

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE HORMIGUEROS

AUDITORIA 2004-2005

30 DE JUNIO DE 2005



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

*FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)*

FISCAL YEAR ENDED JUNE 30, 2005

Hon. Pedro J. García Figueroa
Mayor

Mrs. Marinelda Acosta
Finance Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

Table of Contents

FINANCIAL SECTION	PAGE
Independent Auditors' Report	1-2
Management Discussion and Analysis	3-13
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Assets	14
Statement of Activities	15
Governmental Funds' Financial Statements:	
Balance Sheet – Governmental Funds	16-17
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds	18-19
Notes to Basic Financial Statements	20-48
Required Supplementary Information:	
Budgetary Comparison Schedule – General Fund	49
Notes to Required Supplementary Information - Budgetary Comparison Schedule – General Fund	50-51
SINGLE AUDIT SECTION	
Supplemental Information:	
Schedule of Expenditures of Federal Awards	52
Notes to Schedule of Expenditures of Federal Awards	53
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	54-55
Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over compliance with OMB Circular A-133	56-57
Schedule of Findings and Questioned Costs	58-60

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

P.O. Box 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

INDEPENDENT AUDITORS' REPORT

Mayor and Members of the Municipal Legislature
Municipality of Hormigueros
Hormigueros, 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 Hormigueros, Puerto Rico, as of and for the year ended June 30, 2005, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these 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 respective financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Hormigueros as of June 30, 2005, 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 December 13, 2005 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The Management Discussion and Analysis on pages 3 through 14 and the Budgetary Comparison Schedule – General Fund on page 49 are not required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Hormigueros, Puerto Rico 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 and Circular A-133 “Audits of States, Local Governments, and Non-Profit Organizations”, and is not a required part of the basic financial statements. Such information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.



San Juan, Puerto Rico
December 13, 2005

Stamp 2109889 was affixed
to the original

MANAGEMENT DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

As management of the Municipality of Hormigueros, we offer readers of the Municipality's financial statements this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with the Municipality's financial statements, which follow this analysis.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

Information reported in the government-wide statements is based on the economic resources measurement focus and the accrual basis of accounting:

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2005 by \$24,976,530 (net assets). This represents an increase of 9% with respect to year 2004.
- Revenues (not including special items) increased by 17% and expenses decreased 2% in comparison with previous year.
- Change in net assets increased 3011% compared to change in net assets of year 2004.

Highlights for Fund Financial Statements

Fund financial statements presents information of the most significant funds of the Municipality based on the current financial resources measurement focus and the modified accrual basis of accounting:

- Fund balances of governmental funds decreased \$263,404 amounting to \$7,738,986.
- Total fund balance of the general fund decreased by 6% but the unreserved fund balance of increased 6% in comparison to fiscal year 2004-2005.

General Financial Highlights

- The investment in capital assets as of June 30, 2005 was \$29,577,241 (net of depreciation).
- Long term debt decreased to \$13,129,416, approximately 1 % with respect to prior year.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$201,684.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

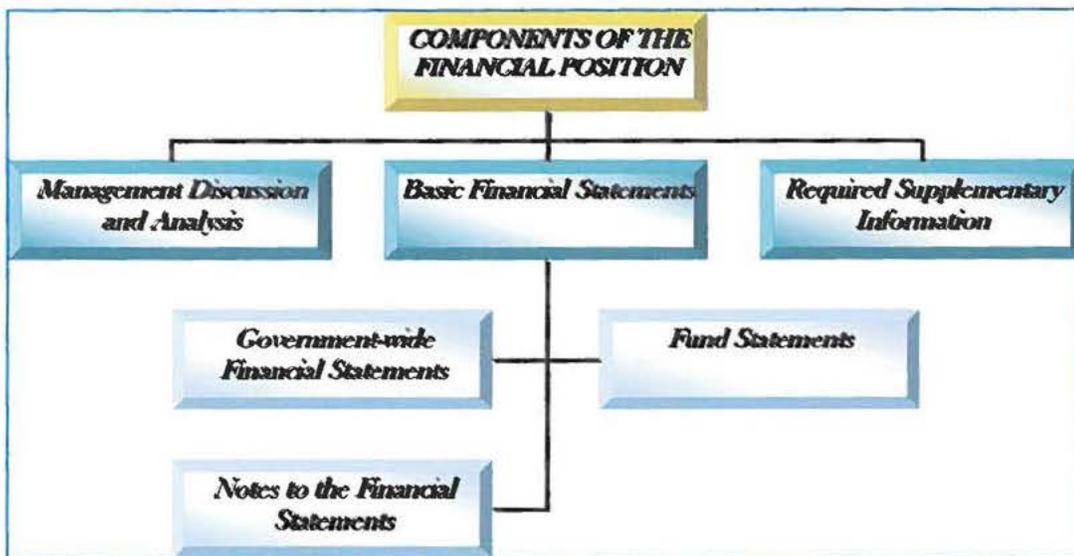
MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise three components:

- management discussion and analysis (presented here)
- basic financial statements
- required supplementary information.



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

➤ **Government-Wide Statements**

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

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

➤ ***Fund Financial Statements***

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

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

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

➤ ***Notes to the financial statements***

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

➤ ***Required supplementary information***

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

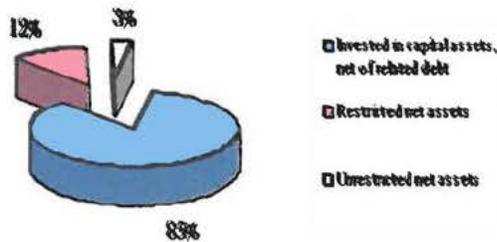
The following table presents a summary of the Statement of Net Assets as of June 30, 2005 and 2004:

TABLE 1

<i>Summary Statement of Net Assets As of June 30,</i>		
	Governmental Activities	
	2005	2004 (as restated)
Assets		
Current and other assets	\$11,458,928	\$ 11,433,561
Capital assets	29,577,241	27,429,169
Total assets	\$ 41,036,169	\$ 38,862,730
Liabilities		
Current and other liabilities	\$ 2,930,224	\$ 2,697,567
Long term liabilities	13,129,416	13,264,983
Total liabilities	16,059,640	15,962,550
Net assets		
Invested in capital assets, net of related debt	22,700,465	21,411,258
Restricted	3,162,577	3,011,463
Unrestricted	(886,511)	(1,522,544)
Total net assets	\$ 24,976,530	\$ 22,900,180

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. At the close of the fiscal year, the assets of the Municipality exceeded its liabilities by \$24,976,530 representing an increase of 9% with respect to year 2004. The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure); less accumulated depreciation and less any related outstanding debt used to acquire those assets.

*Municipality of Hormigueros
Composition of Net Assets
As of June 30, 2005*



The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt. Restricted net assets represent resources that are subject to external restrictions on how they may be used. Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

Changes in net assets

The following table summarizes the changes in net assets for the fiscal years ended 2005 and 2004:

TABLE 2

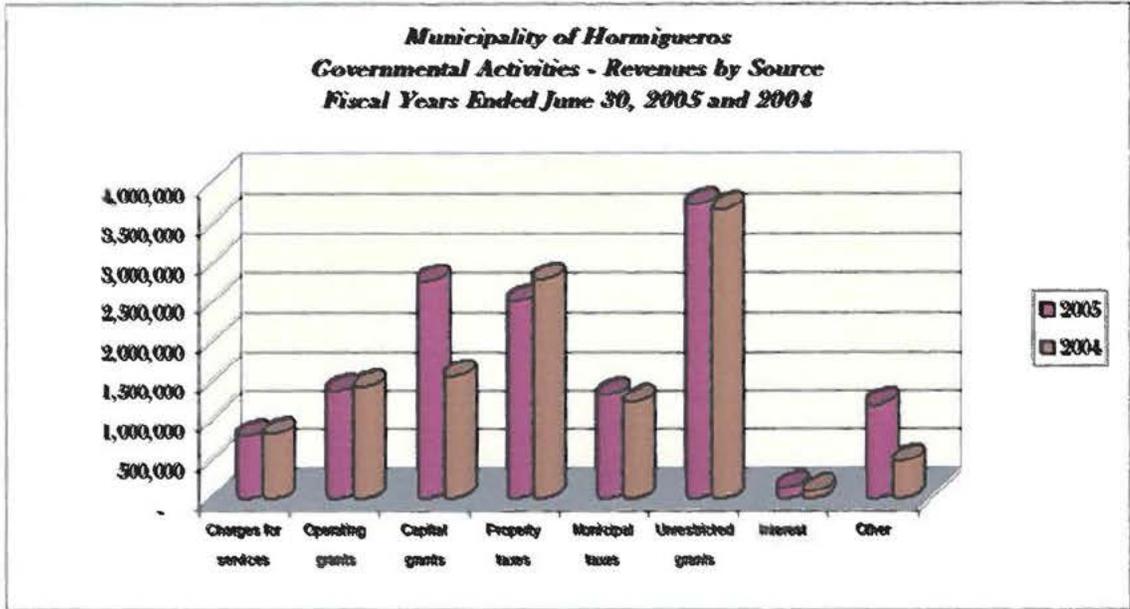
<i>Summary of Changes in Net Assets As of June 30,</i>		
	Governmental Activities	
	2005	2004 (as restated)
Program revenues:		
Fees, fines and charges for services	\$802,449	\$825,885
Operating grants and contributions	1,371,342	1,417,552
Capital grants and contributions	2,753,670	1,554,503
General revenues:		
Property taxes	2,501,295	2,778,922
Municipal license taxes	1,319,029	1,232,946
Grants and contributions not restricted to specific programs	3,728,769	3,671,462
Interest	143,455	100,486
Other	1,151,170	234,127
Total revenues	13,771,179	11,815,883
Expenses:		
General government	4,428,990	5,287,249
Public works and sanitation	3,204,647	2,579,731
Public safety	716,070	712,581
Culture and recreation	836,599	838,265
Health	357,506	334,557
Housing, welfare and community development	1,690,047	1,648,555
Education	21,855	25,570
Interest on long term debt	471,941	556,087
Total expenses	11,727,655	11,982,595
Special items:	32,826	233,454
Change in net assets	2,076,350	66,742
Net assets-beginning of year	22,900,180	22,833,438
Net assets-end of year	\$ 24,976,530	\$ 22,900,180

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

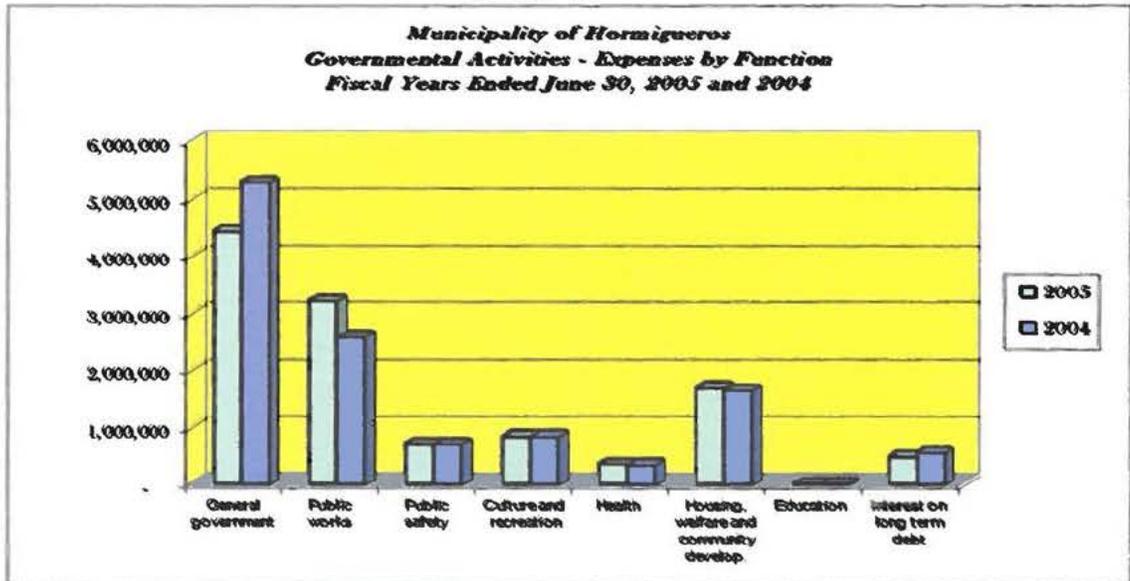
Fiscal year ended June 30, 2005

FIGURE 1



Approximately 30% of the Municipality's revenues came from operating and capital grants, 27% from grants and contributions not restricted to specific programs and 18% from property taxes. Revenues (not including special items) increased by 17% in comparison with year 2004. The most significant change is a 153% increase in others, due to donation income.

FIGURE 2



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

The Municipality's expenses cover a range of services. The largest expenses are general government representing approximately 38%, public works and sanitation with 27% and welfare with 14%. Program revenues of the Municipality covered 41% of total expenses.

Expenses decreased 2% in comparison with previous year. This includes a net difference of an increase in public works and sanitation of 24% (due to additional capital assets maintenance and other noncapitalizable costs); a 15% decrease in education (due to less depreciation expense) and a decrease of 15% in interest of long term debt (due to lower rates in bonds variable interest expense).

Changes in net assets in 2005 include additional resources from property tax amnesty in the amount of \$32,826, which were reported as special items in the financial statements.

As noted previously the increase in revenues combined with an increase in expenses caused the net change in net assets to increase approximately 3011% compared with net change in net assets reported in 2004 statement of activities.

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

TABLE 3

<i>Net Cost of Municipality's Governmental Activities</i>				
<i>Fiscal years ended June 30,</i>				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2005	2004 (as restated)	2005	2004 (as restated)
General government	\$4,428,990	\$5,287,249	\$ 3,122,524	\$ 3,860,950
Public works and sanitation	3,204,647	2,579,731	469,584	1,268,477
Public safety	716,070	712,581	712,491	670,133
Culture and recreation	836,599	838,263	803,279	769,840
Housing, welfare and community development	1,690,047	1,648,555	841,014	699,041
Other	851,302	916,214	851,302	916,214
	<u>\$ 11,727,653</u>	<u>\$ 11,982,595</u>	<u>\$ 6,800,194</u>	<u>\$ 8,184,655</u>

Some of the cost of governmental activities was paid by those who directly benefited from the programs (\$802,449) and other governments and organizations that subsidized certain programs with grants and contributions (\$4,125,012). The \$6,800,194 net cost of services was fully covered by other general revenues including property and municipal license taxes.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2005, the governmental funds reported combined ending fund balances of \$7,738,988, a net decrease of \$263,402 in comparison with the prior year. This decrease was caused primarily by a net change in the General Fund of \$(258,975) and \$285,838 in Commonwealth Legislature Resolution Fund. Of total combined fund balances, \$3,190,023 (41%) constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents 41% of total combined ending fund balance. For the year ended June 30, 2005, the fund balance of the general fund decreased by \$258,975. The key factor of this change is a net decrease of \$497,181 in other special funds with self imposed restrictions included as part of the general fund. Resources to finance these special funds were provided in previous years but funds were expended in current year.

General fund budgetary highlights

The general fund original budget for the fiscal period 2004-2005 presented an increase of 5% with respect to prior year budget due to an increase in the estimated amount of compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA) and an increase in the estimated amount of property tax advances.

Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year budget revenues were increased by \$329,500 mostly due to additional collections for property taxes and construction permits. An amendment to budget expenditures of \$100,000 was approved, representing a readjustment of current year budget with prior year's budgetary surpluses. Actual revenues exceeded the revised budgeted revenues by \$317,527. The most significant variances were in municipal license taxes \$175,260 and \$61,684 in fees, fines and charges for services due to certain business openings and additional funds acquired by services provided by the municipality. The Municipality reported a net negative variance of \$15,843 between revised budgeted appropriations and actual expenditures and ended with a total net positive variance of \$201,684.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$29,577,241 in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of 8% over the prior year.

TABLE 4

	<i>Capital Assets As of June 30,</i>	
	Governmental Activities	
	2005	2004 (as restated)
Non-depreciable assets:		
Land	\$ 3,806,471	\$ 3,186,599
Construction in progress	2,155,696	1,138,904
Depreciable assets:		
Land improvements	837,733	873,735
Buildings and buildings improvements	12,350,050	11,555,458
Infrastructure	8,209,469	8,508,091
Vehicles, machinery and equipment	2,217,822	2,166,382
Total	\$ 29,577,241	\$ 27,429,169

This year's completed projects, which were reported as decreases in construction in progress include the completion of Carretera Nueva Community Center for \$602,193 and improvements to various basketball courts for \$320,221. Certain projects are still in construction in progress as of June 30, 2005. The most significant of these projects is the construction of "Lavadero Sanitary Sewer System" with reported costs of \$1,405,006.

The Municipality's fiscal year 2005-2006 capital budget calls for approximately \$4,302,418 for capital projects. Of this amount, \$1,020,000 will be invested in the construction of an Elderly Center in Verdum area, which will be financed through grants from CDBG, Commonwealth Legislature Resolutions and Citizen Participation Funds. Another project that is on schedule for this fiscal year is the rehabilitation of the "Bobby Cruz" Multiple Purposes Center, with an estimated cost of \$879,964 which will be financed in part by a grant from CDBG. The remaining projects will be financed with other federal grants, funds from the Commonwealth Legislature and Municipal funds. More detailed information about the Municipality's capital assets and future projects is presented in Notes F and R to the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

Long term debt

At year-end, the Municipality had \$ 8,851,000 in general and special bonds and notes, a increase of 15% with respect to prior year. The Municipality is required to maintain a legal debt margin of 10% of the total assessment of property located within the Municipality plus the balance of the property taxes in the debt service fund.

TABLE 5

<i>Outstanding Long-term Debt Fiscal years ended June 30,</i>			
	Governmental Activities		
	2005	2004 (as restated)	
General and special obligation bonds and notes	\$ 8,844,646	\$	7,723,000
Compensated absences	1,084,535		1,002,110
Claims and judgments	56,000		10,000
Bond anticipation note	-		1,000,000
Payable to CRIM – prior years doubtful accounts	16,588		43,635
Payable to CRIM – prior year property taxes	61,177		61,177
Note payable-Puerto Rico Treasury Department	1,325,389		1,502,507
Payable to FEMA	-		538,334
Christmas bonus payable	182,955		186,393
Payable to CRIM - LIMS	186,445		209,332
Estimated landfill closing costs	1,025,797		988,495
Note payable to FEMA	345,884		-
Total	\$ 13,129,416	\$	13,264,983

The Municipality reported a decrease in the other long term debts of \$1,244,201. This decrease was primarily due to the payment of the Bond Anticipation Note of \$1,000,000 with Rural Development due to the issuance of the corresponding General Obligation Bond. Other significant decrease in long term debt results from the partial repayment of the disallowed costs found in the audit performed by FEMA by \$159,935 and the restructuring of the remaining debt. More detailed information about the Municipality's long term liabilities is presented in Note H to the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's officials considered certain factors when setting the fiscal year 2005-2006 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 8.2%, which compares with the Commonwealth rate of 10.6%.

For year 2005-2006 the Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2006 are \$8,210,025 representing an increase of approximately 11% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase modestly by the close of 2006 fiscal year. In addition to the general fund estimated budget the Municipality plans to submit Federal and Commonwealth funds proposals for welfare and community development as well as permanent capital improvements and public works.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Director of Finance at PO Box 97, Hormigueros, Puerto Rico 00660.

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**STATEMENT OF NET ASSETS
JUNE 30, 2005**

ASSETS	<u>Governmental Activities</u>
Cash and cash equivalents	\$ 5,405,795
Receivables, net	
Municipal license taxes (note C1)	3,937
Lease (note C2)	455,492
Other	13,645
Due from	
Commonwealth Government (note D)	433,882
Federal Government (note D)	422,104
Restricted assets:	
Cash and cash equivalents	2,655,207
Cash with fiscal agents	1,995,076
Deferred bond issuance costs	73,790
Capital assets (note F):	
Land and construction in progress	5,962,167
Other capital assets, net	23,615,074
Total capital assets, net	<u>29,577,241</u>
 Total assets	 <u><u>\$ 41,036,169</u></u>
 LIABILITIES	
Accounts payable and accrued liabilities	\$ 1,129,874
Interest payable	209,389
Due to	
Commonwealth Government	12,814
Federal Government	61,570
Deferred revenues	
Municipal license taxes (note C1)	1,121,611
Intergovernmental-Commonwealth Government	282,675
Federal grants (note G)	112,291
Long term liabilities (note H):	
Due within one year	1,265,203
Due in more than one year	11,864,213
Total liabilities	<u>16,059,640</u>
 NET ASSETS	
Invested in capital assets, net of related debt	22,700,465
Restricted for:	
Capital projects	2,205,731
Debt service	861,531
Other purposes	95,314
Unrestricted (deficit)	(886,511)
Total net assets	<u><u>\$ 24,976,530</u></u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2005**

<u>Functions</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Total</u>
		<u>Fees, Fines and Charges for services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
Governmental Activities:					
General government	\$ 4,428,990	\$ 735,786	\$ 570,680	\$ -	\$ (3,122,524)
Public works and sanitation	3,204,647	33,343	-	2,701,720	(469,584)
Public safety	716,070	-	3,579	-	(712,491)
Culture and recreation	836,599	33,320	-	-	(803,279)
Health	357,506	-	-	-	(357,506)
Housing, welfare and community development	1,690,047	-	797,083	51,950	(841,014)
Education	21,855	-	-	-	(21,855)
Interest on long term debt	471,941	-	-	-	(471,941)
Total	<u>\$ 11,727,655</u>	<u>\$ 802,449</u>	<u>\$ 1,371,342</u>	<u>\$ 2,753,670</u>	<u>(6,800,194)</u>

General revenues

Taxes

Property taxes

2,501,295

Municipal license taxes

1,319,029

Grants and contributions not restricted to specific programs

3,728,769

Interest

143,455

Other

1,151,170

Special item (note P)

Property tax amnesty

32,826

Total general revenues and special item

8,876,544

Change in net assets

2,076,350

Net assets-beginning as restated (note L)

22,900,180

Net assets-ending

\$ 24,976,530

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2005

	Fondo 01	Special Funds in General Fund	S/T	Dr.	Cr.	Total General Fund
ASSETS						
Cash and cash equivalents	\$ 4,718,081	\$ 687,714	\$ 5,405,795			\$ 5,405,795
Receivables, net:						
Municipal license taxes (note C1)	3,937	-	3,937			3,937
Lease (note C2)	455,492	-	455,492			455,492
Other	13,645	-	13,645			13,645
Due from:						
Commonwealth Government (note C2)	180,614	149,829	330,443			330,443
Federal Government	-	-	-			-
Other funds	211,094	-	211,094		155,698	55,396
Restricted assets:						
Cash and cash equivalents	-	-	-			-
Cash with fiscal agents	-	-	-			-
Total assets	<u>\$ 5,582,863</u>	<u>\$ 837,543</u>	<u>\$ 6,420,406</u>	<u>\$ -</u>	<u>\$ 155,698</u>	<u>\$ 6,264,708</u>
LIABILITIES						
Accounts payable and accrued liabilities	\$ 417,890	\$ -	\$ 417,890			\$ 417,890
Matured bonds and interest payable	-	-	-			-
Due to:						
Commonwealth Government	12,814	-	12,814			12,814
Federal Government	-	-	-			-
Other funds	-	155,698	155,698	155,698		-
Deferred revenues:						
Municipal license taxes (note C1)	1,121,611	-	1,121,611			1,121,611
Lease (note C2)	455,492	-	455,492			455,492
Intergovernmental-Commonwealth Government (note F)	152,013	-	152,013			152,013
Federal grants	-	-	-			-
Total liabilities	<u>2,159,820</u>	<u>155,698</u>	<u>2,315,518</u>	<u>155,698</u>	<u>-</u>	<u>2,159,820</u>
FUND BALANCES						
Reserved for:						
Encumbrances	233,020	-	233,020			233,020
Debt service	-	-	-			-
Capital projects	-	-	-			-
Other specified purposes	-	681,845	681,845			681,845
Unreserved	3,190,023	-	3,190,023			3,190,023
Total fund balances	<u>3,423,043</u>	<u>681,845</u>	<u>4,104,888</u>	<u>-</u>	<u>-</u>	<u>4,104,888</u>
Total liabilities and fund balances	<u>\$ 5,582,863</u>	<u>\$ 837,543</u>	<u>\$ 6,420,406</u>	<u>\$ 155,698</u>	<u>\$ 155,698</u>	<u>\$ 6,264,708</u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2005**

Total governmental fund balances: **\$ 7,738,988**

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

Capital assets used in governmental activities are not financial
resources and therefore are not reported in the funds: 29,577,241

Other assets used in governmental activities are not current
financial resources and therefore are not reported in the funds:
Deferred charges - bond issuance costs 73,790

Other assets are not available to pay current-period
expenditures and therefore are deferred in the funds:

Lease receivable	\$ 455,492	
Due from Commonwealth entities - Christmas bonus reimbursement	<u>152,013</u>	607,505

Interest liabilities are not due and payable in the current
period and therefore are not reported in funds (116,578)

Long term liabilities, including bonds payable, are not due
and payable in the current period and therefore are not
reported in the funds:

General obligation bonds and notes	8,619,646	
Note payable to CRIM-LIMS	186,445	
Note payable to CRIM-financing of delinquent accounts	16,588	
Note payable -PR Department of Treasury	1,325,389	
Note payable - FEMA	345,884	
Compensated absences	1,084,535	
Christmas bonus payable	182,955	
Judgments and legal claims	56,000	
Estimated landfill closing costs	1,025,797	
Payable to CRIM-current year property tax settlement	<u>61,177</u>	<u>(12,904,416)</u>

Net assets of governmental activities: **\$ 24,976,530**

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES-
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2005

	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Rural Development- Lavadero Sanitary Sewer	Other Governmental Funds	Total Governmental Funds
Revenues							
Taxes:							
Property taxes (note J)	\$ 1,889,513	\$ -	\$ -	\$ 551,247	\$ -	\$ -	\$ 2,440,760
Municipal license taxes (note C1)	1,319,029	-	-	-	-	-	1,319,029
Intergovernmental							
Commonwealth government (note K)	4,432,681	-	648,602	-	-	149,314	5,230,597
Federal government	-	902,468	-	-	749,494	974,444	2,626,406
Fees, fines and charges for services	802,449	-	-	-	-	-	802,449
Interest	118,199	-	2,948	22,308	-	-	143,455
Other	66,291	-	-	-	-	-	66,291
Total revenues	8,628,162	902,468	651,550	573,555	749,494	1,123,758	12,628,987
Expenditures							
Current:							
General government	4,401,170	158,167	-	-	-	28,110	4,587,447
Public works and sanitation	1,834,759	95,503	203,900	-	-	20,503	2,154,665
Public safety	615,775	-	-	-	-	10,432	626,207
Culture and recreation	450,832	-	-	-	-	-	450,832
Health	357,506	-	-	-	-	-	357,506
Housing, welfare and community development	477,250	220,406	51,986	-	-	788,213	1,537,855
Education	17,104	-	-	-	-	-	17,104
Capital outlays	515,016	428,392	106,497	-	1,405,007	108,700	2,563,612
Debt service							
Principal	-	-	-	629,118	-	-	629,118
Interest	-	-	-	444,681	-	-	444,681
Bond issuance costs	-	-	-	-	-	12,406	12,406
Total expenditures	8,669,412	902,468	362,383	1,073,799	1,405,007	968,364	13,381,433
Excess (deficiency) of revenues over expenditures	(41,250)	-	289,167	(500,244)	(655,513)	155,394	(752,446)
Other financing sources (uses)							
Lease principal payments (note C2)	76,152	-	-	-	-	-	76,152
Proceeds from note payable - FEMA	345,884	-	-	-	-	-	345,884
Payment of long term debt to FEMA	(538,334)	-	-	-	-	-	(538,334)
Discount on note payable to FEMA	32,514	-	-	-	-	-	32,514
Payment of refunded bonds	-	-	-	-	-	(1,345,000)	(1,345,000)
General obligation bonds	-	-	-	-	1,000,000	530,000	1,530,000
Proceeds from refunding bonds	-	-	-	-	-	1,355,000	1,355,000
Payment of bond anticipation notes	-	-	-	-	(1,000,000)	-	(1,000,000)
Transfers in	174,682	-	-	335,866	-	-	510,548
Transfers out	(335,866)	-	(3,329)	(11,416)	-	(159,937)	(510,548)
Total other financing sources (uses)	(244,968)	-	(3,329)	324,450	-	380,063	456,216
Special item (note P)							
Property taxes-amnesty	27,243	-	-	5,583	-	-	32,826
Net change in fund balance (note Q)	(258,975)	-	285,838	(170,211)	(655,513)	535,457	(263,404)
Fund balance at beginning of year	4,363,863	-	1,787,704	922,396	655,513	272,916	8,002,392
Fund balance at end of year	\$ 4,104,888	\$ -	\$ 2,073,542	\$ 752,185	\$ -	\$ 808,373	\$ 7,738,988

Handwritten signature/initials in blue ink.

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2005

Net change in fund balances-total governmental funds:		\$ (263,404)
Amounts reported for governmental activities in the Statement of activities are different because:		
Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:		
Expenditures for capital assets	\$ 2,563,611	
Less: current year depreciation	<u>(1,392,256)</u>	1,171,355
Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset		
		(29,600)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
CRIM-current year property tax settlement	60,535	
Due from Commonwealth entities-Christmas bonus	91,478	
Donated capital assets	<u>1,006,317</u>	1,158,330
Revenues reported in funds which are not reported as revenues in the Statement of Activities		
Christmas bonus- prior year	(93,196)	
Capital lease principal payment	<u>(31,608)</u>	(124,804)
Proceeds from notes payable and general obligation bonds are an other financing sources in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:		
		(3,230,884)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		40,000
Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:		
General Obligation Bonds and Notes	1,757,000	
Other Long Term Liabilities	<u>1,951,779</u>	3,708,779
Governmental funds report the effect of bond issuance costs as expenditure when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This amount is the net effect of these differences:		
Bond issuance costs	12,406	
Amortization of deferred charges	<u>(4,842)</u>	7,564
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:		
Christmas Bonus	(182,955)	
Judgement and claims	(46,000)	
Estimated Landfill Closing Costs	(37,302)	
Compensated Absences	(82,425)	
Accrued interest (net change)	<u>(12,304)</u>	(360,986)
Change in net assets of governmental activities:		<u><u>\$ 2,076,350</u></u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Hormigueros was founded in 1874. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of twelve (12) members of the Municipal Legislature. The Municipality engages in a comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

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

1. *Financial reporting entity*

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

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

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

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

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

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

Management Discussion and Analysis

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

Basic financial statements

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Government-wide statements

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

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

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

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

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fund Statements

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

The Municipality reports the following major governmental funds:

General Fund: The General Fund is the general operations fund of the Municipality. It is used to account for all financial resources except those required to be accounted in another fund.

Community Development Block Grant Program Fund (CDBG): CDBG fund is used to account for revenues sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

Commonwealth Legislature Resolutions Fund: This fund accounts for revenue sources from grants provided by the Commonwealth Legislature for specific purposes which includes, among others, acquisition, development and improvements of capital assets.

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

Rural Development - Lavadero Sanitary Sewer Fund: This fund accounts for revenue sources from a grant provided by the USDA Rural Development for specific purposes that is, the construction of a sanitary sewer system for the Lavadero's community.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Governmental funds are accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet in the funds statements. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets. The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method of accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when the related liability is incurred.

Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred, subject to the availability criteria. Revenues on intergovernmental grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met and revenue becomes available. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. Licenses and permits, charges for services, rent and miscellaneous revenues are recorded as revenues when received because they are not measurable and available.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

Notes to Financial Statements

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

Required Supplementary Information:

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

3. *Cash, cash equivalents (unrestricted and restricted) and restricted cash with fiscal agents*

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

Restricted cash with fiscal agent in the debt service fund consists of the undisbursed balance of property tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of other governmental funds represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB or a federal government agency.

4. *Receivables and due from governmental entities*

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

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property tax revenue of current fiscal year collected by the CRIM on the first month (July) of the subsequent fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. *Interfund receivables and payables*

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

6. *Inventories*

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

7. *Capital assets*

Capital assets, which include property, plant, equipment, and infrastructure, (e.g., roads, bridges, sidewalks, and similar items), are reported in the governmental activities column in the Statement of Net Assets. Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The Municipality maintains a threshold level of \$1,000 or more for capitalizing vehicles, machinery and equipment. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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

<u>Description</u>	<u>Years</u>
Land improvements	20
Buildings and building improvements	20-50
Infrastructure	10-50
Vehicles, machinery and equipment	5-20

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

8. *Long-term obligations*

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

9. *Deferred bond issuance costs*

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

10. *Compensated absences*

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

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

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

11. *Fund balances and Net Assets*

In the fund financial statements, governmental funds report reserved and unreserved fund balances. Reservations of fund balance represent portions of the fund balance that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- Encumbrances: Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.
- Debt Service: Represents net assets available to finance future debt service payments.
- Capital Projects: Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed.
- Other specified purposes: Represent amounts to be used for future expenditures of Federal and Commonwealth grants to be used to finance activities other than construction or capital improvement commitments

Net assets

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

- Invested in capital assets, net of related debt: Consists of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.
- Restricted net assets: Represents net assets (restricted assets net of related debt) that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).
- Unrestricted net assets: Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

12. *Interfund transactions*

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

13. *Risk financing*

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

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

14. *Use of estimates*

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

15. *Future adoption of accounting pronouncements*

The GASB has issued the following statements, which the Municipality has not yet adopted:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

	Statement	To be Adopted in Fiscal year ended,
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	June 30, 2006
43	Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans	June 30, 2008
44	Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement No. 1	June 30, 2006
45	Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions	June 30, 2009
46	Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34	June 30, 2007

The Municipality's management has concluded that the adoption of these statements will not have a significant impact on the Municipality's basic financial statements.

NOTE B – CUSTODIAL CREDIT RISK - DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Municipality maintains cash deposits in commercial and governmental banks located in Puerto Rico.

Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. At year-end the Municipality's bank balance in commercial banks amounts to \$7,157,165.

Deposits in governmental banks are uninsured and uncollateralized. At year-end the Municipality's bank balance in governmental banks amounts to \$3,155,011.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE C - RECEIVABLES

1. *Municipal license taxes*

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15. During the fiscal year ended June 30, 2005 the tax rates were as follows:

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

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable representing uncollected tax as of June 30, 2005 on filed tax returns follows:

	<u>Amount</u>
Receivable as of June 30, 2005	\$286,544
Less: allowance for uncollectible	<u>(282,607)</u>
	<u>\$ 3,937</u>

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$1,121,611 are recorded as deferred revenues.

2. *Lease*

The Municipality is a lessor of a property, which consist of a building facility, classified as direct financing lease. The lease term is for twenty years under a noncancelable lease agreement. The following list the component of the net investment in direct financing lease as of June 30:

Total minimum lease payments to be received	\$672,676
Less: Unearned income	<u>(217,184)</u>
Net investment in direct financing lease	<u>\$455,492</u>

At June 30, 2005, minimum lease payments for each of the five succeeding fiscal years are as follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE C - RECEIVABLES – Continued

Year	Amount
2006	\$ 76,152
2007	76,152
2008	76,152
2009	76,152
2010	76,152
2011-2014	291,916
	\$ 672,676

The net investment in direct financing lease in the amount of \$455,492 is recorded as deferred revenue in the governmental fund statements since is not available as required by current standards.

NOTE D - DUE FROM GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2005 follows:

	Commonwealth Entities	Federal Government
Puerto Rico Department of Education	\$ 14,100	\$ -
Puerto Rico Firefighters Corps	2,500	-
Municipal Revenue Collection Center (CRIM)- current year liquidation (general fund)	60,535	-
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	35,010	-
Puerto Rico Department of Family- Home Auxiliary Asistance	777	-
Commonwealth Legislature Resolutions	67,652	
US Department of Transportation-FTA	-	456
Office of Commissioner of Municipal Affairs - CDBG	-	93,894
Puerto Rico Department of Family – Child Care Rural Development (RD)	-	2,065
Puerto Rico Department of Treasury – Christmas bonus reimbursement	91,478	-
Puerto Rico Department of Treasury – others	7,000	-
Public Schools Improvement Office	5,001	-
Puerto Rico Department of Labor – Law No. 82	20,699	-
Puerto Rico Department of Labor – Law No. 52	129,130	-
	\$ 433,882	\$ 422,104

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE D - DUE FROM GOVERNMENTAL ENTITIES – Continued

The amount due from Puerto Rico Department of Treasury (\$91,478) and Municipal Revenue Collection Center-current year liquidation (\$60,535) are recorded as deferred revenues in the governmental funds statements (general fund) since they are not available as required by current standards.

NOTE E - INTERFUND TRANSACTIONS

1. Due from/to other funds

Amounts due from/to other funds represent temporary advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Major fund-CDBG	\$ 34,510
	Major Fund-R/C's	1,532
	Other governmental funds	19,353
Total:		\$ 55,395

2. Operating transfers

Transfers between individual funds were made for operational purposes. Transfers includes interest earned on restricted cash with fiscal agents in the debt service fund and operating and capital improvement loans in other governmental funds which is transferred to the general fund; principal and interest payments of general long term debt transferred from the general fund to the debt service fund; and a transfer from FEMA special fund to the general fund for a principal payment of a long term debt due to FEMA.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE F - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2005 is as follows:

	Balance July 1, 2004, as restated	Increases	Decreases	Balance June 30, 2005
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 3,186,599	\$ 619,872	\$ -	\$3,806,471
Construction in progress	1,138,904	1,943,206	926,414	2,155,696
Total capital assets not being depreciated:	4,325,503	2,563,078	926,414	5,962,167
Capital assets, being depreciated:				
Land improvements	1,046,506	-	-	1,046,506
Buildings and building improvements	16,168,682	1,298,403	20,250	17,446,835
Infrastructure	10,712,605	241,763	25,954	10,928,414
Vehicles, machinery and equipment	5,398,754	393,098	105,384	5,686,468
Total capital assets being depreciated	33,326,547	1,933,264	151,588	35,108,223
Less accumulated depreciation for:				
Land improvements	172,771	36,003	-	208,774
Buildings and building improvements	4,613,224	485,595	2,035	5,096,784
Infrastructure	2,204,514	540,385	25,954	2,718,945
Vehicles, machinery and equipment	3,232,372	330,273	93,999	3,468,646
Total accumulated depreciation	10,222,881	1,392,256	121,988	11,493,149
Total capital assets being depreciated, net	23,103,666	541,008	29,600	23,615,074
Governmental activities capital assets, net	\$ 27,429,169	\$ 3,104,086	\$ 956,014	\$ 29,577,241

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

<u>Governmental activities:</u>	
General government	\$ 73,252
Public works and sanitation	685,727
Public safety	90,567
Culture and recreation	385,767
Welfare and community development	152,192
Education	4,751
Total depreciation expense, governmental activities	\$ 1,392,256

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

NOTE G - DEFERRED REVENUES

1. Commonwealth government – other governmental funds

On December 2000, the Municipality and other municipalities of Puerto Rico filed a complaint against the Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth of Puerto Rico, requesting the payment by PREPA of contributions in lieu of taxes and electric energy sales set aside on prior fiscal years. On March 18, 2003, the Board of Directors of PREPA approved a resolution by which PREPA agreed to settle the claims with all municipalities. As both parties agreed the settlement would be paid in cash and in electrical infrastructure projects to be performed by PREPA. Accordingly, the Municipality received \$377,184 in cash during fiscal year 2003-2004.

During the fiscal year 2004-2005 the original settlement was amended to advance funds to the Municipalities for the electrical infrastructure projects, to be performed by the Municipality, subject to certain restrictions and conditions imposed by PREPA. Non compliance with these conditions may require reimbursement of funds to PREPA. On April 2005, the Municipality received \$282,675 in cash, which is recorded as deferred revenue in the financial statements.

2. Federal government

Deferred revenues for federal grants represent resources are received before allowable expenditures are incurred. A detail of these balances follows:

Fund/Grant	Federal Grants
Major Fund-CDBG	\$ 4,828
Other Governmental Funds- Office of Governor's Authorized Representative (GAR) - FEMA	96,416
Other Governmental Funds -Child and Adult Care Food Program	11,047
Total:	\$ 112,291

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE H – LONG-TERM DEBT

1. Summary of long-term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2005:

	Balance at July 1, 2004, as restated	Increases	Decreases	Balance at June 30, 2005	Due within one year
General, Special Obligations Bonds and Notes	\$ 7,723,000	\$ 2,878,646	\$ 1,757,000	\$ 8,844,646	\$ 425,000
Bond anticipation note	1,000,000	-	1,000,000	-	-
Note payable to CRIM- LIMS	209,332	-	22,887	186,445	24,269
Note payable to CRIM- financing of delinquent accounts	43,635	-	27,047	16,588	-
Note Payable-Puerto Rico Treasury Department	1,502,507	-	177,118	1,325,389	304,584
Note Payable-FEMA	-	345,884	-	345,884	85,579
Compensated absences	1,002,110	212,854	130,429	1,084,535	125,639
Christmas Bonus	186,393	182,955	186,393	182,955	182,955
Payable to FEMA	538,334	-	538,334	-	-
Judgments and legal claims	10,000	46,000	-	56,000	56,000
Estimated Landfill Closing Costs	988,495	37,302	-	1,025,797	-
Payable to CRIM- final settlement 2003-2004	61,177	-	-	61,177	61,177
	<u>\$ 13,264,983</u>	<u>\$ 3,703,641</u>	<u>\$ 3,839,208</u>	<u>\$ 13,129,416</u>	<u>\$ 1,265,203</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2005 amount to \$8,851,000. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to levy and collect property taxes for payment of principal and interest on bonds and notes. A debt service fund has been established for the bonds and notes at GDB with the proceeds of those property taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of \$690,000 Revenue bonds are made from an "Interest Bearing Account" (IBA) maintained by GDB, which is financed with proceeds from lessee's rental payments. Principal and interest payments of long term debt issued for operational purposes are made through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). A detail of the general and special obligation bonds and notes as of June 30, 2005 follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE H – LONG-TERM DEBT – Continued

	Outstanding Amount
1994 public improvement bonds of \$85,000 due in annual installments of \$5,000 to \$10,000 through July 1, 2008; bearing interest at rates ranging from 5% to 7.61% (7.31% at June 30, 2005)	\$ 30,000
1994 public improvement bonds of \$125,000 due in annual installments of \$3,000 to \$10,000 through January 1, 2019; bearing interest at 5%	93,000
1992 public improvement bonds of \$168,000 due in annual installments of \$2,000 to \$17,000 through January 1, 2017; bearing interest at 5%	124,000
1997 general obligation bonds of \$175,000 due in annual installments of \$5,000 to \$15,000 through July 1, 2021; bearing interest at rates ranging from 4.865% to 6.56% (5.42% at June 30, 2005)	135,000
1983 public improvement bonds of 251,000 due in annual installments of \$5,000 to \$17,000 through January 1, 2008; bearing interest at 5%	48,000
1996 general obligation bonds of \$390,000 due in annual installments of \$5,000 to \$40,000 through July 1, 2020; bearing interest at rates ranging from 4.70% to 6.63% (5.93% at June 30, 2005)	330,000
1999 general obligation bonds of \$410,000 due in annual installments of \$5,000 to \$35,000 through July 1, 2024; bearing interest at rates ranging from 2.70% to 7.81% (2.89% at June 30, 2005)	375,000
2001 general obligation bonds of \$425,000 due in annual installments of \$5,000 to \$40,000 through July 1, 2025; bearing interest at rates ranging from 2.70% to 6.13% (2.89% at June 30, 2005)	405,000
1999 general obligation notes of \$705,000 due in annual installments of \$80,000 to \$125,000 through July 1, 2006; bearing interest at rates ranging from 5% to 7.81% (2.89% at June 30, 2005)	240,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE H – LONG-TERM DEBT – Continued

	<u>Outstanding Amount</u>
1999 general obligation bonds of \$736,000 due in annual installments of \$19,000 to \$52,000 through January 1, 2024; bearing interest at 4.75%	674,000
1998 general obligation bonds of \$983,000 due in annual installments of \$23,000 to \$65,000 through January 1, 2024; bearing interest at 4.5%	855,000
2002 general obligation bonds of \$1,000,000 due in annual installments of \$21,000 to \$65,000 through January 1, 2030; bearing interest at 4.50%	1,000,000
2000 general obligation bonds of \$1,040,000 due in annual installments of \$27,000 to \$76,000 through January 1, 2025; bearing interest at 5.12%	985,000
1997 general obligation bonds of \$1,538,000 due in annual installments of \$41,000 to \$109,000 through January 1, 2022; bearing interest at 4.75%	1,312,000
1992 revenue bonds of \$690,000 due in annual installments of \$5,000 to \$25,000 through July 1, 2013; bearing interest at 9%	360,000
2004 general obligation bonds of \$530,000 due in annual installments of \$15,000 to 40,000 through July 1, 2024; bearing interest at rates ranging from 3.28% to 5.00% (4.37% at June 30, 2005)	530,000
2004 general obligation bonds of \$1,355,000 due in annual installments of \$35,000 to 85,000 through July 1, 2029; bearing interest at rates ranging from 3.50% to 5.00% (4.37% at June 30, 2005)	1,355,000
	<u>8,851,000</u>
Less: deferred charges arising from debt refunding:	<u>(6,354)</u>
	<u><u>\$ 8,844,646</u></u>

In order to achieve debt service savings, during fiscal year 2004-2005 the Municipality issued general obligation bonds of \$1,355,000 to currently refund a 2002 special obligation bonds issuance with an interest rate of 7.5%. The new bonds bear interest at rates ranging from 3.50% to 5.00% (4.37% at June 30, 2005). The reacquisition price of the old debt exceeds the net carrying amount of the old debt by \$6,354. This amount is presented as a reduction of the new liability and will be amortized over the remaining life of the old debt. As a result of the refunding the Municipality reduced its total debt service requirements by \$ 1,016,935, which resulted in an economic gain of approximately \$715,333. The annual requirements to amortize general and special obligation bonds and notes as of June 30, 2005 follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE H – LONG-TERM DEBT – Continued

June 30	Principal	Interest
2006	\$ 425,000	\$ 415,360
2007	446,000	391,255
2008	346,000	373,420
2009	343,000	355,292
2010	342,000	337,858
2011-2015	1,924,000	1,399,097
2016-2020	2,226,000	895,378
2021-2025	2,087,000	347,623
2026-2030	712,000	62,103
Totals	8,851,000	<u>\$ 4,577,386</u>
Less: deferred charges arising from debt refunding:	<u>(6,354)</u>	
	<u>\$ 8,844,646</u>	

3. Other long-term liabilities

Note payable to CRIM (LIMS) - On November 28, 2001 the Municipality entered into a financing agreement with the CRIM in the amount of \$261,009 for the payment of the Municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$17,503, including interest of 5.95% and is due on November 28, 2011. Amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center. Debt service requirements in future years are as follows:

Outstanding Amount
\$186,445

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE H – LONG-TERM DEBT – Continued

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 24,269	\$ 10,617
2007	25,734	9,145
2008	27,288	7,583
2009	28,936	6,000
2010	30,684	5,062
2011-2012	49,534	4,590
Totals	<u>\$ 186,445</u>	<u>\$ 42,997</u>

Outstanding
Amount

Note payable to CRIM (Financing of delinquent accounts)– On March 19, 2002 the Municipality entered into a financing agreement with the CRIM in the amount of \$158,431 to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a nonrevolving line of credit bearing interest of 6.5% for the first 5 years and variable for the next 25 years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first 5 years will be financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico’s general fund. Also, during the first 5 years any collection from those delinquent accounts will be credited to the loan principal. After the 5 year period the loan outstanding balance will be restructured for a 25 years period. Debt service requirements in future years are as follows:

\$16,588

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ -	\$ 1,078
2007	-	1,078
2008	-	1,078
2009	285	1,070
2010	304	1,051
2011-2015	1,856	4,919
2016-2020	2,566	4,209
2021-2025	3,550	3,225
2026-2030	4,909	1,866
2031-2033	3,118	271
Totals	<u>\$ 16,588</u>	<u>\$ 19,845</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE H – LONG-TERM DEBT – Continued

Outstanding
Amount

Note Payable–Puerto Rico Treasury Department- As of June 30, 2003 the Municipality recorded in the government-wide statements a \$1,850,000 liability for a legal case settled on July, 2003. On October 14, 2003 the Municipality refinanced this debt on a long term basis through a \$1,601,720 non-interest bearing note (imputed interest rate is 5.125%), from the Puerto Rico Department of the Treasury. The note is payable in annual installments of \$20,833 to \$37,500 (including interest) through November 1, 2008. The note balance as of June 30, 2005 is net of an unamortized discount of \$128,778 and will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:

\$1,325,389

June 30	Principal	Interest
2006	\$ 304,584	\$ 62,082
2007	407,159	42,841
2008	428,524	21,476
2009	185,122	2,379
Totals	\$ 1,325,389	\$ 128,778

Note Payable–FEMA As of June 30, 2004 the Municipality recorded in the government-wide statements a \$538,334 liability for final disallowed costs as determined by an audit performed by the Governor’s Authorized Representative (GAR) of FEMA funds related to Hurricane Georges. On June 9, 2005 the Municipality refinanced this debt on a long term basis through a \$345,884 non-interest bearing note (imputed interest rate is 5.00%), from Governor’s Authorized Representative (GAR) of FEMA. The note is payable in annual installments of \$47,300 (including interest) through January, 2008. The note balance as of June 30, 2005 is net of an unamortized discount of \$32,514 and will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:

\$345,884

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE H – LONG-TERM DEBT – Continued

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 85,579	\$ 9,020
2007	82,477	12,123
2008	86,696	7,903
2009	91,132	3,468
Totals	<u>\$ 345,884</u>	<u>\$ 32,514</u>

	<u>Outstanding Amount</u>
Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds	\$1,084,535
Christmas Bonus - represent the accrued portion corresponding to fiscal year 2004-2005 of the Christmas bonus to be paid in December 2005	\$182,955
Claims and judgments - represent the final settlement of legal cases paid subsequent to June 30, 2005. The awarded amount will be paid with unrestricted funds.	\$56,000
Estimated closure and post-closure care costs of Municipal Landfill - The Municipality owns and operates a MSW landfill in Barrio Jaguitas, Hormigueros since about 1977. The Municipality has recognized an estimated liability for future closure and post-closure care costs. (See Note I)	\$1,025,797
Payable to CRIM - represents the balance owed to CRIM at June 30, 2005 for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal year ended June 30, 2004.(see note J). This amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).	\$61,177

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE I - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS

The Municipality operates a landfill since 1977. Commonwealth and Federal laws and regulations require the Municipality to place a final cover on its landfill when it stops accepting waste and perform certain maintenance and monitoring functions at the landfill site for thirty years after closure. In addition to operating expenses related to current activities of the landfill, an expense provision and related liability should be recognized based on the future closure and post closure care costs that will be incurred near or after the date the landfill no longer accepts waste.

The Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations. As a result of this study, the Municipality has recognized an estimated liability for future closure and post-closure care costs. The recognition of this liability is based on the amount of the landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$1,025,797 as of June 30, 2005, which is based on 47% usage of the landfill. It is estimated that an additional \$1,137,602 will be recognized as closure and post-closure care expenditures between the date of the balance sheet and the date the landfill is expected to be filled to capacity (December 2035). The estimated total current costs of the landfill closure and post-closure care (\$2,163,499) is based on the amount that would be paid if all the equipment, facilities and services required to close, monitor and maintain the landfill were acquired as of June 30, 2005. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. As of June 30, 2005 the Puerto Rico Solid Waste Authority approved \$375,000 as a contribution to closure and post-closure care costs.

NOTE J - PROPERTY TAXES

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

The tax rates in force as of June 30, 2005 are 8.28% for real property (of which 8.08% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.28% for personal property (of which 6.08% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.25% and 5.25%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.25% on both tax rates belonging to the Municipality is restricted for debt service and accounted for in the debt service fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE J - PROPERTY TAXES – Continued

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

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net payable to the CRIM of \$ \$61,177 resulting from the final settlement for fiscal year 2003-2004. The total amount is recorded as a long-term debt in the government-wide statement since will not be paid with expendable available resources. A receivable of \$60,535 resulting from the final settlement for fiscal year 2004-2005 is recorded as deferred revenue in since is not available as required by current standards.

NOTE K - INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of the following:

	<u>Amount</u>
Amount of municipal equalization fund send by CRIM	\$ 2,750,479
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	805,785
Puerto Rico Department of Labor – Law No. 52	521,926
Reimbursement from Commonwealth Government of Christmas Bonus expenditure	147,287
Solid Waste Administration	144,707
Other intergovernmental revenues	62,497
	<u>\$ 4,432,681</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE L - FUND BALANCE AND NET ASSETS RESTATEMENTS

1. *Net assets*

Net assets at beginning of year have been adjusted to reflect the following restatements:

	Amount
Net assets at beginning of year as previously reported:	\$ 23,891,302
Restatements:	
Correction of errors - capital assets	73,488
Correction of errors - compensated absences liability	(24,464)
Correction of errors - note payable to FEMA	(51,651)
Estimated Landfill closing costs debt not recorded	(988,495)
Net assets at beginning of year as restated:	<u>\$ 22,900,180</u>

NOTE M - RETIREMENT PLAN

1. *Plan description*

Regular employees of the Municipality contribute to a cost sharing multiple employer defined benefit retirement plan, administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirement pensions, death and disability benefits.

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE M - RETIREMENT PLAN - Continued

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

2. Funding policy

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

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

Fiscal year ended:	Law No. 447	System 2000
2005	\$ 198,889	\$ 72,441
2004	<u>\$ 195,644</u>	<u>\$ 58,000</u>
2003	<u>\$ 182,597</u>	<u>\$ 37,729</u>

NOTE N - COMMITMENTS

1. Operating leases

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted approximately \$ 6,762. Management believes that the summary of the future minimum rental commitments under noncancelable operating leases with terms exceeding one year is not significant.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE N – COMMITMENTS - Continued

2. Construction

The Municipality has commitments at June 30, 2005 of approximately \$ 3,048,985 for construction, improvements or renovation of certain municipal facilities.

NOTE O - CONTINGENCIES

1. Federal and State grants

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

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. As a result of one settled case subsequent to June 30, 2005 and not to be covered by insurance, the Municipality accrued \$10,000 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsels that, based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

NOTE P – SPECIAL ITEM

1. Property tax amnesty

Law No. 74 of March 1, 2004 approved by the Commonwealth's Legislature (as amended by Law No. 131 of June 1, 2004) granted to taxpayers (for the period March 1, 2004 to June 30, 2004) an amnesty for payment of real and personal property tax debts. As a result, the CRIM distributed to the Municipality \$ 32,826 on property tax collections as of June 30, 2005 of which \$27,243 were recorded in the general fund and \$ 5,583 recorded in the debt service fund. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of the Municipality's management.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE Q – NET CHANGE IN FUND BALANCE – GENERAL FUND

The Statement of revenues, expenditures and changes in fund balance reported a net change in fund balance for the general fund in the amount of (\$258,975), which is composed of the following:

	Amount
Net change in fund balance, 01 Fund	\$ 238,207
Net change in fund balance, other special funds (with self imposed restrictions) included as part of the general fund:	(497,182)
	<u>\$ (258,975)</u>

Resources to finance these special funds were provided in previous years but funds were expended in current year.

NOTE R- SUBSEQUENT EVENTS

1. Issuance of general obligation bonds

On August 1, 2005 the Municipality issued \$748,000 special obligation bonds through the Governmental Development Bank of Puerto Rico (GDB) to finance the purchase of equipment. Bonds are payable in annual installments of \$92,000 to \$124,000 through July 1, 2029.

On August 1, 2005 the Municipality issued \$920,000 general obligation bonds through the Governmental Development Bank of Puerto Rico (GDB) to finance construction, rehabilitation and improvements to the Julio Rivera Lopez Park. Bonds are payable in annual installments of \$20,000 to \$70,000 through July 1, 2024.

REQUIRED SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2005

	Budgeted amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues				
Property taxes	\$ 2,659,612	\$ 2,769,431	\$ 2,781,528	\$ 12,096
Municipal license taxes	1,088,080	1,147,461	1,322,721	175,260
Intergovernmental	2,857,688	2,859,688	2,912,692	53,004
Fees, fines and charges for services	664,000	752,859	814,543	61,684
Interest	85,000	120,916	133,233	12,317
Other	80,000	113,525	116,691	3,166
Total revenues	7,434,380	7,763,880	8,081,407	317,527
Expenditures				
General government	3,624,710	4,114,973	4,172,199	(57,226)
Public works and sanitation	1,632,061	1,747,638	1,729,363	18,275
Public safety	634,903	617,830	611,989	5,841
Culture and recreation	481,742	449,872	444,225	5,647
Health	357,528	357,528	356,179	1,349
Welfare and community development	559,661	548,621	538,950	9,671
Education	17,900	17,704	17,104	600
Total expenditures	7,308,505	7,854,166	7,870,009	(15,843)
Excess (deficiency) of revenues over expenditures	125,875	(90,286)	211,398	301,684
Other financing sources (uses)				
Transfers out	(125,875)	(9,714)	(9,714)	-
Total other financing sources (uses)	(125,875)	(9,714)	(9,714)	-
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	-	(100,000)	201,684	301,684
Readjustment from prior year fund balance	-	100,000	-	(100,000)
	\$ -	\$ -	\$ 201,684	\$ 201,684

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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

June 30, 2005

NOTE A - BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

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

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

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

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

NOTE B - BUDGET TO GAAP RECONCILIATION

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

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

June 30, 2005

NOTE B - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ 201,684
Budget to GAAP differences:	
Entity differences:	
Non budgeted funds recorded as revenues for financial reporting purposes:	710,910
Non budgeted funds recorded as expenditures for financial reporting:	(1,207,802)
Non budgeted transfers out:	(289)
Basis of accounting differences:	
Revenues recorded for financial reporting purposes but not in budgetary basis:	42,246
Revenues recorded in budgetary basis but not for financial reporting purposes:	(127,272)
Expenditures recorded in budgetary basis but not for financial reporting purposes:	85,038
Expenditures recorded for financial reporting purposes but not in budgetary basis:	(63,230)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	233,020
Prior year encumbrances recorded as expenditures for financial reporting purposes:	(133,281)
Net change in fund balance (GAAP basis):	<u>\$ (258,975)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2005

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Entity Identifying Number (note C)	Federal Expenditures (note A)
<u>U.S. Department of Agriculture</u>			
Non-Mayor Programs:			
Direct Program:			
Rural Housing Preservation Grant	10.433	N/A	\$ 1,012
Passed through the P.R. Department of Education:			
Child and Adult Care Food Program	10.558	N/AV	7,743
Mayor Program:			
Direct Programs:			
Water and Waste Disposal System for Rural Communities	10.760	N/A	1,405,007
			<u>1,413,762</u>
<u>U.S. Department of Housing and Urban Development</u>			
Mayor Programs:			
Passed through the Office of Commissioner of Municipal Affairs:			
Community Development Block Grant - States's Program	14.228	FD - 30 AF - 30 AB - 30 CD - 30	\$ 902,468
Direct Program:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	495,953
			<u>1,398,421</u>
<u>U.S. Department of Transportation</u>			
Non-Mayor Program:			
Direct Program:			
Federal Transit Formula Grants	20.507	N/A	28,110
<u>U.S. Department of Health and Human Services</u>			
Non-Mayor Programs:			
Passed through the P.R. Department of Family - Families and Children Administration:			
Community Food Program	93.571	N/AV	6,251
Child Care and Development Block Grant	93.575	N/AV	188,337
			<u>194,588</u>
Total Expenditures of Federal Awards			<u>\$ 3,034,881</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2005

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments and Nonprofit Organizations". Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - FEDERAL CFDA NUMBER

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

NOTE C – PASS-THROUGH ENTITY IDENTIFYING NUMBER

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

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

<u>Description</u>	<u>Community Development Block Grant Fund</u>	<u>Rural Development - Lavadero Sanitary Sewer System Fund</u>	<u>Other Governmental Funds</u>
10.558	\$ -	\$ -	\$ 7,743
10.760	-	1,405,007	-
10.433	-	-	1,012
14.228	902,468	-	-
14.871	-	-	495,953
20.507	-	-	28,110
93.571	-	-	6,251
93.575	-	-	188,337
Total federal awards expenditures	<u>902,468</u>	<u>1,405,007</u>	<u>727,406</u>
Total nonfederal awards expenditures	<u>-</u>	<u>-</u>	<u>240,958</u>
Total expenditures, fund statements	<u>\$ 902,468</u>	<u>\$ 1,405,007</u>	<u>\$ 968,364</u>

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

P.O. Box 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

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

Mayor and Municipal Legislature
Municipality of Hormigueros
Hormigueros, Puerto Rico

We have audited the financial statements of the Municipality of Hormigueros as of and for the year ended June 30, 2005, and have issued our report thereon dated December 13, 2005, in which we have expressed an unqualified opinion. 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.

Compliance

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

In planning and performing our audit, we considered the Municipality of Hormigueros' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

This report is intended for the information of the Audit Committee, Management, Municipal Legislature and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in blue ink, appearing to read "Rosa, Garcia + Marin".

San Juan, Puerto Rico
December 13, 2005

Stamp 2109890 was affixed
to the original

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

P.O. BOX 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

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

Mayor and Municipal Legislature
Municipality of Hormigueros
Hormigueros, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Hormigueros 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, 2005. The Municipality of Hormigueros' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality of Hormigueros' Management. Our responsibility is to express an opinion on the Municipality of Hormigueros' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Municipality of Hormigueros' 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 on the Municipality of Hormigueros' compliance with those requirements.

In our opinion, the Municipality of Hormigueros 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, 2005.

We noted certain immaterial instances of noncompliance that we have reported to the Management of the Municipality of Hormigueros in a separate letter dated December 13, 2005.

Internal Control Over Compliance

The Management of the Municipality of Hormigueros is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality of Hormigueros' 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 and to test and report on internal control over compliance in accordance with OMB Circular A-133.

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

This report is intended for the information of the Audit Committee, Management, Municipal Legislature and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



San Juan, Puerto Rico
December 13, 2005

Stamp 2109891 was affixed
to the original

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Auditor's Results

Year ended June 30, 2005

Part I - Financial Statements

1. Type of auditor's report issued Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
2. Material weakness(es) identified? Yes No
3. Reportable condition(s) identified that are not considered to be material weakness? Yes No
4. Noncompliance material to financial statements noted? Yes No

Part II - Federal Awards

Internal control over major programs:

1. Material weakness(es) identified? Yes No
2. Reportable condition(s) identified that are not considered to be material weakness(es)? Yes No
3. Type of auditor's report issued on compliance for major programs: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
4. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? Yes No

5. Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
14.228	Community Development Block Grant - State's Program
14.871	Section 8 Housing Choice Vouchers Program
10.760	Water and Waste Disposal for Rural Communities

6. Dollar threshold used to distinguish between type A and type B programs: \$300,000
7. Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

Section II – Financial Statements Findings

Finding No matters were reported.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

RECIBO DEL COMISIONADO
MUNICIPAL DE

06 JAN 13 AM 8:21

Section III – Federal Award Findings and Questioned Costs

RECIBIDO
UNIDAD DE CORREO

Finding No matters were reported.