxes receivable	(27,023)
Net increase in construction excise taxes receivable	24,954
Net increase in sales and volume taxes receivable	67,266
Net increase in intergovernmental receivables	6,764
Net increase in accrued interest receivable	5,897
Net increase in miscellaneous receivables	21,712
Net decrease in due and advances from other funds	(229,362)
Net decrease in deferred revenue	546,433
Net increase in accounts payable and accrued liabilities	(190,732)
Net increase in intergovernmental payables and accrued liabilities	(173,185)
Net increase in due/advances to other funds	(18,255)
Deficiency of revenues and other financing sources under expenditures and other financing uses –general fund– GAAP basis	$ (1,031,346)

g) Unrestricted and Restricted Deposits

The Municipality's deposits at June 30, 2008 are composed of: (1) demand deposits in commercial banks (2) demand deposits in the Government Development Bank for Puerto Rico (GDB, fiscal agent) and (3) cash equivalents consisting of certificates of deposits in commercial banks of $3,800,000, with original maturities of three months or less. Cash equivalents are recorded at amortized cost, which approximates fair value.

The Municipality follows the practice of pooling cash. At June 30, 2008, the pool cash account has a balance of $420,755 of which $190,748 and $544,335 have been recorded in non-major capital project funds and non-major special revenue funds respectively. In addition, at June 30, 2008, an excess of check drawn over bank balance (negative balance) of $314,328 in the pool cash account has been recorded in the general fund.

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

Cash in fiscal agent in the general fund and debt service funds consist principally of property tax collections amounting to $576,250 and $2,265,465, respectively, which are restricted for the payment of the Municipality's debt service, as required by law. Cash in fiscal agent of $538,292 in the general fund also includes unspent proceeds of bonds that are restricted for the acquisition of certain capital assets and the payment of certain accounts payable. Cash with fiscal agent recorded in the non-major governmental funds consists principally of unspent proceeds of bonds and notes and the balance of interest and non-interest bearing accounts amounting to $634,069 which are restricted for the acquisition, construction or improvements of major capital assets.

Restricted cash in commercial banks for other governmental funds, amounting to $2,712,352, represents the balance of interest and non-interest bearing accounts restricted to finance the operations of various federal and state funded programs.

h) Unrestricted and Restricted Accounts and Notes Receivable

Receivables consist of all revenues earned but not collected at June 30, 2008. These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

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

On July 1, 2007, the Municipality adopted the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB No. 48). This Statement establishes standards for the measurement, recognition, and display of transactions where governments exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments, generally, a single lump sum. GASB No. 48 provides technical guidance to determine whether this type of transaction should be regarded as a sale or as a collateralized borrowing resulting in a liability. This criteria is used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. Accordingly, GASB No. 48 establishes that a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. If it is determined that a transaction involving receivables should be reported as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale in the change statements. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue should be deferred and amortized, except when specific criteria are met. This Statement also provides additional guidance for sales of receivables and future revenues within the same financial reporting entity.

GASB No. 48 also provides guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. According to the criteria set forth by GASB. No. 48, there were no transactions involving receivables that should be reported as a sale as of and for the fiscal year ended June 30, 2008, therefore, the adoption of GASB No. 48 had no effect in the accompanying basic financial statements.

i) Inventories and Other Current Assets

Inventories consist of construction materials and inventories of office supplies, food and medicines, which are held for consumption. Other current assets consist of prepaid costs. Generally, inventories are capitalized and stated at cost using the first-in, first-out method (FIFO) in the GWFS. Inventories and prepaid expenses in the GFFS are generally recorded as expenditures (purchase method) when purchased (paid) rather than capitalized as an asset.

j) Deferred Charges

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

k) Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of $500 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under $500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as capital outlays (expenditures).

In the statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2002 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2002 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

Major outlays for capital assets and improvements are capitalized in the statement of net assets as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight–line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

	Years
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20
Machinery and equipment under capital leases	3 to 5

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

l) ***Deferred Revenues***

In the GFFS, deferred revenue arises when one of the following situations occur:

- Potential revenue does not meet both the "measurable" and "available" criteria for revenue recognition in the current period (unavailable revenue). As previously discussed, available is defined as due (or past due) at June 30, 2008 and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria are met, the liability for deferred revenue is removed and revenue is recognized.

- The Municipality receives resources before it has a legal claim to them (unearned revenue). In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

m) Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences,* issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2008 and (2) is not contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of Social Security taxes and Medicare taxes).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. In addition upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed previously. After 10 years of services, any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

The liability for compensated absences is reported in the statement of net assets. A liability for compensated absences is reported in the GFFS only when matured (when payment is due), for example, as a result of employee resignations or retirements.

n) Long-term Debt

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds payable, notes payable, obligations under capital leases, accrued compensated absences, and federal cost disallowances.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due on July 1, 2008 are recorded as governmental fund liabilities in the GFFS (debt service fund) when resources are available in the debt service fund (June 30, 2008). In the GFFS, the face amount of debt issued (gross debt reported) is reported as other financing sources when issued.

In the GWFS debt issuance costs are reported as deferred charges, which are amortized under the straight-line method over the life of the debt, while in the GFFS such costs are recognized as expenditures during the current period.

Non-interest bearing notes payable are accounted for under the provisions of Opinion No. 21, *Interest on Receivables and Payables*, issued by the Accounting Principles Board (APB No. 21). According to APB No. 21, the Municipality has recorded such notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The discount is amortized over the life of the notes using the effective interest method. Amortization of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses during the current period.

o) Leases

The Municipality classifies its lease agreements either as operating or capital leases according to Statement No.13, *Accounting for Leases*, issued by FASB (FASB No. 13). Capital lease agreements are generally non-cancelable and involve, substance over form, the transfer of substantially all benefits and risks inherent in the ownership of the leased property, while operating leases do not involve such transfer. Accordingly, a capital lease involves the recording of an asset and a related lease obligation at the inception of the lease. According to FASB No. 13, the Municipality classifies a lease agreement as a capital lease if at its inception the lease meets one or more of the following four criteria:

- By the end of the lease term, ownership of the leased property is transferred to the Municipality.

- The lease agreement contains a bargain purchase option.

- The lease term is substantially equal (75 percent or more) to the estimated useful life of the leased property.

- At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90 percent or more of the estimated fair value of the leased property.

Although the Municipality is prevented legally from entering into obligations extending beyond one fiscal year, most capital lease agreements entered by the Municipality contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have a fiscal funding or a cancellation clause have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered remote. The Municipality's lease agreements do not include contingent rental payments nor escalation clauses.

In the GWFS, the obligation under capital leases is recorded at the lesser of the estimated fair value of the leased property or the present value of the minimum lease payments, excluding any portion representing executory costs and profit thereon to be paid by the lessor. A portion of each minimum lease payment is allocated to interest expense and the balance is applied to reduce the lease obligation using the effective interest method.

In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded simultaneously as: (1) expenditures and (2) other financing sources. Minimum lease payments are recorded as expenditures in the GFFS.

p) Accounting for Pension Costs and Post-Employment Benefits

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the state government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth of Puerto Rico.

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

On July 1, 2007, the Municipality adopted the provisions of GASB Statement No. 50, *Pension Disclosures* (GASB No. 50). This Statement more closely aligns current pension disclosure requirements for governments with those that governments are beginning to implement for retiree health insurance and other post-employment benefits. Specifically, GASB No. 50 amends GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures* *for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers,* by requiring:

- Disclosure in the notes to the financial statements of pension plans and certain employer governments of the current funded status of the plan—in other words, the degree to which the actuarial accrued liabilities for benefits are covered by assets that have been set aside to pay the benefits—as of the most recent actuarial valuation date.

- Governments that use the aggregate actuarial cost method to disclose the funded status and present a multi-year schedule of funding progress using the entry age actuarial cost method as a surrogate; these governments previously were not required to provide this information.
- Disclosure by governments participating in multi-employer cost-sharing pension plans of how the contractually required contribution rate is determined.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB No. 45) establishes standards for the measurement, recognition, and display of expense/expenditures and related liabilities/assets of post-employment benefits other than pensions (OPEB), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local government employers. At June 30, 2008, there were no OPEB plans adopted by the Municipality. Accordingly, during the fiscal year ended June 30, 2008, the Municipality did not incur in any post-employment benefits costs other than pensions, therefore, the adoption of GASB No. 45 had no effect in the accompanying basic financial statements.

q) Risk Management

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by the Municipal Revenue Collection Center ("CRIM", by its Spanish acronyms), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration (ACAA), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is $35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a cost reimbursement basis.

The Municipality also obtains medical insurance coverage from several health insurance companies for its employees. Different health insurance coverage and premium options are negotiated each year by the Department of Treasury on behalf of the Municipality. The current insurance policies have not been canceled or terminated at June 30, 2008. Premiums are paid on a monthly basis directly to the insurance company. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

r) Reservations of Fund Balances

Reservations of fund balances represent portions of fund balances in the GFFS that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has recorded the following types of reservations of fund balances in the GFFS:

- ***Encumbrances*** – Represent reservations of fund balances for commitments related to unperformed (executory) contracts for goods or services (future expenditures under purchase orders, contracts and other commitments). These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future fiscal years as the goods or services are received.

- ***Debt service*** – Represent fund balances available to cover future debt service payments (principal and interest) on bonds payable, which are accounted for in the debt service fund.

- ***Capital assets and projects*** – Represent the reservation of financial resources to be used for the acquisition, construction or improvement of capital assets under contracts and other commitments.

- ***Advances from other funds*** – Represent the reservation of financial resources set aside for long-term inter-fund receivables, which are not considered current available financial resources at June 30, 2008.

- ***Federal and state funded programs*** – Represent financial resources set aside for use in federal and state grant programs.

s) Inter-fund Activities

The Municipality has the following types of reciprocal and non-reciprocal interfund activities recorded among governmental funds in the accompanying GFFS:

- ***Inter-fund loans*** – Represent amounts provided with a requirement for repayment, which are recorded as "due from" in the lender governmental fund and "due to" in the borrower governmental fund. Inter-fund receivables, which are not considered to be currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period of time, inter-fund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as an operating transfer from the governmental fund that made the loan.

- ***Inter-fund transfers*** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Operating transfers are reported as other financing sources in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.

- ***Inter-fund reimbursements*** – Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

In the GFFS, inter-fund activity has not been eliminated, as permitted by GAAP.

t) Use of Estimates

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

u) Future Adoption of Accounting Pronouncements

In December 2006, GASB issued its Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB No. 49). This Statement identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation. According to the standard, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.

- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals but will be employed for the first time by governments. GASB No. 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

The requirements of GASB No. 49 are effective for the Municipality's fiscal year commencing on July 1, 2008.

In June 2007, GASB issued its Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (GASB No. 51). This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The guidance specific to intangible assets referred to above includes guidance on recognition. This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This guidance serves as an application of the specified-conditions approach described above to the development cycle of computer software. This Statement also establishes guidance specific to intangible assets related to amortization. This Statement provides guidance on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions. If there are no factors that limit the useful life of an intangible asset, the Statement provides that the intangible asset be considered to have an indefinite useful life. Intangible assets with indefinite useful lives should not be amortized unless their useful life is subsequently determined to no longer be indefinite due to a change in circumstances.

The requirements of GASB No. 51 are effective for the Municipality's fiscal year commencing on July 1, 2009.

In November 2007, GASB issued its Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments (GASB No. 52).* This Statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value.

GASB No. 52 more appropriately reports the resources available in endowments and more closely aligns financial reporting with the objectives of endowments. It results in property held for similar purposes by comparable entities being reported in the same manner. Reporting land and other real estate held as investments at fair value enhances users' ability to meaningfully evaluate an entity's investment decisions and performance.

The requirements of GASB No. 52 are effective for the Municipality's fiscal year commencing on July 1, 2008.

In June 2008, GASB issued its Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* This Statement requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements. GASB No. 53 provides specific criteria that governments will use to determine whether a derivative instrument results in an effective hedge. Changes in fair value for effective hedges that are achieved with derivative instruments will be recognized in the reporting period to which they relate.

The requirements of GASB No. 52 are effective for the Municipality's fiscal year commencing on July 1, 2008.

The Municipality's management has concluded that the future adoption of GASB Statements No. 49, 51, 52 and 53 will not have a significant impact on the Municipality's basic financial statements.

2. Deposits

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and the Government Development Bank for Puerto Rico (GDB). Proceeds from all bonds and the funds related to certain federal grant awards are required by law to be held with GDB.

On July 1, 2004, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3.* This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, and (4) foreign exchange exposure.

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth of Puerto Rico, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico, issued by the Government Development Bank for Puerto Rico* as promulgated by Law No. 113 of August 3, 1995. Accordingly, the Municipality is only allowed to invest in obligations of the Commonwealth of Puerto Rico, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments (debt securities) for which credit risk exposure may be significant. Consequently, at June 30, 2008 and for the fiscal year then ended, the Municipality invested only in certificates of deposit in commercial banks, which are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of $100,000 per depositor. No investments in debt of equity securities were made during the fiscal year ended June 30, 2008. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2008.

- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2008, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. At June 30, 2008, the interest rate risk associated with the Municipality's cash and cash equivalent is considered low since the investment portfolio of the Municipality consists of certificates of deposit and do not include debt securities or any type of investments that could be affected by changes in interest rates.

- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico,* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of $100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits of GDB, amounting to $4,443,539 at June 30, 2008 ($4,746,298 bank balance), are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2008. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2008, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

- **Foreign exchange risk** – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2008.

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Cash and cash equivalents at June 30, 2008, are classified in the accompanying balance sheet – governmental funds a follows:

	Major governmental funds			
Unrestricted deposits:	General fund	Debt service fund	Other governmental funds	Total
Cash equivalents in commercial banks	$ 3,800,000			$ 3,800,000
Cash in commercial banks	219,008	-	-	219,008
Total unrestricted deposits	4,019,008	-	-	4,019,008
Restricted deposits:				
Cash in commercial banks	-	-	2,712,352	2,712,352
Cash in fiscal agent	1,115,242	2,635,465	634,069	4,384,776
Total restricted deposits	1,115,242	2,635,465	3,346,421	7,097,128
Total carrying amount of deposits	$ 5,134,250	2,635,465	3,346,421	$ 11,116,136

In addition, at June 30, 2008, the general fund has recorded an excess of check drawn over bank balance (negative balance) of $314,328, which is related to the general fund's share in the pool cash account.

3. Municipal License Taxes

The Municipality is authorized by Act No. 81 to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of Canóvanas. This is a self-assessed tax generally based on the business volume of taxpayers, measured by gross revenues. The Municipality establishes the applicable tax rates. At June 30, 2008, the municipal license tax rates imposed by the Municipality were 1.50 percent for financial institutions and 0.50 percent for other types of taxpayers. Any taxpayers that have been granted with a partial tax exemption under any of the tax incentive acts of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must asses the corresponding municipal license tax by declaring the volume of business through a tax return to be filed every April 15, based on the actual volume of business (revenues) generated in the preceding calendar year. Taxpayers with a sales volume of $1 million or more must include audited financial statements with their tax return filings. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration on April 15. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5 percent discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as deferred revenues in the GWFS and the GFFS (see note 8). Total municipal license tax receivable amounted to $347,995 at June 30, 2008. Unearned (deferred) municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to $4,145,806 at June 30, 2008.

4. Property Taxes

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

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (lien; levy date) and reporting such taxable value through a personal property tax return filed on May 15 (due date and collection date) subsequent to the assessment date. The total personal property tax rate in force at June 30, 2008 was 6.83 percent (of which taxpayers pay 6.63 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed every January 1 (lien; levy date) and is based on estimated current values of the property, deflated to 1957 market prices. Real property taxes a due and collectible on January 1 and July of every fiscal year. The total real property tax rate in force at June 30, 2008 was 8.83 percent (of which 8.63 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

Residential real property occupied by its owner (not engaged in trade or business) is exempt from property taxes only on the first $15,000 of the assessed value (at 1957 market prices). For exempt amounts, the Department of Treasury assumes the payment of the basic tax (4.00 percent and 6.00 percent for personal and real property, respectively), except for property assessed for less than $3,500 (at 1957 market prices), for which no payment is made by the Department of Treasury.

Included within the total personal and real property tax rates of 6.83 percent and 8.83 percent, respectively, there is a portion of the tax rate in the amount of 1.40 percent that is restricted for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

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The composition of property taxes receivable and the related deferred revenue is as follows at June 30, 2008:

	General fund	Debt service fund	Total
Gross property taxes receivable	$ 16,609,829	3,406,555	$ 20,016,384
Less:			
Allowance for uncollectible accounts	(1,950,540)	(2,861,154)	(16,811,694)
Net property tax receivable	$ 2,659,289	545,401	$ 3,204,690
Deferred (earned and unavailable) property tax revenues in GFFS	$ 1,309,865	268,644	$ 1,578,509

5. Intergovernmental Receivables and Payables

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows at June 30, 2008:

	Major governmental funds	Other governmental funds	Total governmental funds	Statement of net assets
Intergovernmental receivables:				
U.S. Department of Health and Human Services - Child Care Program fund	$ -	118,204	118,204	$ 118,204
Puerto Rico Treasury Department – general fund: - Christmas bonus reimbursement program fund	147,209	-	147,209	147,209
U.S. Department of Housing and Urban Development – CDBG IDIS fund	-	49,616	49,616	49,616
Puerto Rico Department of Transportation and Public Works – DTOP capital projects fund	-	10,899	10,899	10,899
Puerto Rico Department of Labor: - Law 52/82 Payroll Subsidy Program fund	-	314,924	314,924	314,924
Total intergovernmental receivables	$ 147,209	493,643	640,852	$ 640,852

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		Major governmental funds	Other governmental funds	Total governmental funds		Statement of net assets
Intergovernmental payables:						
Payroll withholdings and employer's contributions - general fund:						
Puerto Rico Treasury Department	$	305,504	-	305,504	$	305,504
Employees Retirement System of the Government of the Commonwealth of Puerto Rico		179,400	-	179,400		179,400
Utilities - general fund:						
Puerto Rico Water and Sewer Authority		113,468	-	113,468		113,468
Miscellaneous:						
U.S. Department of Education		166	-	166		166
Total intergovernmental payables	$	598,538	-	598,538	$	598,538

6. Inter-fund Transactions

The composition of inter-fund balances at June 30, 2008 and for the fiscal year then ended is as follows:

	Due/advances from:				
	Major governmental funds				
Due/advances to:	General Fund	Debt service fund	Other governmental funds		Total governmental funds
Major governmental funds:					
General fund	$ -	576,250	6,722	$	582,972
Debt service fund	1,839	-	-		1,839
Other governmental funds:					
Special revenue funds	815,795	-	-		815,795
Capital project funds	241,036	-	75,818		316,854
Total	$ 1,058,670	576,250	82,540	$	1,717,460

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	Transfers in:			
	Major governmental funds			
Transfers out:	**General fund**	**Debt service fund**	**Other governmental funds**	**Total governmental funds**
Major governmental funds:				
General fund	$ -	612,990	482,802	$ 1,095,792
Debt service fund	52,103	-	-	52,103
Other governmental funds:				
Special revenue funds	2,878	-	18,372	21,250
Capital project funds	12,298	-	-	12,298
Total	$ 67,279	612,990	501,174	$ 1,181,443

The principal purposes of inter-fund receivables and payables are:

- Recognize in the debt service fund the amounts due from the general fund to cover the principal and interest payments on certain bonds, amounting to $576,250. These payments are due on July 1, 2008.

- Recognize in the general fund the outstanding balance of the loans granted to non-major capital project and special revenue funds ($1,056,831) to temporarily cover the payroll and other operating costs of several federally and state funded programs.

The principal purposes of inter-fund transfers are to:

- Make a routinary transfer of interest income, amounting to $52,103 from the debt service fund to the general fund, as permitted by law. This interest income is generated by the debt service fund's deposits and is transferred on a quarterly basis to the general fund.

- Make a routinary transfer of resources, amounting to $612,990, from the general fund to the debt service fund to cover the principal and interest payments on certain bonds. These debt service payments were made on January and July 2008.

- Make a routinary transfer of resources, amounting to $481,592, from the general fund to the HUD Section 108 loan guarantee capital projects fund, to cover the principal and interest payments on notes payable to the U.S. Department of Housing and Urban Development.

Inter-fund receivables and payables represent the pending settlements of the aforementioned transfers, which are considered by management to be fully realizable at June 30, 2008.

At June 30, 2008, the general fund reported advances (long-term inter-fund receivables) from non-major special revenue funds and non-major capital project funds amounting to $67,335 and $121,133, respectively. In addition, the non-major capital project funds reported advances from the general fund and other non-major capital project funds amounting to $6,722 and $75,818, respectively. These advances among governmental funds have been reported at June 30, 2008 within due and advances from other funds and are not expected to be repaid within one year after year-end. Accordingly, at June 30, 2008, the general fund and the non-major capital project funds reported reservations of fund balances amounting to $188,468 and $82,540, respectively, to properly disclose the portion of inter-fund receivables that are considered current available financial resources at June 30, 2008.

7. Capital Assets

Capital assets activity for the fiscal year ended June 30, 2008:

Cost basis:	Balance At June 30, 2007	Capital Outlays/ additions	Reclassifications	Balance at June 30, 2008
Cost basis of capital assets, not subject to depreciation and amortization:				
Infrastructure land	$ 1,611,480	-	-	$ 1,611,480
Construction in progress	885,508	1,494,315	(1,686,305)	693,518
Total cost basis of capital assets, not subject to depreciation and amortization	2,496,988	1,494,315	(1,686,305)	2,304,998
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	19,881,620	41,447	427,933	20,351,000
Infrastructure	12,669,081	-	1,218,963	13,888,044
Land improvements	2,094,491	-	39,409	2,133,900
Licensed vehicles	6,509,212	20,974	-	6,530,186
Furniture, fixtures, machinery and equipment	2,180,794	227,964	-	2,408,758
Machinery and equipment held under capital leases	205,245	-	-	205,245
Total cost basis of capital assets subject to depreciation and amortization	43,540,443	290,385	1,686,305	45,517,133
Total cost basis of capital assets	$ 46,037,431	1,784,700	-	$ 47,822,131

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	Balance At June 30, 2007	Depreciation and amortization expense	Reclassifications	Balance at June 30, 2008
Accumulated depreciation and amortization:				
Buildings, structures and building improvements	$ 3,510,110	401,928	-	$ 3,912,038
Infrastructure	4,730,135	319,177	-	5,049,312
Land Improvements	1,381,706	76,164	-	1,457,870
Licensed vehicles	4,818,444	435,780	-	5,254,224
Furniture, fixtures, machinery and equipment	980,119	191,302	-	1,171,421
Machinery and equipment held under capital leases	205,245	-	-	205,245
Total accumulated depreciation and amortization	15,625,759	1,424,351	-	17,050,110
Capital assets, net	$ 30,411,672	360,349	-	$ 30,772,021

Depreciation and amortization expense was charged to functions in the accompanying government – wide statement of activities as follows for the fiscal year ended June 30, 2008:

General government	$ 103,936
Public safety	44,513
Public housing and welfare	6,345
Health and sanitation	51,733
Urban and economic development	920,340
Culture, recreation and education	297,484
Total depreciation and amortization expense	$ 1,424,351

At June 30, 2008 the estimated aggregate replacement cost of the Municipality's capital assets amounted to approximately $53 million.

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8. Deferred Revenues

At June 30, 2008, deferred revenues recorded in the GWFS and the GFFS are as follows:

	Major governmental funds				
	General fund	Debt service fund	Other governmental funds	Total governmental funds	Statement of net assets
Earned and unavailable revenues:					
Property taxes	$ 1,309,865	268,644	-	1,578,509	$ -
Intergovernmental grants and Contributions	147,209	-	-	147,209	-
Total earned and unavailable revenues	$ 1,457,074	268,644	-	1,725,718	$ -
Unearned revenues:					
Municipal licenses	$ 4,145,806	-	-	4,145,806	$ 4,145,806
Intergovernmental grants and Contributions	-	-	2,034,626	2,034,626	2,034,626
Total unearned revenues	4,145,806	-	2,034,626	6,180,432	6,180,432
Total deferred revenues	$ 5,602,880	268,644	2,034,626	7,906,150	$ 6,180,432

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9. Long-Term Obligations

The general long-term debt activity for the fiscal year ended June 30, 2008 is as follows:

	Balance at beginning of fiscal year	Borrowings and other Increases	Payments or deductions	Balance at end of fiscal year	Balance due within one year
Bonds payable	$ 12,850,000	-	(1,305,000)	$ 11,545,000	$ 1,385,000
Notes payable:					
Municipal Revenue Collection Center	1,142,415	50,640	(336,000)	857,055	299,960
U.S. Department of Housing (HUD) and Urban Development	3,820,000	-	(285,000)	3,535,000	295,000
Reserve for federal cost disallowances	182,210	-	-	182,210	-
Obligations under capital leases	36	-	(36)	-	-
Compensated absences	3,092,767	3,173,980	(3,092,767)	3,173,980	316,698
Total	$ 21,087,428	3,224,620	(5,018,803)	$ 19,293,245	$ 2,296,658

Historically, the general fund has been used to liquidate certain notes payable, compensated absences, obligations under capital leases, federal cost disallowances and any other long-term liabilities other than bonds, except for notes payable to HUD, which have been recorded in the non-major capital project funds.

a) Debt Limitation

The Municipal Legislature is legally authorized to approve the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth of Puerto Rico also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and bond anticipation notes) are backed by the full faith, credit and taxing power of the Municipality; and

- Direct obligations are not to be issued by the Municipality if the amount of the principal of, and the interest on, such bonds and bond anticipation notes (and on all bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or bond anticipation notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable and bond anticipation notes to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. The Municipality's available legal debt margin amounted to $1,764,805 at June 30, 2008, as published by the Government Development Bank for Puerto Rico.

b) Bonds Payable

The Municipality issues general obligation, special obligation and public improvement bonds to finance the acquisition, construction and improvement of capital assets, as well as, to finance certain operating needs, including the payment to suppliers in certain circumstances.

The laws and regulations of the Commonwealth of Puerto Rico provide that the Municipality's public debt will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and bond anticipation notes. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of bonds.

As described in Note 4, the Municipality levies an annual additional special tax of 1.80 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2008:

	Outstanding amount
Public Improvement Bonds:	
1995 serial bonds for the acquisition of major capital assets, original amount of $2,315,000, due in annual principal installments ranging from $95,000 to $265,000; plus interests due in semiannually installments at variable rates (6.05% at June 30, 2008) through July 1, 2009	505,000
2005 serial bonds for the acquisition of major capital assets, original amount of $3,115,000, due in annual principal installments ranging from $145,000 to $285,000; plus interests due in semiannually installments at variable rates (4.17% at June 30, 2008) through July 1, 2019	2,660,000
Total public improvement bonds	3,165,000

	Outstanding amount
General obligation bonds:	
2003 serial bonds for the acquisition of vehicles, original amount of $3,375,000, due in annual principal installments ranging from $405,000 to $565,000; plus interest due in semiannually installments at variable rates (6.60% at June 30, 2008) through July 1, 2009	$ 1,100,000

	Outstanding amount
2001 serial bonds for the acquisition of major capital assets, original amount of \$5,500,000, due in annual principal installments ranging from \$75,000 to \$475,000; plus interests due in semiannually installments at variable rates (3.64% at June 30, 2008) through July 1, 2026	4,950,000
2004 serial bonds for the payment of accounts payable to suppliers, original amount of \$1,435,000, due in annual principal installments ranging from \$175,000 to \$235,000; plus interests due in semiannually installments at variable rates (4.17% at June 30, 2008) through July 1, 2011	880,000
2007 serial bonds for the payment of accounts payable to suppliers, original amount of \$1,560,000, due in annual principal installments ranging from \$110,000 to \$215,000; plus interests due in semiannually installments at variable rates (6.60% at June 30, 2008) through July 1, 2016	1,450,000
Total general obligation bonds	8,380,000
Total bonds payable	$ 11,545,000

Variable interest rates on serial bonds are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper: (1) in the taxable and tax-exempt markets of the United States of America, (2) in the Eurodollar market, and (3) to corporations having tax exemptions under the Commonwealth's Industrial Incentives Acts and, which qualify for benefits provided by the former Section 936 of the U.S. Internal Revenue Code.

Annual debt service requirements of maturity for bonds payable are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2009	$ 1,385,000	587,846	$ 1,972,846
2010	1,475,000	553,057	2,028,057
2011	685,000	463,667	1,148,667
2012	725,000	413,108	1,138,108
2013	805,000	397,724	1,202,724
2014-2018	2,195,000	1,197,043	3,392,043
2019-2023	2,220,000	1,194,040	3,414,040
2024-2028	2,055,000	599,571	2,654,571
Totals	$11,545,000	5,406,056	$16,951,056

At June 30,2008, accrued interest payable on bonds amounted to $300,776. Interest expense and interest paid on bonds amounted to $608,733 and $613,744, respectively, for the fiscal year ended June 30, 2008.

According to sections 103 and 148 to 150 of the U.S. Internal Revenue Code and sections 1.148 to 1.150 of the U.S. Treasury Regulation, the Municipality's the tax-exempt bonds are subject to the arbitrage rebate requirements. At June 30, 2008, the Municipality had no federal arbitrage liability on bonds since interest income earned from the investment of unspent bond proceeds were made in bank deposits that generate yields lower than the rates applicable to the debt service payments.

c) *Notes Payable to Municipal Revenue Collection Center*

The Municipality entered into a financing agreement of $2,627,775 with the Municipal Revenue Collection Center (CRIM) through 2011. The notes are payable in monthly installments ranging from $25,000 to $28,000, at no interest. This notes have an imputed interest rate of 5.00 percent. The outstanding balance of the notes, net of the unamortized discount of $61,713, amounted to $857,055 at June 30, 2008. Amortization of the notes discount amounted to $50,640 for the fiscal year ended June 30, 2008, which has been recorded as interest expense in the accompanying statement of activities. The principal maturities and the scheduled amortization of discount are as follows:

Fiscal year ending June 30,	Principal	Discount accretion	Total
2009	$ 299,960	36,040	$ 336,000
2010	315,306	20,694	336,000
2011	241,789	4,979	246,768
Totals	$ 857,055	61,713	$ 918,768

d) *Notes Payable to U.S. Department of Housing and Urban Development*

The Municipality has a loan guarantee commitment of $4,770,000 with the U.S. Department of Housing and Urban Development (HUD) pursuant to an application under Section 108 of the Housing and Community Development Act of 1974 (Section 108) for the construction of the Multiples Use Center of the Municipality, which was concluded during the current fiscal year. Section 108 commitments are required to be supported by a credit subsidy appropriation pursuant to the Federal Credit Reform Act of 1990 (Credit Reform Act) and implementing guidance issued by the U.S. Office of Management and Budget (OMB). Therefore, in connection with its guarantee of these notes, HUD obligated appropriated funds to cover the credit subsidy cost of the loan guarantee, as required under the Credit Reform Act. Under the Credit Reform

Act procedures, such funds are disbursed into a financing account as loan proceeds are disbursed by the lender (a local commercial bank). The financing account is in some respects equivalent to an internal loss reserve for the federal government. Each disbursement into the financing account is equal to the loan advance times the credit subsidy rate, which is part of HUD's budget approved by OMB and the Congress.

Pursuant to the credit subsidy implementation guidance issued by OMB, the undisbursed balance of the credit subsidy obligation must be canceled on September 30th of the 5th fiscal year after the period of availability for obligation of a fixed appropriation account ends.

The proceeds of the loan guarantee commitment are used by the Municipality to provide low-income communities with another source of financing for the economic development, housing rehabilitation, public facilities and large-scale physical development projects. The notes on the loan guarantee commitment bear interest at various rates ranging from 3.82 percent to 6.67 percent. The proceeds and uses of the loan guarantee commitment are accounted for in the Section 108 loan guarantee fund, a capital projects fund. The loan guarantee commitment is repaid through financial resources transferred from the general fund to the Section 108 loan guarantee fund. Principal and interest on these notes are accounted for in the Section 108 loan guarantee fund, a non-major capital projects fund. At June 30, 2008, the outstanding principal balance of the loan guarantee commitment amounted to $4,095,000. The loan guarantee commitment is subject to various positive, negative and restrictive covenants that the Municipality has complied with at June 30, 2008. The principal and interest maturities on the Section 108 loan guarantee commitment are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2009	295,000	189,222	484,222
2010	305,000	176,096	481,096
2011	305,000	161,622	466,622
2012	315,000	144,262	459,262
2013	335,000	129,672	464,672
2014-2018	1,200,000	421,522	1,621,522
2019-2023	780,000	129,154	909,,154
Totals	$3,535,000	1,351,550	$4,886,550

e) *Capital Lease Obligations*

The Municipality was obligated under various capital lease agreements with third parties that expired in June 30, 2008 for the acquisition of machinery and equipment. At June 30, 2008, the capitalized costs and the related accumulated depreciation of the leased machinery and equipment amounted to $205,245 each, respectively, which are accounted for as capital assets in the accompanying statement of net assets. These assets were fully amortized at June 30, 2007, therefore, there was no amortization charge applicable to capital leases for the fiscal year ended June 30, 2008.

f) *Compensated Absences*

At June 30, 2008, the liability for compensated absences is composed as follows:

	Due within one year	Due after one year	Total
Vacations	$ 137,515	1,240,676	$ 1,378,191

Sick leave	179,183	1,616,606	1,795,789
Total	$ 316,698	2,857,282	$ 3,173,980

10. Employees' Retirement Systems

a) *Plan Description*

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth and administered by the Retirement Systems Administration of the Commonwealth of Puerto Rico. Substantially all full-time employees of the Commonwealth and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed.

ERS members, other than those joining it after March 31, 1990, are eligible for the benefits described below:

- ***Retirement Annuity***

  ERS members are eligible for a retirement annuity upon reaching the following age:

Policemen and firemen:	Other employees:
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

  ERS members are eligible for monthly benefit payments determined by the application of the 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 member is eligible, is limited to a minimum of $300 per month and a maximum of 75 percent of the average compensation.

- ***Merit Annuity***

  ERS members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65 percent and a maximum of 75 percent of the average compensation.

- ***Deferred Retirement Annuity***

  A participating employee who ceases to be an employee of the Municipality after having accumulated a minimum of ten years of credited service qualifies for retirement benefits provided his/her contributions are left in ERS until reaching 58 years of age.

- ***Coordinated Plan***

  On the coordinated plan, by the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

  (a) $165 per month, if retired with 55 years of age and 30 years of credited service.

  (b) $110 per month, if retired with less than 55 years of age and 30 years of credited service.

  (c) All other between $82 and $100 per month.

  (d) Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over $165 per month.

- ***Non-Coordinated Plan***

  On the non-coordinated plan the participating employee and does not have any change on the pension benefits upon receiving social security benefits.

- ***Reversionary Annuity***

  An ERS member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than $240 per year or greater than the annuity payments being received by the retiree.

- ***Occupational Disability Annuity***

  A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50 percent of the compensation received at the time of the disability.

- ***Non-occupational Disability Annuity***

  A participating employee, totally and permanently disabled for causes not related to his/her occupation and with no less than 10 years of credited service, is eligible for an annuity of 1.50 percent of the average compensation of the first 20 years of credited services, increased by 2 percent for every additional year of credited service in excess of 20 years.

- ***Death Benefits***

  Occupational:

  (a) **Surviving spouse** – annuity equal to 50 percent of the participating employee's salary at the date of the death.

  (b) **Children** - $10 per month for each child, minor or student, up to a maximum benefit per family of $100.

Non-occupational:

Beneficiary – the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

- ***Refunds***

A participating employee who ceases his/her employment with the Municipality without the right to a retirement annuity has the right to a refund of the contributions to ERS plus any interest earned thereon.

- ***Amendment to Act No. 447 effective January 1, 2000 to create a Defined Contribution Plan***

On September 24, 1999, Public Act No. 305, an amendment to Act No. 447, was enacted to establish a defined contribution plan, known as System 2000, to cover employees joining ERS on or after January 1, 2000.

Employees that participated in the original plan as of December 31, 1999, had the opportunity to elect to either stay in the defined benefit plan or transfer to System 2000. Employees that joined the Municipality on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan administered by the Retirement Systems Administration of the Commonwealth of Puerto Rico, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

Historically, the state government of the Commonwealth of Puerto Rico has reported ERS and System 2000 in its basic financial statements as pension trust funds. Accordingly, the Commonwealth is currently assuming any actuarial deficiency that may exist or arise related to the Municipality's participating employees because ERS does not allocate to the

Municipality any actuarial deficiencies pertaining to participating municipal employees. The Municipality is only required by law to make statutory contributions at the rates detailed below.

- ***Recent Amendments to Act No. 447***

The Senate and the House of Representatives of the Commonwealth of Puerto Rico have the authority for establishing or amending the contribution requirements of System 2000 by approving the necessary amendments or laws, subject to the final approval of the Governor of the Commonwealth of Puerto Rico.

In June and July 2003, the Governor of the Commonwealth signed three Public Acts that provided the following certain benefits to retirees:

(a) Increase in minimum monthly pension payments to $300, effective January 1, 2005.

(b) Triennial 3 percent increase in all pensions, effective January 1, 2005.

(c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2005.

All the benefits granted will be funded through budgetary assignments in the Municipality's general fund with respect to its retired employees.

The Board of Trustees of ERS approved, effective November 17, 2003, an increase in the amount granted on personal loans to participating employees from $3,000 to $5,000.

b) Funding Policy

The contribution requirement to ERS is established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	
Coordination plan:	5.78 percent of gross salary up to $6,600 per year, plus 8.28 percent gross salary in excess of $6,600.
Supplementation plan:	8.28 percent of gross salary. This is the only choice available to policemen, firemen and mayors

The contribution requirement to System 2000 is also established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	5.78 percent of gross salary up to $6,600 per year, plus 8.28 percent gross salary in excess of $6,600.

During the fiscal years ended June 30, 2006, 2007 and 2008, the Municipality and the participating employees contributed 100 percent of the required contributions to ERS and System 2000. The combined actual contributions made by the Municipality and its participating employees to ERS and System 2000 (which equal the required contribution amounts) were as follows during the last three fiscal years:

Fiscal year ended June 30,	Employer contributions	Employee contributions
2006	$1,146,912	$ 964,491
2007	$1,204,258	$ 1,012,716
2008	$1,142,627	$ 960,888

The above actual employer contributions for the fiscal years ended June 30, 2006, 2007, and 2008 include the employer contributions to System 2000 amounting to $182,375, 191,494 and $181,694, respectively. In addition, the above actual employee contributions for the fiscal years ended June 30, 2006, 2007, and 2008 include the employee contributions to System 2000 amounting to $165,177, $173,436 and $164,560, respectively.

The authority under which obligations to contribute to ERS and System 2000 by the plans' members, employers and other contributing entities (i.e., state or municipal contributions) are established or may be amended by law by the House of Representatives, the Senate and the Governor of the Commonwealth of Puerto Rico.

Readers can obtain copies of the audited basic financial statements (GAAP basis) of ERS and System 2000 by writing to Mr. Juan Cancel, Executive Director of the Retirement Systems Administration of the Commonwealth of Puerto Rico (the entity that administers ERS and System 2000) at PO Box 42003, Minillas Station, Santurce, Puerto Rico 00940.

11. Commitments and Contingencies

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Public Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of $75,000 or $150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Public Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, the Municipality has not reported liabilities for awarded or anticipated unfavorable judgments as of June 30, 2008. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significant, if any.

The Municipality has reported outstanding encumbrances amounting to $507,215 in the general fund at June 30, 2008. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

As of June 30, 2008, the Municipality has several outstanding or planned non-cancelable construction projects of which $272,123 have been already incurred and paid as of June 30, 2008 and $114,384 remain outstanding to incur through the end of each project. These projects are evidenced by contractual commitments with contractors and are accounted for in the capital projects fund.

At June 30, 2008, the Law No. 2 Fund and the Public Terminals Fund, two non-major capital project funds, reported unreserved deficits of $75,818 and $3,189, respectively.

The Municipality receives financial assistance from the federal Governments of the United States of America and the Commonwealth in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. Disallowance as a result of these audits may become liabilities of the Municipality. The *"Reports on Compliance and Internal Control in Accordance with Government Auditing Standards and the Requirements of OMB Circular A-133"* for the fiscal year ended June 30, 2006, disclosed various instances of noncompliance with applicable laws and regulations and with internal accounting and administrative controls. If expenditures are disallowed due to noncompliance with grant programs regulations, the Municipality may be required to reimburse the grantor the disallowed amounts. Management believes that the Municipality will be able to comply with the terms of corrective action plans that may be requested by the federal grantors, if any.

On October 4, 2007, the Office of Inspector General (OIG) of the U.S. Department of Housing and Urban Development (HUD) completed an audit of the Community Development Block Grant activities of the Municipality. OIG preliminarily concluded, subject to further discussion and review with the Municipality's management, that the Municipality's financial management system (the System) did not fully comply with the applicable requirements set forth by HUD since allegedly the System: (1) did not support the allowability of more than $885,000 in program disbursements, (2) could not account for more than $501,000 in Block Grant receipts, (3) allowed the use of more than $23,000 for ineligible program expenditures, and (4) did not disburse Block Grant program funds in a timely manner (cash management).

OIG also concluded that the Municipality's management controls over its housing rehabilitation activities were inadequate since allegedly the Municipality used Block Grant funds for new housing construction and lacked adequate documentation to support program accomplishments. Therefore, OIG concluded that the related program expenditures of more than $36,000 are ineligible, and more than $324,000 are considered by OIG as unsupported pending to an eligibility determination by HUD.

Furthermore, OIG concluded that the Municipality awarded six contracts totaling more than $1 million without following all HUD procurement requirements and did not support the reasonableness of more than $109,000 in Block Grant disbursements and paid more than $70,000 for excessive expenditures.

OIG recommended that the Director of the San Juan Office of Community Planning and Development require the Municipality to repay more than $59,000 in ineligible expenditures and $70,374 in excessive costs. OIG has also recommended that the Municipality must provide all supporting documentation showing the appropriateness and eligibility of more than $1.82 million in Block Grant disbursements. In addition, OIG has recommended that the Municipality must develop and implement an internal control plan to ensure that the Block Grant Program has: (1) a financial management system that complies with HUD requirements, (2) controls and procedures which ensure that the housing rehabilitation activities meet the program objectives, and (3) procurement procedures which ensure that goods and services are obtained at the most advantageous terms and in a manner providing full and open competition. Finally, OIG recommended that the Municipality must ensure that Block Grant expenditures are properly accounted for, reconciled with HUD's disbursement system, and in compliance with HUD requirements.

As of the issuance date of this Comprehensive Annual Financial Report, OIG's findings, conclusions and recommendations do not necessarily contain final conclusions and are subject to revision based on discussions and further documentation to be provided to OIG by the Municipality's management. Currently, the management of the Municipality is in the process of reviewing the findings, conclusions and recommendations of OIG and anticipates that many of the aforementioned findings will be cleared and will not prevail in the final audit report to be issued by OIG. In addition, the final findings and recommendations arising from this audit are subject to a final determination to be made by HUD.

As a conservative approach, the accompanying basic financial statements include, as part of its long-term obligations, a reserve of $182,210 for federal cost disallowances to cover any disallowed costs arising from the final determination of HUD over OIG's final audit report. Management believes that any unfavorable outcome in relation to any possible disallowed costs would not be significant, if any.

12. Liquidity and Cash Flows

During the last four fiscal years, the Municipality's general fund has reported recurring excesses of expenditures over revenues, which have lead to significant liquidity and cash flows shortfalls during the current fiscal year. Suring the fiscal year ended June 30, 2008 the general fund's excess of expenditures and other financing uses over revenues and other financing sources amounted to $1,031,346. Management of the Municipality is currently evaluating different alternatives for the permanent financing of the Municipality's operations, principally to increase its revenue sources and implementing continuous cost reductions policies.

13. Sales and Use Tax System

On July 1, 2006, the Legislature of the Commonwealth of Puerto Rico approved Law No. 117, known as *Tax Justice Law of Puerto Rico* (Law No. 117). Law No. 117 established a seven percent (7%) sales and use tax to substantially all products and services sold in Puerto Rico, of which 5.5% represents a state tax and 1.5% represents a municipal tax pertaining to the Municipality. The state tax was effective for substantially all products and services sold starting November 15, 2006. The municipal tax became effective on April 2007 after the approval of the Municipal Legislature. Municipal sales and use tax revenues recorded in the general fund amounted to $221,026 for the fiscal year ended June 30, 2008. In addition, at June 30, 2008, the municipal sales and use taxes receivable amounted to $176,082.

On July 29, 2007, the Legislature of the Commonwealth of Puerto Rico approved Law No. 80 (Law No. 80) to amend the provisions of Law No. 117. The amendments made obligatory the implementation of a uniform sales and use tax of 1.5% in all municipalities of Puerto Rico that as of June 30, 2007 had not approved such kind of tax. The total tax rate of 1.5% is divided as 1.00% to be collected by each municipality and 0.5% is collected by the Puerto Rico Treasury Department.

The 0.5% referred to above is being administered by the Government Development Bank for Puerto Rico for the following purposes: (1) 0.2% is deposited in the new "Municipal Debt Service Fund", strictly for granting loans to the municipalities of Puerto Rico, (2) 0.2% for the creation of the "Municipal Development Fund" % to be distributed among all municipalities pursuant to a formula established by Law No. 80, and (3) 0.1% for the creation of the "Permanent Improvements Fund", to be distributed by the Legislature of the Commonwealth of Puerto Rico to carry out public works and permanent improvement projects.

14. Prior-Period Adjustments and Restatements

On July 1, 2007, the Municipality recorded a prior-period adjustment of $15,329 to eliminate the deferred revenue with a credit to reserved fund balance recorded at June 30, 2007 on its Section 8 housing choice voucher program fund, a non-major special revenue fund. The adjustment was made to discontinue the use of the expenditure-driven approach for revenue recognition as requested by the Real Estate Assessment Center of the U.S. Department of Housing and Urban Development, the grantor. The adjustment was also recorded in the accompanying government-wide financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Budgetary Comparison Schedule – General Fund
Fiscal Year Ended June 30, 2008

	Budgeted amounts		Actual amounts (budgetary basis)	Variance with final budget -
	Original	Final	(see note 1)	over (under)
Revenues:				
Taxes:				
Property taxes	$ 7,823,596	7,823,596	7,954,005	$ 130,409
Municipal license taxes	4,500,000	4,500,000	4,414,778	(85,222)
Construction excise taxes	3,300,000	3,300,000	1,579,617	(1,720,383)
Sales and use tax	-	-	153,760	153,760
Charges for services	1,094,500	1,094,500	1,117,618	23,118
Intergovernmental grants and contributions	1,591,581	1,843,940	1,776,793	(67,147)
Interest on deposits	250,000	250,000	337,515	87,515
Miscellaneous	252,721	252,721	294,790	42,069
Total revenues	18,812,398	19,064,757	17,628,876	(1,435,881)
Expenditures:				
Current:				
General government	9,241,268	10,755,627	7,789,590	(2,966,037)
Urban and economic development	1,992,465	1,992,465	2,816,346	823,881
Public safety	836,256	836,256	906,608	70,352
Health and sanitation	3,370,561	3,370,561	4,138,881	768,320
Culture, recreation and education	682,790	682,790	865,273	182,483
Public housing and welfare	1,077,777	1,077,777	1,084,475	6,698
Debt service:				
Principal	285,396	285,396	285,396	-
Interest	87,750	87,750	87,750	-
Capital outlays:	207,440	207,440	207,440	-
Total expenditures	17,781,703	19,296,062	18,181,759	(1,114,303)
Excess (deficiency) of revenues over (under) expenditures	1,030,695	(231,305)	(552,883)	(321,578)
Other financing sources (uses):				
Prior fiscal year's cash surplus readjustment	-	1,257,000	-	(1,257,000)
Operating transfers-in from other funds	67,279	67,279	67,279	-
Operating transfers-out to other funds	(1,097,974)	(1,097,974)	(1,097,974)	-
Total other financing sources (uses), net	(1,030,695)	226,305	(1,030,695)	(1,257,000)
Deficiency of revenues and other financing sources under expenditures and other financing uses	$ -	(5,000)	(1,583,578)	$ (1,578,578)

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Schedule of Expenditures of Federal Awards
June 30, 2008

	Federal CFDA Number	Pass-through Grantor's Number	Expenditures
U.S. Department of Housing and Urban Development			
Section 8 Housing Choice Voucher	14.871	RQ-46V-07501	$ 254,523
Housing Opportunities for persons with AIDS	14.241	N/A	12,538
Community Development Block Grant / Entitlement Grants	14.218	B-06-MC-72-0018*	1,467,726
Community Development Block Grant - Section 108 Loan Guarantee	14.248	B-99-MC-72-0018*	496,092
Total U.S. Department of Housing and Urban Development			2,230,879
U.S. Department of Health and Human Services			
Pass-through of the Governor's Office for Human development – Child Care and Development Block Grant	93.575	N/A*	796,030
Total U.S. Department of Health and Human Services			796,030
U.S. Department of Agriculture			
PACNA	N/A	N/A	3,677
Pass-through of the Puerto Rico Elderly Commission – Food Distribution-Child and Adult Care Food Program	10.558	N/A	78,625
Total U.S. Department of Agriculture			82,302
Total Federal Financial Assistance			$ 3,109,211

* Major programs

1. General

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Canóvanas of the Commonwealth of Puerto Rico and is presented on the accrual basis of accounting. The Municipality of Canóvanas reporting entity is defined in Note 1 to the Municipality's basic financial statements. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in our used in the preparation of the basic financial statements.

2. Relationship to the Basic Financial Statements

Revenues and expenditures of the federal awards are included in the Municipality's basic financial statements within the Major and Nonmajor Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Expenditures in the basic financial statements:

Nonmajor governmental funds	$ 4,619,666
Less: Non-federal expenditures	(1,510,455)
Total expenditures in the Schedule of Federal Awards	$ 3,109,211

3. Loans or loans guarantees

Section 108 Loan Guarantee is included in the Statement of Net Assets within the long-term debt. Outstanding balance of the note payable to HUD at June 30, 2008, amounted to $3,535,000.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements performed in accordance with Government Auditing Standards
June 30, 2008

To the Honorable Mayor
and the Municipality of Canóvanas
Canóvanas, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Canóvanas of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2008, which collectively comprise the Municipality's basic financial statements, and have issued our report thereon dated October 31, 2008. 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 *Governmental 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's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality of Canóvanas of the Commonwealth of Puerto Rico internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over financial reporting.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Municipality's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the Municipality's financial statements that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting as items 08-01 thru 08-07.

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

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Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 08-01, 08-06 and 08-07 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of Canóvanas of the Commonwealth of Puerto Rico 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 08-08 thru 08-22.

We noted certain matters that we reported to management of the Municipality of Canóvanas, in a separate letter dated October 31, 2008.

The Municipality of Canóvanas of the Commonwealth of Puerto Rico response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Municipality's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Municipality's management, municipal legislature, 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.

Toa Alta, Puerto Rico
October 31, 2008

Stamp No. 2235776
was affixed to the
original report.

CPA - PSC

BENITEZ-JAIME, CPA-PSC
Certified Public Accountants and Business Consultants

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Report on compliance with requirements applicable to each major program and on Internal Control over compliance in accordance with OMB Circular A-133
June 30, 2008

To the Honorable Mayor
and the Municipality of Canóvanas
Canóvanas, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Canóvanas of the Commonwealth of Puerto Rico (the Municipality) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. Municipality's major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality's management. Our responsibility is to express an opinion on Municipality's compliance based on our audit.

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

As described in items 08-09, 08-10, 08-11d, 08-12, 08-13, 08-14 and 08-15 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with requirements regarding to procurement, suspension and debarment, equipment and real property management, reporting and cash management requirements, that are applicable to its Pass-through of the Governor's Office for Human Development-Child Care. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

As described in items 08-09, 08-10, 08-11e, 08-16, 08-17, 08-18, 08-19, 08-20 and 08-21 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with requirements regarding to procurement, suspension and debarment, equipment and real property management and cash management, special tests and provisions, Davis-Bacon Act, reporting requirements, that are applicable to its Community Development Block Grant – Entitlement Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

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In our opinion, except for the noncompliance described in the preceding paragraphs the Pass-through at the Governor's Office for Human Development – Child Care and Development Block Grant Program Community Development Block Grant – Entitlement Program, the Municipality of Canóvanas of the Commonwealth of Puerto Rico, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

The results of our auditing procedures also disclosed other instance of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 08-08, 08-11a, b, c, f, g, h, and I, and 08-22.

Internal Control Over Compliance

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

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 08-01thru 08-07 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 08-01, 08-06 and 08-07 to be material weaknesses.

The Municipality of Canóvanas, Commonwealth of Puerto Rico response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Municipality's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Municipality's management, Municipal legislature, 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.

Toa Alta, Puerto Rico
October 31, 2008

Stamp No. 2313620 was affixed to the original report.

CPA - PSC

Section I - Summary of Auditors' Results

Financial Statements

Type of auditor's report issued:		Unqualified
Internal control over financial reporting:		
Material weakness(es) identified?	_X_ yes	____ no
Significant deficiency (ies) identified not considered to be material weakness?	_X_ yes	____ none reported
Noncompliance material to financial statements noted?	_X_ yes	____ no

Federal Awards

Internal Control over major programs:		
Material weakness (es) identified?	_X_ yes	____ no
Significant deficiency (ies) identified not considered to be material weaknesses?	_X_ yes	____ none reported
Type of auditor's report issued on compliance For major programs:	Qualified	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	_X_ yes	____ no

Identification of major programs:

CFDA Numbers	Name of Federal Program or Cluster
14.218	Community Development Block Grant – Entitlement Grants
93.575	Pass-through Governor's Office for Human Development Child Care Program

Dollar threshold used to distinguish Between Type A and Type B programs:		$300,000
Auditee qualified as low-risk auditee?	____ yes	_X_ no

Section II - Financial Statement Findings

The current year findings and questioned costs were discussed with the Municipality's management which generally concurred with our comments and recommendations. The Municipality of Canóvanas will respond to the following findings through the issuance of a separate letter addressed to the Cognizant Agency.

08-01 DEFICIENCIES IN THE UNIFORM ACCOUNTING SYSTEM AND OTHER ACCOUNTING RECORDS

The Uniform Accounting System (UAS) and the accounting records currently used by the Municipality do not have the necessary capabilities, procedures, internal controls and records to ensure accurate financial reporting and to prepare the Municipality's basic financial statements and federal programs' reports in conformity with Accounting Principles Generally Accepted in the United States of America for State and Local Governments (GAAP). The UAS is a system promulgated by the Office of the Commissioner of Municipal Affairs of Puerto Rico (OCAM, by its Spanish acronyms), a governmental entity created by law to provide technical assistance to the municipalities of Puerto Rico in several administrative and fiscal matters.

The Municipality's UAS mostly provides for the recording of revenue collections, disbursements and other limited transactions. In addition, the accounting records are not fully integrated, and a double entry system is not generally followed. Accounting records are maintained on the cash basis and budgetary accounting bases (two accounting bases that differ significantly from GAAP) and do not comply with Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended.

The following specific additional conditions were noted in relation to the UAS of the Municipality:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the UAS. The balance sheet accounts in the UAS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.

- The UAS does not have the capabilities of: (1) distinguish between expenditures (expenses) incurred and encumbered, (2) recording and processing all types of capital asset transactions, principally the accounting of depreciation and amortization expense, (3) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (4) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, estimated liability for municipal solid waste landfill closure and post-closure maintenance costs, etc.

- No adequate year-end closing procedures are made to account for all transactions affecting all funds.

- No adequate segregation is made between items representing actual accounts payable and those representing outstanding encumbrances. Accordingly, material amounts of unrecorded liabilities are generally recorded at fiscal year-end.

- The management of the federal programs administered by the Municipality maintains separate accounting records for each federal program, which are not reconciled with the UAS (the official accounting system of the Municipality).

- No adequate and complete accounting records are kept for inter-fund balances and transactions.

- The audit adjustments resulting from Single Audits are not completely posted in the UAS.

The basic financial statements of the Municipality must be prepared using the financial information obtained from various municipal departments and accounting records outside of the official UAS, and from information obtained from regulators and independent third parties. In addition, the Department of Finance does not maintain accounting records and working papers supporting the balances and disclosures reported in the basic financial statements, principally those related to government-wide financial reporting.

The Department of Finance does not maintain accounting records supporting the following procedures performed as part of the preparation of the basic financial statements of the Municipality:

- The conversion of accounting records from the cash basis of accounting to the modified accrual basis of accounting used by governmental funds;

- The conversion of governmental funds from the modified accrual basis to the accrual basis of accounting used by government-wide financial statements; and

- Working papers and analyses of significant balances reported in the basic financial statements, such as capital assets, accounts receivable (municipal licenses, grants and contributions, etc.), deferred revenues, accounts payable, and long-term obligations (for which the general practice is to rely upon the notifications received from the Government Development Bank for Puerto Rico, the Puerto Rico Treasury Department, the Federal Government and the Municipal Revenue Collection Center for the balance of its outstanding debt and the withholding for its debt service).

CRITERIA:

Article 8.010(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality must maintain its fund accounting in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP), as promulgated by the Governmental Accounting Standards Board (GASB), the National Committee on Governmental Accounting (NCGA) and the Governmental Accounting, Auditing and Financial Reporting book (commonly known as Blue Book).

In addition, Article 8.010(c) of Law No. 81 states that uniform accounting system used by the Municipality must: (1) produce reliable reports and financial statements, (2) provide complete information about the results of operations of the Municipality, and (3) include the necessary internal controls to account all funds, capital assets and other assets of the Municipality.

Furthermore, Section 5 of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico*, which were created pursuant to Article 19.011 of Law No. 81 and approved by the Office of the Commissioner of Municipal Affairs, state that the accounting system of the Municipality should include:

- Final entry books that allow for the preparation of month-end summaries of transactions for posting in the original entry records and for the gathering of information needed for the preparation of basic financial statements and other reports;

- Fiscal procedures for the system's operations, establishing proper internal controls and the prevention of irregularities. These procedures should provide for the timely and accurate performance of operations. It should include the necessary records, files, reconciliations, adjustments, closing entries, reports, and all other necessary documentation to support the basic financial statements.

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2008 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

The continued failure to have an adequate accounting system does not allow the Municipality to have timely and accurate financial information for its decision making process. In addition, financial reports prepared may have errors or omissions that will affect future financial decisions. Another effect is the use of inaccurate financial information as a base for the preparation of annual budgets, which, therefore, may result in budgetary compliance problems.

RECOMMENDATION:

We recommend the Municipality to explore different alternatives for the implementation of a new accounting system in compliance with all applicable federal and local laws and regulations. This process should include only accounting systems that will enable the Municipality to prepare its basic financial statements in a timely manner and in conformity with GAAP. The systems to be evaluated must provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements, including:

- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for federal funds;

- The preparation of periodic financial reports to be submitted to the Director of finance, the Mayor, the Municipal Legislature and the federal grantors; and

- Adequate training to all accounting personnel to improve the understanding of the system and to promote operational efficiency

The Department of Finance must establish and document new accounting policies and procedures addressed to correct the non-compliance situations referred to above. Accounting policies and procedures shall be promulgated by an appropriate level of management to emphasize their importance and authority. The documentation of such accounting policies and procedures shall be updated periodically according to a predetermined schedule.

08-02 CASH AND BANK ACCOUNTS

The Municipality has not established sufficient controls in the handling of bank accounts to prevent errors and irregularities from being timely detected. The following control deficiency was noted during our examination:

a) Reconciling items or differences have been outstanding for more than one year without adequate explanation. The bank reconciliations are the following:

BANK ACCOUNT NAME	RECONCILING ITEMS AMOUNT
-Cuenta Regular	$ 15,112
-Cash Concentration	49,836
	$ 64,948

RECOMMENDATION:

Monthly bank reconciliations are a strong internal control feature over cash and could indicate any potential misapplications of cash. We recommend the Municipality identify and resolve reconciling items each month in order to provide a more accurate accounting of cash accounts, enhance the internal controls over the cash function, and improve cash management.

b) Checks totaling $3,632, as of June 30, 2008, have been outstanding for more than one year. The bank reconciliations are the following:

Account Name	Amount
Cuenta Regular	$2,579
CDBG IDIS	1,053
	$ 3,632

RECOMMENDATION:

The Municipality should improve its control procedures over bank reconciliations to record the necessary adjustments when there are outstanding checks for more than one year. Stop payments should be issued to cancel checks outstanding over twelve months. Such checks should be substituted with new checks and deposited in the appropriate accounts in order to make the funds available to the Municipality.

08-03 DISBURSEMENT TEST

As part of our test of cash disbursements during the year, we selected 40 disbursement vouchers amounting to $134,366. The following deficiencies were noted during our examination:

- During our examination we noted that the Municipality acquired goods and services below the amount of $40,000, without performing the procedure of obtaining the required three (3) quotations. In 2 (5%) disbursement vouchers amounting to $1,532, the Municipality did not follow the required purchasing procedures.

CRITERIA:

According to the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico, the pre-auditing unit or person in charge of pre-auditing the documents shall keep a record of the authorized signatures of the Municipality. He shall check against such record to ascertain that the officers certifying the documents are so authorized. He shall check the documents correctness in all of its parts and that the transactions in order to pursuant the correct legislation, ordinances, resolutions, contracts and regulations. Once everything is found to be in order, the document shall be certified as preaudited and shall be sent for the approval of the Finance Director. In addition, of the aforementioned regulation, the vouchers, all canceled checks and any other document, that justifies a payment, shall be filed by the Finance Director to be audited by the Puerto Rico Comptroller's Office or any other agency as required by law.

RECOMMENDATION:

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the process of acquisition of materials and supplies, equipment, and construction and service contracts.

08-04 PERSONNEL FILES AND RELATED PAYROLL PROCEDURES

During our audit, we tested a sample of 40 employee files and noted that several files lacked documentation supporting the employee's salary, status or eligibility. The following exceptions were noted during our examination:

Health examination	1 file	3%
Change Report GMB-OP-15	2 files	5%
Work performance evaluation	5 files	13%
Eligibility verification form (Form I-9)	1 files	3%
Job Description OCAP-16	8 files	20%
Social Security card	2 files	5%
Good Behavior certificate	4 files	10%
PR Retirement System Documents	2 files	5%

RECOMMENDATION:

The Personnel Department should review each employee file and ascertain their completeness. Management could design a standard checklist where the file reviewer could determine if documents are missing from each file. Signed exemptions certificates and authorizations for non -statutory withholdings should always support the amounts withheld from employees.

08-05 PAYROLL AND RELATED LIABILITIES PROCEDURES

The Municipality has not established sufficient controls in the payroll payment procedures to prevent errors and irregularities from being timely detected. The following control deficiencies were noted during our examination:

a- Payroll expenditures are not compared to budget and prior periods at an appropriate level of detail.

b- The payroll system does not provide a master file change log, showing all changes made to payroll information, to be reviewed by the payroll department and by human resources to ensure it reflects accurate and complete information.

c- The Human Resources Department neither the Finance Department, nor another appropriate person does not review the allocation of payroll costs to accounts, funds, departments and programs.

d- Current payrolls are not compared with previous payrolls, so variances could be investigated and documented.

The Municipality does not have any procedures and internal controls in place to ascertain that the payroll expenditures and the related payroll liabilities totals reflects accurate and complete information.

RECOMMENDATION:

The Municipality must establish and document new accounting policies and procedures addressed to correct the situations referred to above. The Municipality should improve its control procedures over payroll process to ensure that payroll payments are accurate and that payroll expenditure is properly allocated to different departments.

08-06 INACTIVE AND UNNECESSARY FUNDS AND INACTIVE BANK ACCOUNTS

The Municipality is maintaining an excessive number of funds and bank accounts that have been inactive for a long period. The accounting records include over 19 different funds which amounted to $1,405,341, which have been inactive or had insignificant movement or operations during the year under audit. Also, the accounting records include 10 bank accounts amounting to $674,489, which have been inactive or had insignificant movement during the current fiscal year.

This situation results from the need to analyze and close inactive funds and basic accounts when the fund's objective has been achieved or are no longer of significance. The internal control structure should provide for the accurate maintenance of the books, records, funds and accounts necessary to carry out the Municipality's operations.

CRITERIA:

Article 8.007(b) of the Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that funds without specific fiscal years should be closed when the fund's objectives have been completed.

NCGA Statement No. 1, paragraph 4, states that "governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established since unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration".

In addition, the recommended practice on *"Improving the Effectiveness of Fund Accounting"* (2004), issued by the Government Finance Officers Association of the United States and Canada (GFOA), states that it is important in this regard to distinguish accounting from financial reporting. Whereas an accounting system must collect all of the data needed to ensure and demonstrate legal compliance, financial reporting is concerned with only those aspects of compliance that are of importance to users of general purpose external financial reports.

This situation occurred because the Municipality has not analyzed and closed inactive funds and bank accounts when the fund's objectives have been met or are no longer relevant. The continued maintenance of these funds and accounts exposes the Municipality to the unauthorized use of funds from inactive accounts for activities not intended to be financed with these funds. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

RECOMMENDATION:

The Municipality should close all unnecessary and inactive funds or accounts. Budgetary balances or deficits remaining in those funds should be investigated and properly closed or established by law. The Municipality should determine whether the intended objectives of these funds were met. For all funds that have complied with the requirements, the Municipality should close them. Remaining balances in those funds should be disposed of in accordance with local and federal laws and regulations.

08-07 DEFICIENCIES IN ACCOUNTING RECORDS OF CAPITAL ASSETS

The Municipality has not performed periodical physical inventories of its capital assets (real property, personal property and infrastructure). As part of our internal control and substantive tests, we noted that the Municipality has not organized and performed a physical inventory during the fiscal year ended June 30, 2008.

The following additional conditions were noted in relation to capital assets:

- Currently, the capital asset records are prepared manually which may increase the risks of clerical errors or irregularities over capital assets.

- The subsidiary ledger of capital assets is not periodically reconciled with the property subsidiary ledgers maintained by the Municipality's several individual federal financially assisted programs.

CRITERIA:

Article 9.002 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that all municipalities must prepare and maintain an updated subsidiary ledger (record) of all real properties.

In addition, Chapter VII, Section 22, of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico,* requires that each Municipality must maintain an adequate control of capital assets through annual physical inventories. In addition, any differences between physical inventory amounts and subsidiary records must be investigated and adjusted. Considering that according to accounting records of the Municipality, the capital assets represent the most significant assets of the Municipality, there is a significant risk of unauthorized use or disposition of capital assets because there are no adequate internal controls in place to ensure accountability of capital assets by department or federal program.

Chapter VII, Sections 3, 4, 14, 15 and 21 of the *Revised Regulation on Basic Standards for the Municipalities of Puerto Rico* establish the following guidelines regarding property management:

- Section 3 establishes that the Finance Director is responsible for the accountability of the capital assets acquired by the Municipality through purchases or donations.

- Section 4 establishes that the Municipal Property Administrator shall be responsible to the Mayor and the Finance Director for the direct administration, use and maintenance of the entire real and personal property owned by the Municipality.

- Section 14(1) establishes that all municipal property shall be numbered and identified as to ownership by the Municipal Property Administrator.

- Section 15(1) establishes that the Municipal Property Administrator is responsible for accurately maintaining the central property records.

- Section 21(c) establishes that management shall write-off from the property records all property and equipment sold or disposed of when certified by the Internal Auditor of the Municipality upon determination that such disposal is adequate.

These instances of non-compliance occurred because the Property Division of the Municipality has not enforced the requirement to perform a capital assets inventory and to ensure the proper accountability of capital assets during the fiscal year ended June 30, 2008. Accordingly, the Municipality's internal controls in place over capital assets are not designed to effectively account for capital assets, since it do not allow for the reconciliation of detailed property records with the general ledger. These inadequate property internal controls may expose the Municipality to questioned or disallowed costs by the federal government for lost or stolen property. This condition represents a material weakness in the Municipality's internal controls over financial reporting.

Furthermore, this situation represents a significant risk of loss of capital assets because there is a lack of accountability for acquired capital assets. Any federally funded capital assets lost would need to be repaid to the federal government with municipal funds.

RECOMMENDATION:

A physical inventory of the Municipality's capital assets should be taken as soon as possible and subsequently on annual basis. Physical inventory amounts should be reconciled with the capital assets recorded in the subsidiary ledgers. Furthermore, the Mayor may issue an executive order to require compliance with this requirement. For these purposes, the Property Division of the Municipality must require from each Municipal Department that acquires or manage capital assets to submit a report including a full description of the asset, location, use, source of funds used to acquire the asset, responsible personnel, cost and any other pertinent data required by state and local regulations. This information should be reconciled with the monthly disbursements (capital outlays) made against the budgetary accounts used for property acquisitions. Sales or other dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance Director, and should be carried out by persons other than the users and through public announcements or bids.

We also recommend that the Municipality implement a formal policy whereby all capital expenditures in excess of an established amount are capitalized with all other amounts charged to operations. This will lead to improved consistency and simplification of accounting records.

We also recommend that the subsidiary ledger of capital assets be updated on a monthly basis for the write-off of non-operational, fully depreciated, or impaired items. Having such a procedure in place will ensure that the Municipality has an accurate record of its capital assets and will ensure that gains and losses on disposals are recorded in the proper accounting period.

We also recommend that the subsidiary ledger shall be periodically reconciled with the property subsidiary ledgers maintained by the Municipality's several individual federal programs.

To provide greater control over the recording of capital asset additions and retirements, we also recommend the Municipality to consider purchasing a software package to automate the recording of capital assets along with automatically computing depreciation expense for financial reporting purposes. The use of such software package would improve the overall efficiency within the accounting function and allow for departmental reporting of depreciation expense, including federal programs.

Program	Findings/Noncompliance Recommendations	Questioned Cost

Section III - Federal Award Findings and Questioned Costs

Program	Findings/Noncompliance Recommendations	Questioned Cost
All Federal Programs	**08-08 FEDERAL FINANCIAL REPORTS** The accounting records maintained by the Federal Programs Office are not reconciled with the accounting records maintained by the Municipality's central accounting department records. The Municipality has not established procedures for the reconciliation of the transactions recorded in the Program's accounting records with those recorded in the Municipality's central accounting department records. As a result, this condition may lead to inaccurate reporting of programs supported activities. Criteria: OMB Circular A-102, 20 (b) (2) requires recipient of federal funds to have a financial management system that provides for the maintenance of accurate, current and complete records of the financial results of federally assisted activities in accordance with the financial reporting requirements of the Federal Program. The Municipality should prepare federal financial reports based on the Programs underlying accounting records.	NONE
All Federal Programs	**08-09 PROCUREMENT, SUSPENSION AND DEBARMENT** Statement of Condition: The Municipality has not established effective procurement procedures to verify in the acquisition of goods and services that the supplier was not suspended or debarred or otherwise excluded. The Municipality did not performed any step to ascertain that supplier is not included in the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), obtaining a certification from the entity or adding a written clause or condition to the covered transaction with that entity. Criteria: 2 CFR, Part 180 and 70 FR 51863 state that contractors receiving individual awards for $25,000 or more and all	NONE

Program	Findings/Noncompliance Recommendations	Questioned Cost

sub recipients must certify that the organization and its principals are not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), collecting a certification from the entity or adding a clause or condition to the covered transaction with the entity.

Recommendation:

We recommend the Municipality to obtain the EPLS in printed or electronic format in order to use it as part of the procurement cycle. The printed version is published on a monthly basis. Copies can be obtained by purchasing a yearly subscription to the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by calling the Government Printing Office Inquiry and Order Desk at (202) 783-3238. The electronic version can be obtained on the Internet (http:/epls.arnet.gov). The Municipality should enforce strict compliance with the prescribed federal requirement.

All Federal Programs

08-10 EQUIPMENT AND REAL PROPERTY MANAGEMENT

Statement of Condition:

The Municipality has not complied with the property management requirements. There were no physical inventories performed during the fiscal year ended June 30, 2008.

The Federal Programs has subsidiary ledger of equipment acquired with federal funds, however, such subsidiary ledger does not comply with federal requirements because it does not: (1) have information needed to calculate the federal share of the cost of the equipment, (2) have information about the identification number of the asset, such as the manufacturer's serial numbers, (3) identify the grant under which the program acquired the equipment, (4) have information about the location, use and condition of the equipment and the date the information was obtained, and (5) have all pertinent information on the ultimate transfer, replacement, or disposal of the equipment (6) have information about acquisition date and unit acquisition cost.

Program	Findings/Noncompliance Recommendations	Questioned Cost

Furthermore, there is no evidence that the total amount of capital expenditures and the composition of capital assets incurred by Federal Programs have been reconciled with the general ledger or other control account to enhance the controls to prevent unauthorized disposition of assets.

Criteria:

29 CFR 97.32 (d) (2) established that the Municipality should take the physical inventory and reconcile the results with the property records. In addition, section (d) (3) establishes that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property.

Federal regulations also require that, every two years, at a minimum, a physical inventory shall be conducted and the results shall be reconciled with property records to verify the existence, current utilization, and continued need for the equipment. Any discrepancies between quantities determined by the physical inspection with those shown in the accounting records shall be investigated to determine the causes of the differences. Property records shall be accurate. Property records shall include the following for each item:

- A description of the equipment including manufacturer's serial numbers.
- Identification number, as the manufacturer's serial numbers.
- Identification of the grant under which the recipient acquired the equipment.
- The information needed to calculate the federal share of the cost of the equipment.
- Acquisition date and unit acquisition cost.
- Location, use and condition of the equipment and the date the information was obtained.
- All pertinent information on the ultimate transfer, replacement or disposal of the equipment.

Program	Findings/Noncompliance Recommendations	Questioned Cost

Recommendation:

A physical inventory of the Federal Programs capital assets should be taken as soon as possible. Physical inventory amounts should be reconciled with the property recorded on the subsidiary ledgers. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions. Dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance.

Various Federal Programs

08-11 FEDERAL CASH MANAGEMENT SYSTEM

Statement of Condition:

The Municipality has not established effective cash management procedures for the programs receiving federal financial assistance. There were months which reported balances exceeding the Programs' immediate cash needs as detailed below:

NONE

Program name	CFDA No.	Average cash Balance	Highest cash Balance
a. Section 8 – Voucher	14.871	$179,957	$193,424
b. SBGP	14.219	5,744	5,744
c. UMTA	20.500	34,575	34,575
d. Child Care	93.575	157,033	293,019
e. CDBG	14.218	131,813	336,991
f. FEMA 1247	83.544	182,184	182,184
g. FEMA 155	83.544	54,356	54,356
h. Pass-through the Puerto Rico Elderly Commission- Food Distribution	10.558	103,623	123,846
i. HOPWA	14.241	19,102	20,806

Criteria:

Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs. When grant awards are advanced to the Program, the Municipality must follow procedures to minimize the time elapse between the receipt and the disbursement of such funds. When

Program	Findings/Noncompliance Recommendations	Questioned Cost

advances are made by letter if credit or electronic transfer of funds, the Municipality must make drawdowns as close as possible to the time of making disbursements. Disbursement of funds received should be made within three days of the date of deposit of funds from grant advances greater than $5,000. 31 CFR 205.6 established that the zero balance accounting is a method of transferring federal funds to the Municipality based on the actual amount of fund that are paid out by the Municipality. The funding technique must be auditable for internal control purposes. Auditable means the sources of data and information for a calculation can be replicated and proven to comply with all pertinent standards.

Recommendation:

In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely and possible to the actual disbursements.

Child Care
CFDA NO. 93.575

08-12 FINANCIAL REPORTING

Statement of Condition:

Our review of the quarterly financial reports submitted to Administration for Integral Care and Development of Children (ACUDEN, by its Spanish acronym), disclosed that they were submitted after the required submission date, as detailed below.

NONE

Quarter Ended	**Due Date**	**Date Submitted**	**Past Due Days**
September 30, 2007	October 10, 2007	February 12, 2008	125 days
December 31, 2007	January 10, 2008	February 7, 2008	28 days
June 30, 2008	July 10, 2008	September 8, 2008	60 days

Criteria:

According to contract with ACUDEN quarterly reports, must be submitted during the first ten days of October, January, April and July.

Program	Findings/Noncompliance Recommendations	Questioned Cost

Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Quarterly Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

Child Care
CFDA NO. 93.575

08-13 FINANCIAL REPORTING

Statement of Condition:

Our review of the annual financial report submitted to Administration for Integral Care and Development of Children (ACUDEN, by its Spanish acronym), disclosed that it was submitted after the required submission date, as detailed below.

NONE

Year Ended	Due Date	Date Submitted	Past Due Days
September 30, 2007	October 15, 2007	January 28, 2008	105 days

Criteria:

According to federal regulations annual report, Form CC-006 must be submitted at least 15 days after the close of program year.

Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Quarterly Reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

Child Care
CFDA NO. 93.575

08-14 FINANCIAL REPORTING

Statement of Condition:

Our review of the quarterly financial reports submitted to

Program	Findings/Noncompliance Recommendations	Questioned Cost
	Administration for Integral Care and Development of Children (ACUDEN, by its Spanish acronym), disclosed that the information presented in the financial reports did not agree with the information recorded in the Program General Ledger, as detailed below.	NONE

Quarter Ended	Account Name	Amount per per Report	Amount per G/L
December 31, 2007	Salaries	$ 7,467	$ 5,643
	Fringe Benefits	1,022	1,896
	Direct Service Salaries	23,364	15,597
	Direct Service Fringe	8,518	7,721
	Professional services	85,734	72,316
	Equipment Rent	297	-
	Building Rent	7,200	-
	Quality Salary	27,978	7,865
	Quality Fringe Benefits	12,439	5,253
March 30, 2008	Quality Salaries	32,167	31,478
	Quality Fringe Benefits	8,305	15,852
	Direct Service Fringe	8,989	8,064
	Professional services	75,000	145,276
	Equipment	1,367	387
	Equipment Rent	600	-
	Building rent	14,400	-
	Miscellaneous expenses	5,610	2,308
	Fringe Benefits	1,758	4,242
June 30, 2008	Fringe Benefits	2,810	6,169
	Direct Service Fringe	7,815	17,531
	Travel	1,450	2,300
	Professional services	146,646	223,411
	Building rent	21,600	28,800
	Miscellaneous expenses	5,846	6,000
	Quality Fringe Benefits	7,908	20,312

Criteria:

Federal regulations require that the financial management system must meet some requirements, including the financial reporting. It states that accurate, current and complete disclosure of the financial results of the financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.

Recommendation:

The Municipality should prepare financial reports based on the Program's underlying accounting records. Any

Program	Findings/Noncompliance Recommendations	Questioned Cost
	difference should be investigated and reconciled, accordingly.	
Child Care CFDA NO. 93.575	**08-15 FINANCIAL REPORTING**	

Statement of Condition:

Our review of the annual financial report submitted to Administration for Integral Care and Development of Children (ACUDEN, by its Spanish acronym), disclosed that the information presented in the financial report did not agree with the information recorded in the Program General Ledger, as detailed below.

NONE

Program Year	Account Name	Amount per per Report	Amount per G/L
2006-2007	Fringe Benefits	$ -	$ 5,062
	Materials	3,793	-
	Equipment Rent	594	-
	Direct Service Fringe	-	8,385
	Equipment Rent	5,879	4,373
	Building Rent	27,800	20,600
	Training	5,980	5,300
	Miscellaneous expenses	5,668	2,975
	Quality Fringe Benefits	35,403	45,468

Criteria:

Federal regulations require that the financial management system must meet some requirements, including the financial reporting. It states that accurate, current and complete disclosure of the financial results of the financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.

Recommendation:

The Municipality should prepare financial reports based on the Program's underlying accounting records. Any difference should be investigated and reconciled, accordingly.

Program	Findings/Noncompliance Recommendations	Questioned Cost
CDBG CFDA No. 14.218	**08-16 FEDERAL CASH MANAGEMENT SYSTEM**	
	Statement of Condition:	NONE

The Municipality has not established effective cash management procedures. During our review of the drawdowns performed during the year, we noted the following deficiencies:

a. From 105 drawdowns performed during the year, 20 (19%) payments has a delay of 10 days or more between the funds receipt date and the disbursement date.

b. From 105 drawdowns performed during the fiscal year, 4 (5%) of the drawdowns amounting to $90,520 has not been disbursed as of August 31, 2008. The drawdowns were the following:

Date	Amount
April 25, 2008	$ 17,681
April 25, 2008	34,534
April 25, 2008	112
April 30, 2008	3,168
April 30, 2008	35,025
	$90,520

Criteria:

Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.

Recommendation:

In accordance with Federal regulations, the Municipality should estimate drawdown's of Federal funds as closely as possible to the actual disbursements. The Municipality should established procedures to minimize the time elapsing between drawdowns and disbursements.

Program	Findings/Noncompliance Recommendations	Questioned Cost
CDBG CFDA NO. 14.218	**08-17 FEDERAL CASH MANAGEMENT SYSTEM** Statement of Condition: The Municipality has not established effective cash management procedures. During our review of the General Ledger cash accounts, the following exceptions were noted: a. CDBG 2005 - Excess of checks drawn over book balance amounting to \$62,303 was maintained from December 2007 thru June 2008. b. CDBG 2006 - Excess of checks drawn over book balance amounting to \$29,008 was maintained from December 2007 thru June 2008. Criteria: Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Program's immediate cash needs. Recommendation: In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely as possible to the actual disbursements.	NONE
CDBG CFDA No. 14.218	**08-18 EQUIPMENT AND REAL PROPERTY MANAGEMENT** Statement of Condition: The Municipality has not established effective control procedures to ascertain the equipment be used in the program for which it was acquired or, when appropriate, other federal program as required by Circular A-102 and OMB Circular A-110. During the observation of equipment acquired under federal awards, we noted that no adequate control procedures exist to ascertain that proper use is given to the motor vehicle acquired with federal funds. The Program did not maintain a log indicating the item description, date, purpose, and the name of the person using such vehicle.	NONE

Program	Findings/Noncompliance Recommendations	Questioned Cost
	Criteria: According to A-102 Common Rule and OMB Circular A-110 requires that equipment be used in the program for which it was acquired or, when appropriate, other federal programs. Recommendation: We recommend the Municipality continue in its effort to implement a system or control procedures that will appropriately document the usage of property acquired with federal funds in order to provide effective accountability over equipment owned.	
CDBG CFDA No. 14.218 B-06-MC-72-0018	**08-19 INADEQUATE DOCUMENTATION OF PARTICIPANT FILES (REHABILITATION)** Statement of Condition: As part of our test to determine whether the grantee assure that the rehabilitation work is properly completed, we selected a sample of 41 participants. The following documents were not available for examination:	NONE

a.	Final inspection	33 Files	80%
b.	Income verification computation did not agree with the income verification documents on participant's file.	7 Files	17%

Criteria:

According to 24 CFR, 570.506 the grantee must assure that the work is properly completed. For each residential rehabilitation activity the following records are needed:

a) Re-habilitation contract describing the deficiencies in each structure to be corrected.

Program	Findings/Noncompliance Recommendations	Questioned Cost
	b) An inspection of the rehabilitation work upon completion to assure that it was carried out in accordance with contract specifications.	

Recommendation:

The Municipality must inspect the rehabilitation work upon completion to assure that it is carried out in accordance with the contract specifications.

CDBG
CFDA 14.218

08-20 DAVIS-BACON ACT

Statement of Condition:

As part of our audit tests we selected 1 weekly payroll for each of the following construction projects:

- Repavimentación San Isidro
- Repavimentación varios caminos Quebrada Prieta
- Repavimentación Camino Los Pagan, Camino Cabito y varios caminos Bo. Quebrada Prieta
- Repavimentación en Barrio Quebrada Prieta

Then following exceptions were noted during our examination of the projects files: — NONE

(a) In two project files no employee's interviews were documented or present on file.
(b) In four project files no preconstruction conference minutes were documented or present on file.
(c) In four project files examined the weekly payrolls did not have evidence of examination by the standard labor officer to assure compliance with the labor standards.
(d) In four project files the standard labor rate applicable to the projects was not present on file.

Criteria:

According to HUD Handbook:

Contractor weekly payrolls and other basic records should be reviewed during routine compliance enforcement activity on every construction project. Submitted payrolls shall be examined to assure

Program	Findings/Noncompliance Recommendations	Questioned Cost

compliance with the labor standards. Also, a preconstruction conference must be held to explain labor standards.

Recommendation:

The Municipality should establish procedures to ascertain that all documents submitted by the contractor are reviewed and approved on a timely basis to ensure compliance with labor standards.

CDBG
CFDA NO. 14.218

08-21 FINANCIAL REPORTING

Our review of the Federal Cash Transaction Reports (Standard Form 272), disclosed that the information presented in the financial reports did not agree with the information recorded in the Program General Ledger, as detailed below.

NONE

Quarter Ended	Account Name	Amount per per Report	Amount per G/L
June 30, 2008	Total Receipts	$758,655	$718,017

Criteria:

Federal regulations require that the financial management system must meet some requirements, including the financial reporting. It states that accurate, current and complete disclosure of the financial results of the financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.

Recommendation:

The Municipality should implement procedures to assure that all required information is included during the preparation of financial reports.

CDBG
CFDA NO. 14.218

08-22 FEDERAL DISBURSEMENT TEST

As part of our test of federal cash disbursements during the year, we selected 40 disbursement vouchers amounting to $564,892. The following deficiency was noted during our examination:

Program	Findings/Noncompliance Recommendations	Questioned Cost

(a) Five (13%) disbursement vouchers amounting to $2,859, the Municipality did not follow the required purchasing procedures.

CRITERIA:

According to the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico, the pre-auditing unit or person in charge of pre-auditing the documents shall keep a record of the authorized signatures of the Municipality. He shall check against such record to ascertain that the officers certifying the documents are so authorized. He shall check the documents correctness in all of its parts and that the transactions in order to pursuant the correct legislation, ordinances, resolutions, contracts and regulations. Once everything is found to be in order, the document shall be certified as preaudited and shall be sent for the approval of the Finance Director. In addition, of the aforementioned regulation, the vouchers, all canceled checks and any other document, that justifies a payment, shall be filed by the Finance Director to be audited by the Puerto Rico Comptroller's Office or any other agency as required by law.

RECOMMENDATION:

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the process of acquisition of materials and supplies, equipment, and construction and service contracts.

Total Questioned Costs $ -0-

Estado Libre Asociado de Puerto Rico
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October 31, 2008

Benítez-Jaime, CPA, PSC
Certified Public Accountants &
Business Consultants
PO Box 191503
San Juan, PR 00919-1503

Dear auditors:

We have received the Schedule of Findings and Questioned Costs, included in the Single audit Report of the Municipality of Canóvanas for the year ended June 30, 2008.

Although we have already discussed the above mentioned findings, (Financial Statements and Federal Awards Findings) we are in the process of gathering all the relevant information and preparing the related responses. In order to comply with OMB Circular A-133, after completing this task we are going to issue our corrective actions taken on all prior audit findings directly to the grantors and required government agencies.

Cordially,

José R. Soto Rivera
Mayor

Lilliam Rodríguez García
Finance Director

Denisse Encarnación López
Federal Programs Director

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Summary schedule of prior years audit findings
Fiscal Year 2006-2007
June 30, 2008

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2007. Under the heading Corrective Action Taken there will be the following:

FR - Fully resolved (indicating the corrective action plan was fully implemented).

PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2007-2008).

NR - Not resolved yet. Finding repeated in fiscal year 2007-2008.

Finding Number	Title	Corrective Action Taken
07-1	Deficiencies in the Uniform Accounting System and Other Accounting Records	NR
07-2	Cash and Bank accounts	PR
07-3	Municipal license tax	FR
07-4	Disbursement test	PR
07-5	Personnel files and related payroll procedures	NR
07-6	Bidding Procedures	FR
07-7	Inactive and unnecessary funds and inactive bank accounts	NR
07-8	Depositing of cash receipts in bank accounts	FR
07-9	Deficiencies in accounting records of capital assets	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Summary schedule of prior years audit findings
Fiscal Year 2006-2007
June 30, 2008

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2007. Under the heading Corrective Action Taken there will be the following:

FR - Fully resolved (indicating the corrective action plan was fully implemented).

PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2007-2008).

NR - Not resolved yet. Finding repeated in fiscal year 2007-2008.

Finding Number	Title	Corrective Action Taken
07-10	Federal Financial Reports	NR
07-11	Procurement, Suspension and Debarment	NR
07-12	Equipment and real property management	NR
07-13	Federal Cash Management System	NR
07-14	Federal Cash Management System	NR
07-15	Federal Cash Management System	NR
07-16	Inadequate Documentation of Participants Files	FR
07-17	Financial Reporting	FR
07-18	Financial Reporting	NR
07-19	Financial Reporting	NR
07-20	Federal Cash Management System	NR
07-21	Federal Cash Management System	NR
07-22	Inadequate Documentation of Participants Files	NR
07-23	Davis-Bacon Act	NR
07-24	Financial Reporting	FR
07-25	Federal Disbursement Test	NR
07-26	Davis-Bacon Act	FR

07-27	Federal Cash Management System	NR
07-28	Federal Cash Management System	NR
07-29	Federal Cash Management System	NR
07-30	Federal Cash Management System	FR
07-31	Equipment and Real Property Management	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Summary schedule of prior years audit findings
Fiscal Year 2005-2006
June 30, 2008

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2006. Under the heading Corrective Action Taken there will be the following:

FR - Fully resolved (indicating the corrective action plan was fully implemented).

PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2007-2008).

NR - Not resolved yet. Finding repeated in fiscal year 2007-2008.

Finding Number	Title	Corrective Action Taken
06-1	Deficiencies in the Uniform Accounting System and Other Accounting Records	NR
06-2	Cash and Bank accounts	NR
06-3	Municipal license tax	FR
06-4	Disbursement test	PR
06-5	Personnel files and related payroll procedures	NR
06-6	Cash receipts test	FR
06-7	Bidding Procedures	FR
06-8	Inactive and unnecessary funds and inactive bank accounts	NR
06-9	Depositing of cash receipts in bank accounts	FR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CANÓVANAS
Summary schedule of prior years audit findings
Fiscal Year 2005-2006
June 30, 2008

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2006. Under the heading Corrective Action Taken there will be the following:

FR - Fully resolved (indicating the corrective action plan was fully implemented).

PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2006-2007).

NR - Not resolved yet. Finding repeated in fiscal year 2006-2007.

Finding Number	Title	Corrective Action Taken
06-10	Federal Financial Reports	NR
06-11	Federal Cash Management System	NR
06-12	Federal Cash Management System	NR
06-13	Federal Cash Management System	NR
06-14	Financial Reporting	FR
06-15	Financial Reporting	NR
06-16	Financial Reporting	NR
06-17	Federal Cash Management System	NR
06-18	Federal Cash Management System	NR
06-19	Inadequate Documentation of Participants Files	NR
06-20	Davis-Bacon Act	FR
06-21	Davis-Bacon Act	NR
06-22	Earmarking Requirement	FR
06-23	Financial Reporting	NR

06-24	Federal Cash Management System	NR
06-25	Federal Cash Management System	NR
06-26	Federal Cash Management System	FR
06-27	Federal Cash Management System	NR
06-28	Federal Cash Management System	NR
06-29	Equipment and Real Property Management	NR

Estado Libre Asociado de Puerto Rico

Gobierno Municipal de Canóvanas

Oficina de Finanzas

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Tel. (787) 876-2328 - (787) 256-6898 (fax)

20 de enero de 2009

Lcdo. Angel M. Castillo, Comisionado
Oficina Comisionado Asuntos Municipales
PO BOX 70167
San Juan, PR 00940-1269

Estimado licenciado Castillo:

Adjunto copia del Informe de Auditoría "Single Audit" correspondiente al año fiscal 2007-2008, del Municipio de Canóvanas, preparado por la firma de auditores Benítez-Jaime, CPA, PSC.

Cordialmente,

Lilliam Rodríguez García
Directora de Finanzas

clr

Anexo