

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE HORMIGUEROS

AUDITORIA 2006-2007

30 DE JUNIO DE 2007



**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, 2007

COMISIONADO MUNICIPAL
AM 9:47
UNIDAD DE CORREO

Hon. Pedro J. García-Figueroa
Mayor

Mrs. Marinelda Acosta
Finance Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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FINANCIAL SECTION

VALDES, GARCIA, MARIN & MARTINEZ, LLP

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, 2007, 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 misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Hormigueros, as of June 30, 2007, 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 21, 2007 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The Management Discussion and Analysis on *pages 3 through 13* and the Budgetary Comparison Schedule – General Fund on *page 49*, are not a 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.

A handwritten signature in black ink, appearing to read "R. A. Garcia, CPA". The signature is written in a cursive style and is positioned to the right of the typed name.

San Juan, Puerto Rico
December 21, 2007

Stamp 2295904 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, 2007

The following discussion and analysis of the Municipality of Hormigueros' financial performance will provide an overview of the Municipality's financial activities for the fiscal year ended June 30, 2007. We encourage readers to consider the information presented here in conjunction with the Municipality's financial statements, which follows 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 2006-2007 by \$31,362,703 (net assets). This represents an increase of 12% with respect to year 2005-2006.
- Revenues and expenses increased by 16% and 11% respectively in comparison with the previous year.
- The change in net assets increased 46% compared to the change in net assets of year 2005-2006 (as restated).

Highlights for Fund Financial Statements

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

- At June 30, 2007, a net change of (\$215,317) in the fund balances of the Municipality's governmental funds resulted in reported combined ending fund balances of \$7,996,478. Approximately 39% of the total combined fund balances is unreserved.
- Total fund balance of the general fund decreased by 19% and the unreserved fund balance decreased 22% in comparison to fiscal year 2005-2006.

General Financial Highlights

- The investment in capital assets as of June 30, 2007 was \$35,786,270 (net of depreciation).
- Long term debt increased to \$14,213,664; approximately .97% with respect to the prior year.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$1,125,167.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

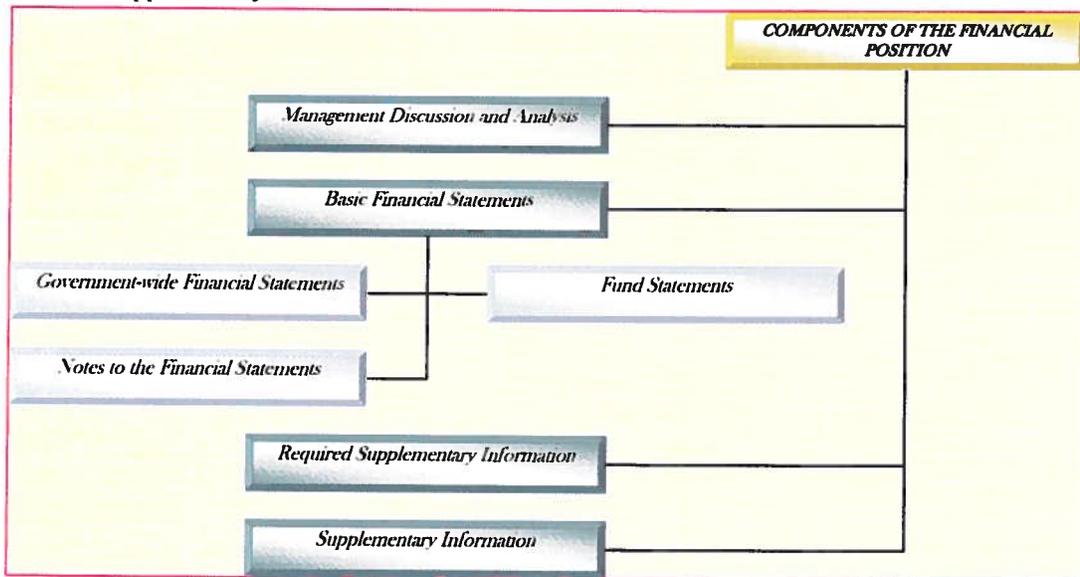
MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's financial report comprises four components:

- management discussion and analysis (presented here)
- basic financial statements
- required supplementary information
- 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 capital assets may need to be considered to assess the overall health of the Municipality. The second statement – the statement of activities – presents information showing how the net assets changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

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, 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 as 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 comply with a minimum criterion (percentage of the assets, liabilities, revenues or expenditures). Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

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

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

➤ ***Required supplementary information***

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

➤ ***Supplementary information***

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

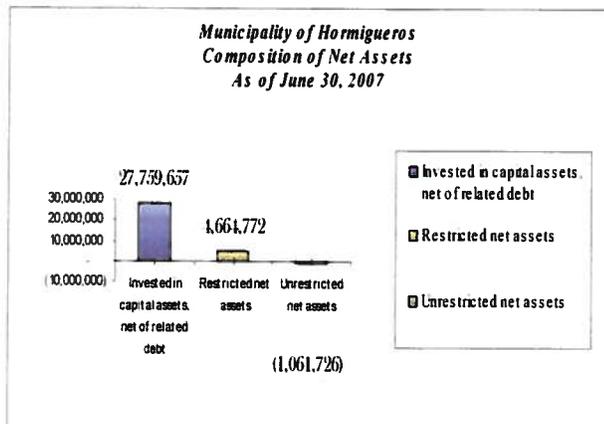
Net Assets

The following table presents a summary of the Statement of Net Assets as of June 30, 2007 and 2006:

TABLE 1

<i>Summary Statement of Net Assets As of June 30,</i>		
	Governmental Activities	
	2007	2006 (as restated)
Assets		
Current and other assets	\$12,616,273	\$ 12,763,211
Capital assets	35,786,270	32,639,836
Total assets	<u>\$ 48,402,543</u>	<u>\$ 45,403,047</u>
Liabilities		
Current and other liabilities	\$ 2,826,177	\$ 3,397,006
Long term liabilities	14,213,664	14,076,704
Total liabilities	<u>17,039,840</u>	<u>17,473,710</u>
Net assets		
Invested in capital assets, net of related debt	27,759,657	25,376,741
Restricted	4,664,772	3,262,434
Unrestricted	(1,061,726)	(709,838)
Total net assets	<u>\$ 31,362,703</u>	<u>\$ 27,929,337</u>

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 \$31,362,703, representing an increase of 12% with respect to fiscal year ended 2006. The largest portion of the Municipality's net assets reflect 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.



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, 2007

As of June 30 2007, the Municipality presented an unrestricted net assets deficit. This deficit primarily arises from long-term obligations such as compensated absences and debts to CRIM for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a "pay as you go" basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as invested in capital assets, net of the related debt section of net assets. Therefore, they are reported as part of the unrestricted net assets section.

Changes in net assets

The following table summarizes the changes in net assets for the fiscal years ended 2007 and 2006:

TABLE 2

<i>Summary of Changes in Net Assets As of June 30,</i>			
	Governmental Activities		
	2007	2006 (as restated)	
Program revenues:			
Fees, fines and charges for services	\$ 842,990	\$ 1,359,577	
Operating grants and contributions	1,149,885	1,298,856	
Capital grants and contributions	3,968,124	2,612,708	
General revenues:			
Property taxes	3,270,654	3,202,988	
Municipal license taxes	1,472,030	1,615,652	
Sales and uses taxes	1,587,192	-	
Grants and contributions not restricted to specific programs	4,391,662	4,133,740	
Interest	509,837	372,854	
Other	106,554	273,236	
Total revenues	17,298,931	14,869,611	
Expenses:			
General government	5,844,519	4,860,790	
Public works and sanitation	3,326,409	3,188,456	
Public safety	835,494	718,048	
Culture and recreation	1,183,301	1,069,543	
Health	362,325	356,525	
Housing, welfare and community development	1,697,149	1,723,825	
Education	29,888	22,237	
Interest on long term debt	586,479	579,753	
Total expenses	13,865,563	12,519,177	
Change in net assets	3,433,367	2,350,437	
Net assets-beginning of year	27,929,337	25,578,900	
Net assets-end of year	\$ 31,362,704	\$ 27,929,337	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

FIGURE 1

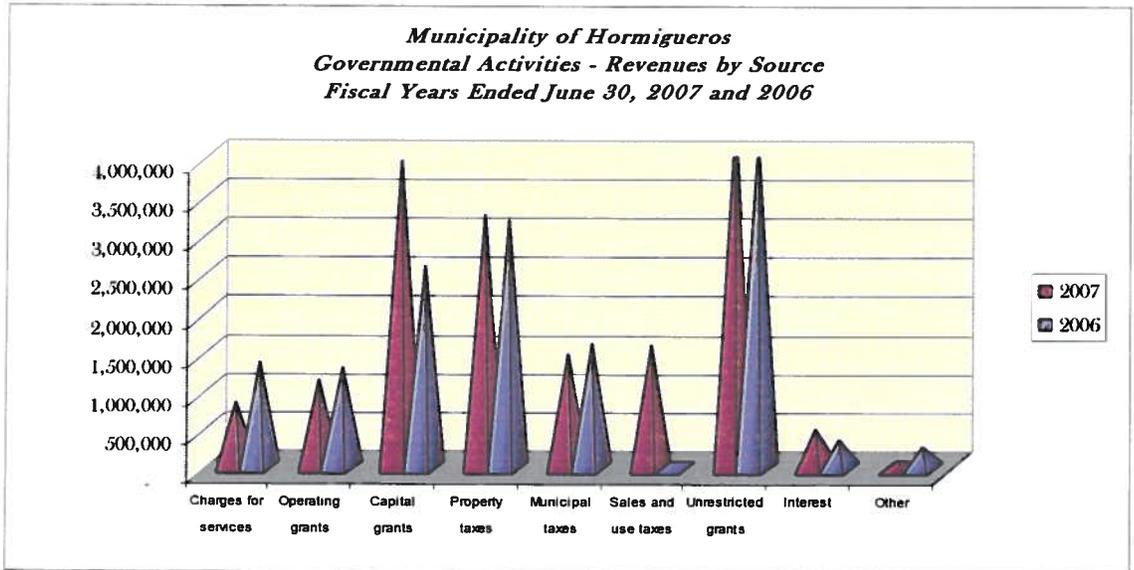
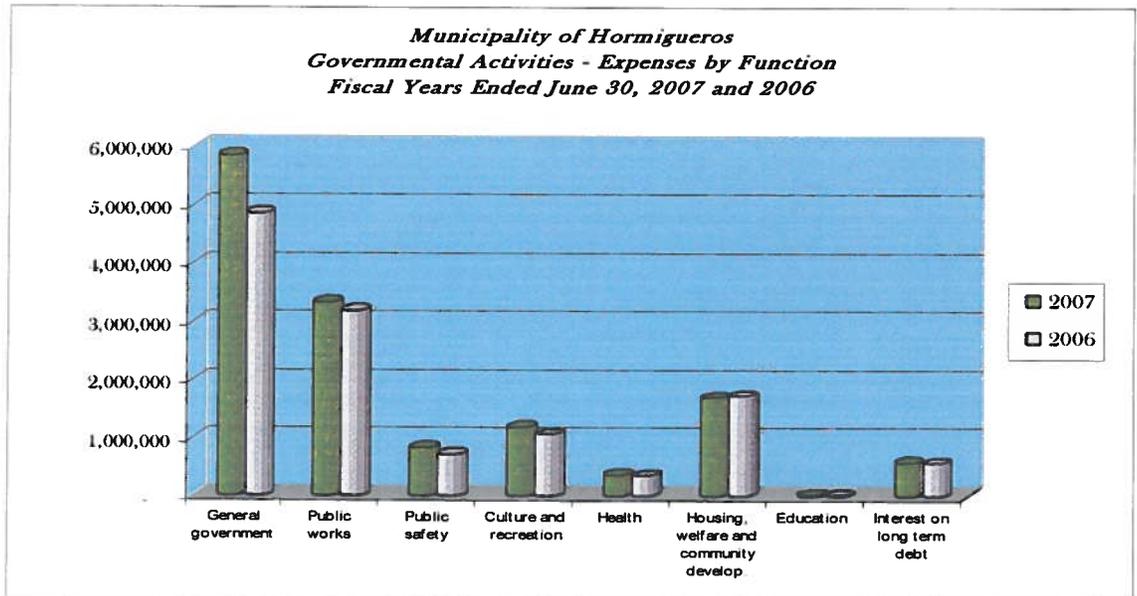


FIGURE 2



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

Approximately 30% of the Municipality's revenues came from operating and capital grants, 25% from grants and contributions not restricted to specific programs and 19% from property taxes. Revenues increased by 16% in comparison with fiscal year ended 2006. This net increase is mostly affected by the recognition of the new revenue source sales and use taxes which amounted to \$1,587,192, and a combination of the following: (1) a 52% increase in capital grants mostly due to an increase in revenues resulting primarily from a surplus of the proceeds of the \$575,000,000 Series A Public Improvements Bonds issued by the Commonwealth Government, (2) a 37% increase in interest revenue mostly from certificates of deposits, (3) a 38% decrease in fees, fines and charges for services due to a decrease in construction taxes collected, and (4) a 61% decrease in other revenues due to non-recurrent revenues received from the Puerto Rico Water and Sewer Authority for capital improvements in prior years.

The Municipality's expenses cover a range of services. The largest expenses are general government representing approximately 42%, public works and sanitation with 24%, welfare with 12% and culture and recreation with 9%. Program revenues of the Municipality covered 43% of total expenses.

Expenses increased 11% in comparison with the previous year. This includes an increase of 20% in general government (due to irregular employees salaries, Christmas bonus, and contribution to retired employees benefits), an increase of 16% in public safety (due to Homeland Security and Crime Prevention programs implementation), and an increase of 11% in culture and recreation (due to activities celebrated for the community).

As noted previously, the increase in revenues combined with an increase in expenses caused the net change in net assets to increase approximately 46% compared with net change in net assets reported in the fiscal year 2006 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	
	2007	2006 (as restated)	2007	2006 (as restated)
General government	\$ 5,844,519	\$ 4,860,790	\$ 4,649,361	\$ 2,985,470
Public works and sanitation	3,326,409	3,188,456	(316,334)	978,142
Public safety	835,494	718,048	738,227	711,805
Culture and recreation	1,183,301	1,069,543	1,161,311	1,057,388
Housing, welfare and community development	1,697,149	1,723,825	693,308	556,716
Other	978,692	958,515	978,692	958,515
	<u>\$ 13,865,563</u>	<u>\$ 12,519,176</u>	<u>\$ 7,904,564</u>	<u>\$ 7,248,035</u>

Some of the cost of governmental activities was paid by those who directly benefited from the programs (\$842,990) and other governments and organizations that subsidized certain programs with grants and contributions (\$5,118,009). The \$7,904,564 net cost of services was fully covered by other general revenues including property, municipal license, and sales and use taxes.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

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, the 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, 2007, the governmental funds reported combined ending fund balances of \$7,996,478, a net decrease of \$215,347 in comparison with the prior year. This net decrease was caused primarily by an decrease in the General Fund of (\$950,182), and a increase of \$1,092,443 in Commonwealth Legislature Resolutions Fund due to the use in the current year of funds provided in previous years. Of the total combined fund balances, \$3,149,623 (39%) constitutes unreserved fund balance. The remainder of the 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 39% of total combined ending fund balance. For the year ended June 30, 2007, the fund balance of the general fund decreased by (\$950,182). The key factors of this change is a new source of revenue from sales and use taxes combined with a decrease of 57% in construction permits and a 24% increase in general government expenses with respect to the fiscal year 2006. In addition, this result includes the net effect of a fund balance readjustment of \$1,957,569 of current year budget with prior year's fund balance resources, approved by the Municipal Legislature.

General fund budgetary highlights

The general fund original budget for the fiscal year 2006-2007 presented an increase of 6% with respect to prior year budget due to an increase in the estimated amount of license taxes, compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA) and sales and use taxes.

Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year budget revenues were increased by \$1,068,247 mostly due to additional collections for sales and use taxes, interest and other revenues. An amendment to budget expenditures of \$1,957,569 was approved, representing a readjustment of current year budget with prior year's budgetary surpluses. Actual revenues exceeded the revised budgeted revenues by \$688,480. The most significant variances were \$520,572 in sales and use taxes, \$89,152 from intergovernmental subsidies, and \$41,843 in interest (due to higher interest rates from certificates of deposit). The Municipality reported a positive variance of \$143,914 between revised budgeted appropriations and actual expenditures but ended with a total net negative variance of (\$1,125,167).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital assets

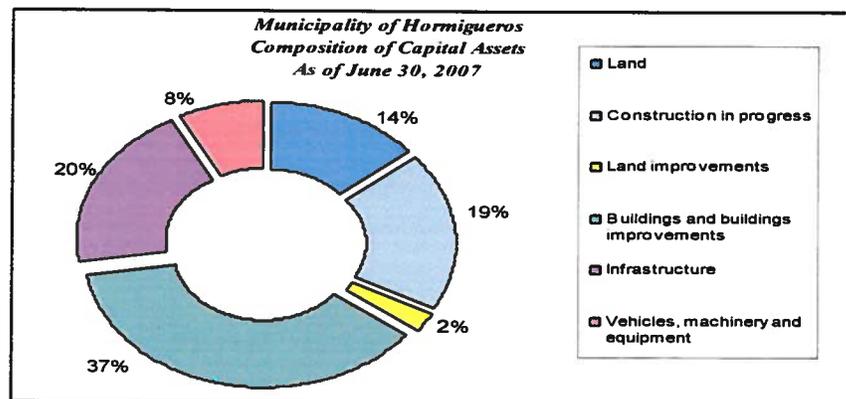
At the end of the fiscal year, the Municipality had invested \$35,786,270 in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of 10% over the prior year.

TABLE 4

<i>Capital Assets As of June 30,</i>		
	Governmental Activities	
	2007	2006
Non-depreciable assets:		
Land	\$ 5,013,333	\$ 3,956,471
Construction in progress	6,858,398	5,587,053
Depreciable assets:		
Land improvements	765,728	801,731
Buildings and buildings improvements	13,243,920	11,955,313
Infrastructure	7,168,497	7,667,115
Vehicles, machinery and equipment	2,736,394	2,672,153
Total	\$ 35,786,270	\$ 32,639,836

Certain projects are still in construction in progress as of June 30, 2007. The most significant of these projects are the construction of "Lavadero Sanitary Sewer System", the construction of the future Elderly Services Center, the construction of the Julio Rivera Urban Park and the construction of Lavadero's Multiuse Center, with reported costs of \$3,538,950, \$249,309, \$2,251,860, and \$315,793, respectively.

Figure 3



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

The Municipality's fiscal year 2007-2008 capital budget calls for a significant amount of new and continuous projects including the construction of an Elderly Services Center in the Verdum area for an approximate investment of \$1,325,000, which is being financed through grants from CDBG, Commonwealth Legislature Resolutions and Citizen Participation Funds. Another project that will be continued in this fiscal year is the construction of the Lavadero Multiple Purpose Center, with an estimated cost of \$1,129,381. "Lavadero de Oro" is a significant project that is on schedule for this fiscal year that is composed of eight housing buildings of social interest requiring an investment of \$6,000,000. This project will be realized with funds granted by the Puerto Rico Department of Housing.

Other projects that will be developed in the next fiscal year are the remodeling of Valle Hermoso Norte and Valle Hermoso Sur community centers, remodeling of the Verdum and Estancias del Rio basketball courts, the rehabilitation of the sport complex of Valle Hermoso Sur, the construction of a recreational park for kids, the construction of an electronic library, the construction of a Taekwondo and Gymnastics' Pavilion, and the construction of the Fine Arts School. All of these projects will be financed with other Commonwealth and 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 Note F to the financial statements.

Long term debt

At year-end, the Municipality had \$ 10,370,252 in general and special bonds and notes; an increase of 14% with respect to the prior year. This increase was due to the addition of two bonds' issuances during the current year.

TABLE 5

<i>Outstanding Long-term Debt</i>		
<i>Fiscal years ended June 30,</i>		
	Governmental Activities	
	2007	2006
General and special obligation bonds and notes	\$ 10,370,252	\$ 10,087,949
Compensated absences	1,182,701	1,110,183
Claims and judgments	7,500	30,000
Payable to CRIM – prior years doubtful accounts	4,984	7,025
Note payable-Puerto Rico Treasury Department	1,039,490	1,203,226
Christmas bonus payable	194,067	152,741
Payable to CRIM - LIMS	136,442	162,176
Estimated landfill closing costs	1,100,400	1,063,099
Note payable to FEMA	177,828	260,305
Total	\$ 14,213,664	\$ 14,076,704

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2007

The Municipality reported a decrease in the other long term debts of \$145,343. This decrease was primarily due to payments applied to the note payable with Puerto Rico Treasury Department, and FEMA. More detailed information about the Municipality's long term liabilities is presented in Note H to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's officials considered certain factors when setting the fiscal year 2007-2008 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 10.7% which compares with the Commonwealth rate of 11.9%.

For fiscal year 2006-2007 the Municipality applied a conservative approach in developing budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2008 are \$9,481,311, representing an increase of approximately 9% with respect to the prior year estimate. Budgeted expenditures are expected to rise according 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 2008 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, 2007**

ASSETS	Governmental Activities
Cash and cash equivalents	\$ 4,846,182
Receivables, net (note C):	
Municipal license taxes	183,314
Sales and use taxes	149,598
Lease	382,643
Other	4,674
Due from (note D):	
Commonwealth Government	994,002
Federal Government	545,472
Restricted assets:	
Cash and cash equivalents	3,319,641
Cash with fiscal agents	2,112,875
Deferred bond issuance costs	77,872
Capital assets (note F):	
Land and construction in progress	11,871,731
Other capital assets, net	23,914,539
Total capital assets, net	<u>35,786,270</u>
Total assets	<u>\$ 48,402,543</u>
LIABILITIES	
Accounts payable and accrued liabilities	\$ 1,268,691
Interest payable	260,007
Due to:	
Commonwealth Government	14,906
Deferred revenues:	
Municipal license taxes	1,256,037
Federal grants	26,535
Long term liabilities (note H):	
Due within one year	1,250,999
Due in more than one year	12,962,665
Total liabilities	<u>17,039,840</u>
NET ASSETS	
Invested in capital assets, net of related debt	27,759,657
Restricted for:	
Capital projects	3,073,883
Debt service	1,477,188
Other purposes	113,701
Unrestricted (deficit)	(1,061,726)
Total net assets	<u>\$ 31,362,703</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2007

	Major Funds							Total Governmental Funds
	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Lavadero Sanitary Sewer System	Recreational Facilities (AFI)	Other Governmental Funds	
Assets								
Cash and cash equivalents	\$ 4,846,182	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,846,182
Receivables, net (note C):								
Municipal license taxes	183,314	-	-	-	-	-	-	183,314
Sales and use taxes	149,598	-	-	-	-	-	-	149,598
Lease	382,643	-	-	-	-	-	-	382,643
Other	-	-	-	-	-	-	4,674	4,674
Due from:								
Commonwealth Government (note D)	568,399	-	81,875	25,371	-	250,000	68,357	994,002
Federal Government (note D)	-	118,040	-	-	334,243	-	93,189	545,472
Other funds (note E)	489,118	-	-	-	-	-	3,510	492,628
Restricted assets:								
Cash and cash equivalents	-	1,571	2,532,576	-	230,180	-	555,314	3,319,641
Cash with fiscal agents	-	-	-	1,726,097	-	-	386,778	2,112,875
Total assets	\$ 6,619,254	\$ 119,611	\$ 2,614,451	\$ 1,751,468	\$ 564,423	\$ 250,000	\$ 1,111,822	\$ 13,031,029
Liabilities and fund balances								
Liabilities:								
Accounts payable and accrued liabilities	\$ 484,820	\$ 87,221	\$ 42,489	\$ -	\$ 358,856	\$ 2,763	\$ 292,542	\$ 1,268,691
Matured bonds and interest payable	-	-	-	397,110	-	-	-	397,110
Due to:								
Commonwealth Government	14,906	-	-	-	-	-	-	14,906
Other funds (Note E)	-	30,951	38,015	14,950	-	247,237	161,475	492,628
Deferred revenues (notes C and G):								
Municipal license taxes	1,256,037	-	-	-	-	-	-	1,256,037
Lease	382,643	-	-	-	-	-	-	382,643
Intergovernmental-Commonwealth Government	534,958	-	54,860	-	-	250,000	-	839,818
Federal grants	-	31,234	-	-	264,881	-	86,603	382,718
Total liabilities	2,673,364	149,406	135,364	412,060	623,737	500,000	540,620	5,034,551
Fund balances (deficits):								
Reserved for:								
Encumbrances	784,939	-	-	-	-	-	-	784,939
Debt service	-	-	-	1,339,408	-	-	-	1,339,408
Capital projects	11,328	(29,795)	2,479,087	-	(59,314)	(250,000)	519,008	2,670,314
Other specified purposes	-	-	-	-	-	-	52,194	52,194
Unreserved	3,149,623	-	-	-	-	-	-	3,149,623
Total fund balances (deficits)	3,945,890	(29,795)	2,479,087	1,339,408	(59,314)	(250,000)	571,202	7,996,478
Total liabilities and fund balances (deficits)	\$ 6,619,254	\$ 119,611	\$ 2,614,451	\$ 1,751,468	\$ 564,423	\$ 250,000	\$ 1,111,822	\$ 13,031,029

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, 2007**

Total governmental fund balances:		\$ 7,996,478
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:		35,786,270
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:		
Deferred charges - bond issuance costs		77,872
Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:		
Receivable:		
Lease agreement	\$ 382,643	
Due from Commonwealth Government:		
P.R. Infrastructure Financing Authority - recreational facilities	250,000	
P.R. Department of Treasury - Christmas bonus reimbursement	186,963	
CRIM - Property taxes (General Fund)	152,733	
P.R. Department of Labor - Law No. 52	150,596	
Commonwealth Legislature Resolutions	54,860	
P.R. Department of Labor - Law No. 82	23,833	
P.R. Department of Treasury - other	20,833	
Due from Federal Government:		
Rural Development	264,881	
HSGP	61,506	
CDBG	29,795	
	1,578,643	
Interest liabilities are not due and payable in the current period and therefore are not reported in funds		(112,897)
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	10,120,251	
Note payable to CRIM-LIMS	136,442	
Note payable to CRIM-financing of delinquent accounts	4,984	
Note payable to P.R. Department of Treasury	1,039,490	
Note payable to FEMA	177,828	
Compensated absences	1,182,701	
Christmas bonus payable	194,067	
Judgments and legal claims	7,500	
Estimated landfill closing costs	1,100,400	
	(13,963,663)	
Net assets of governmental activities:		<u>\$ 31,362,703</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORNIGUEROS

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES-
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2007

	Major Funds							Total Governmental Funds
	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Lavadero Sanitary System	Recreational Facilities (RFI)	Other Governmental Funds	
Revenues:								
Taxes:								
Property taxes (note J)	\$ 1,901,006	-	-	\$ 1,230,734	-	-	\$ -	\$ 3,131,740
Municipal license taxes (note C)	1,472,030	-	-	-	-	-	-	1,472,030
Sales and use taxes (note C)	1,587,192	-	-	-	-	-	-	1,587,192
Intergovernmental								
Commonwealth government (note K)	4,635,812	-	1,803,262	-	40,000	-	783,512	7,262,586
Federal government	-	753,348	-	-	311,798	-	703,299	1,768,445
Fees, fines and charges for services	776,077	-	-	-	-	-	21,778	797,855
Interest	431,714	-	7,372	49,925	-	-	30,836	509,837
Other	55,522	-	-	-	-	-	16,314	71,836
Total Revenues	10,849,353	753,348	1,810,634	1,280,659	351,798	-	1,555,729	16,601,521
Expenditures								
Current:								
General government	5,815,870	121,734	4,200	14,950	-	-	87,295	6,044,049
Public works and sanitation	2,421,568	27,831	99,422	-	-	-	27,240	2,576,061
Public safety	658,848	-	-	-	-	-	81,579	740,427
Culture and recreation	734,617	-	-	-	-	-	-	734,617
Health	356,890	-	-	-	-	-	-	356,890
Housing, welfare and community development	535,630	293,006	458	-	-	-	737,200	1,566,294
Education	18,771	-	-	-	-	-	-	18,771
Capital outlays	1,185,876	340,572	646,428	-	472,357	250,000	1,816,710	4,711,943
Debt service:								
Principal	-	-	-	-	-	-	-	-
Interest	-	-	-	461,000	-	-	-	461,000
Bond issuance costs	-	-	-	511,980	-	-	-	511,980
Total expenditures	11,728,070	783,143	750,508	987,930	472,357	250,000	4,642	17,726,674
Excess (deficiency) of revenues over expenditures	(878,717)	(29,795)	1,060,126	292,729	(120,559)	(250,000)	(1,198,937)	(1,125,153)
Other financing sources (uses):								
Lease principal payments (note C)	69,806	-	-	-	-	-	-	69,806
Proceeds from general obligation bonds	74,938	-	51,321	211,298	-	-	840,000	1,127,567
Transfers in	(216,209)	-	(19,004)	(35,944)	-	-	75,912	(413,469)
Transfers out	(71,465)	-	32,317	175,354	-	-	(142,312)	(413,469)
Total other financing sources (uses)	(66,820)	-	32,317	175,354	-	-	773,600	909,806
Net change in fund balances	(910,182)	(29,795)	1,092,443	468,083	(120,559)	(250,000)	(425,337)	(125,347)
Fund balances at beginning of year, as restated (note L)	4,896,072	-	1,386,644	871,325	61,245	-	996,539	8,211,825
Fund balances at end of year	\$ 3,945,890	\$ (29,795)	\$ 2,479,087	\$ 1,339,408	\$ (59,314)	\$ (250,000)	\$ 571,202	\$ 7,996,478

Handwritten notes:
 11/19/07
 626484
 02/26/08
 03/04/08
 Dr. Alvarez

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, 2007

Net change in fund balances-total governmental funds:		\$ (215,347)
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	\$ 4,711,943	
Less: current year depreciation	<u>(1,541,228)</u>	3,170,715
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:		
		(24,284)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
Intergovernmental - Commonwealth Government:		
CRIM - Property taxes (General Fund - current)	152,733	
P.R. Department of Treasury - Christmas bonus reimbursement (current)	186,963	
P.R. Department of Labor - Law No. 52	150,596	
P.R. Department of Labor - Law No. 82	23,833	
P.R. Infrastructure Financing Authority - recreational facilities	250,000	
Commonwealth Legislature Resolutions	54,860	
Intergovernmental - Federal Government:		
HSGP	61,507	
CDBG	29,795	
Rural Development	<u>6,123</u>	916,410
Revenues reported in funds which are not reported as revenues in the Statement of Activities		
P.R. Department of Treasury - Christmas bonus reimbursement (prior year)	(83,058)	
CRIM - Property taxes (General Fund - prior year)	(59,620)	
Federal Grants - HSGP	(6,242)	
Capital lease principal payment	<u>(35,090)</u>	(184,010)
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:		
		(840,000)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		(97,000)
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	557,697	
Other Long Term Liabilities	<u>611,641</u>	1,169,339
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	4,642	
Amortization of deferred charges	<u>(5,177)</u>	(535)
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	(194,067)	
Judgment and claims	(7,500)	
Estimated Landfill Closing Costs	(37,301)	
Compensated Absences	(227,430)	
Accrued interest (net change)	<u>4,378</u>	(461,920)
Change in net assets of governmental activities:		<u>\$ 3,433,367</u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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 exists between the primary government and the potential component unit.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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 the analysis the private sector provides in their annual reports.

Basic financial statements

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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 and sales and use taxes (derived tax revenues) when the underlying exchange has occurred. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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, Recreational Facilities Fund (AFI), Lavadero Sanitary Sewer Fund 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.

Lavadero Sanitary Sewer System 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.

Recreational Facilities Fund (AFI): This fund accounts for revenue sources from a grant provided by the P.R. Infrastructure Financing Authority for specific purposes, that is, the construction of recreational facilities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Governmental funds are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method of accounting, revenues are recognized when they are susceptible to accrual (i.e. both measurable and available). Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

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

The Municipality reports 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, 2007

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, a reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

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 the 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, 2007

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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.

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

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, 2007

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's grants to be used to finance activities other than construction or capital improvement commitments

a. 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.

12. *Interfund transactions*

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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 deducted monthly from advances of property tax and amounts of municipal equalization funds sent 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:

<u>Statement</u>	<u>To be Adopted in Fiscal year ended,</u>
43 Financial Reporting for Post employment Benefits Plans Other Than Pension Plans	June 30, 2008
45 Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions	June 30, 2009
48 Sales and Pledges of Receivables and Future Revenues and Intra-entity Transfers of Assets and Future Revenues	June 30, 2008
49 Accounting and Financial Reporting for Pollution Remediation Obligations	June 30, 2009
50 Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27	June 30, 2008
51 Accounting and Financial Reporting for Intangible Assets	June 30, 2010

The impact of these statements on the Municipality's financial statements has not yet been determined.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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 amounted to \$8,200,175.

Deposits in governmental banks (all of which are uninsured and uncollateralized), are exposed to custodial credit risk. At year-end the Municipality's bank balance in governmental banks amounted to \$2,112,876.

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, 2007 the tax rates were as follows:

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

Municipal license taxes receivable and corresponding deferred revenues as of June 30, 2007 follows:

	Municipal License Tax receivable	Deferred Revenue
Prior years receivable balance	\$ 1,473	\$ -
Taxes collected in advance as of June 30	-	1,074,196
Taxes receivables on tax returns filed but not collected as of June 30	518,705	518,705
Less: allowance for uncollectible	(336,864)	(336,864)
	\$ 183,314	\$ 1,256,037

As required by current standards, the Municipality recognizes assets related to municipal license taxes when cash is received or in the period when the exchange transaction on which the government imposes the tax occurs. Management understands that as of tax return filing date an enforceable legal claim arises against the provider of resources. Therefore, an asset (receivable) is recognized as of June 30 for the balance on tax returns filed but not paid at that date.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE C - RECEIVABLES – Continued

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Resources are intended to finance the operations of the applicable fiscal year. At this moment the Municipality recognizes revenues on municipal license taxes. A discount of 5% is allowed when full payment is made on or before April 15. Since this time requirement, cash collected and the receivable balance on tax returns filed but not collected are recorded as deferred revenues as of June 30.

2. Sales and use taxes

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

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

The Municipal Legislature approved the imposition of the municipal sales and use tax on November 1, 2006 with Ordinance No. 22 Series 2006-2007, effective on November 15, 2006. Municipalities were authorized to implement municipal sales and use tax of 1% starting on July 1, 2006 and the Municipality has already done so, as approved by the Municipal Legislature. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. Tax is due each 20th day of each month based on tax collected in the preceding month. The Municipal Ordinance does not impose specific restrictions or limitations on the use of the municipal sales and use tax resources. Resources are part of the general fund of the Municipality.

Municipal sales and use taxes receivable of \$149,598 represents the tax collected on June by individuals, organizations and entities but reported and paid to the Municipality on or before July 20, net of uncollectible accounts.

3. 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:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE C - RECEIVABLES – Continued

	Amount
Total minimum lease payments to be received	\$ 520,372
Less: Unearned income	-137,729
Net investment in direct financing lease	\$ 382,643

At June 30, 2007, minimum lease payments for each of the five succeeding fiscal years are as follows:

Year	Amount
2008	\$ 76,152
2009	76,152
2010	76,152
2011	76,152
2012	76,152
2013-2014	139,612
	\$ 520,372

The net investment in direct financing lease in the amount of \$382,643 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

Amounts due from governmental entities as of June 30, 2007 follows:

	Commonwealth Government	Federal Government
P.R. Infrastructure Financing Administration	\$ 250,000	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	186,963	-
P.R. Department of Labor – Law No. 52	153,087	-
Municipal Revenue Collection Center (CRIM) - property taxes (general fund)	152,733	-
Commonwealth Legislature Resolutions	81,875	-
Municipal Revenue Collection Center (CRIM) - property taxes (debt service fund)	25,371	-
Rural Development (RD) – Lavadero Sanitary Sewer	-	334,243
Office of Commissioner of Municipal Affairs - CDBG	-	118,040
US Department of Homeland Security	-	61,507
Others	143,973	31,682
	\$ 994,002	\$ 545,472

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE D - DUE FROM GOVERNMENTAL ENTITIES - Continued

Certain of these accounts are recorded as deferred revenues in the governmental funds statements since they are not available as required by current standards. See related note G.

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	\$ 30,951
	Major Fund - Debt Service fund	14,950
	Major Fund - Commonwealth	
	Legislature Resolutions Fund	38,015
	Major Fund - Recreational Facilities (AFI) Fund	247,237
	Other governmental funds	157,965
Other Governmental Funds	Other	3,510
Total:		\$ 492,628

2. Transfers in (out)

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; and principal and interest payments of general long term debt transferred from the general fund to the debt service fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE F - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2007 is as follows:

	<u>Balance July 1, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2007</u>
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 3,956,471	\$ 1,056,862	\$ -	\$ 5,013,333
Construction in progress	5,587,053	2,850,413	1,579,068	6,858,398
Total capital assets not being depreciated:	9,543,524	3,907,275	1,579,068	11,871,731
Capital assets, being depreciated:				
Land improvements	1,046,506	-	-	1,046,506
Buildings and building improvements	17,568,119	1,818,459	-	19,386,578
Infrastructure	10,940,042	67,894	32,174	10,975,762
Vehicles, machinery and equipment	6,289,735	497,386	55,936	6,731,185
Total capital assets being depreciated	35,844,402	2,383,739	88,110	38,140,031
Less accumulated depreciation for:				
Land improvements	244,775	36,003	-	280,778
Buildings and building improvements	5,612,804	529,852	-	6,142,656
Infrastructure	3,272,929	555,838	21,500	3,807,267
Vehicles, machinery and equipment	3,617,582	419,535	42,326	3,994,791
Total accumulated depreciation	12,748,090	1,541,228	63,826	14,225,492
Total capital assets being depreciated, net	23,096,312	842,511	24,284	23,914,539
Governmental activities capital assets, net	<u>\$ 32,639,836</u>	<u>\$ 4,749,786</u>	<u>\$ 1,603,352</u>	<u>\$ 35,786,270</u>

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

Governmental activities:

General government	\$ 137,021
Public works and sanitation	713,049
Public safety	95,066
Culture and recreation	448,685
Health	5,435
Welfare and community development	130,855
Education	11,117
Total depreciation expense, governmental activities	<u>\$ 1,541,228</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE G - DEFERRED REVENUES – Commonwealth Government and Federal Grants

Deferred revenues represent revenues not available as required by current standards or resources received before allowable expenditures are incurred. A detail of these balances as recorded in the fund statements follows:

	Commonwealth Government	Federal Grants
Major fund - general fund:		
Municipal Revenue Collection Center (CRIM)		
- property taxes	\$ 152,733	\$ -
P.R. Department of Treasury - Christmas bonus reimbursement	186,963	-
P.R. Department of Treasury - other	20,833	-
Major Fund - Commonwealth Legislative Resolutions	54,860	-
Major Fund - Recreational Facilities (AFI)	250,000	-
Major Fund – Rural Development, Lavadero Sanitary Sewer	-	264,881
Major Fund - CDBG	-	31,234
Other Governmental Funds:		
Homeland Security Grant Program	-	61,507
P.R. Department of Labor – Law No. 52	150,596	-
P.R. Department of Labor – Law No. 82	23,833	-
Others	-	25,096
	\$ 839,818	\$ 382,718

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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, 2007:

	<u>Balance at July 1, 2006,</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2007</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 10,087,949	\$ 840,000	\$ 557,697	\$ 10,370,252	\$ 471,000
Note payable to CRIM- LIMS	162,176	-	25,734	136,442	27,288
Note payable to CRIM- financing of delinquent accounts	7,025	-	2,041	4,984	199
Note payable to Puerto Rico Treasury Department	1,203,226	-	163,736	1,039,490	313,661
Note payable to FEMA	260,305	-	82,477	177,828	86,696
Compensated absences	1,110,183	227,430	154,912	1,182,701	150,588
Christmas Bonus	152,741	194,067	152,741	194,067	194,067
Judgments and legal claims	30,000	7,500	30,000	7,500	7,500
Estimated Landfill Closing Costs	1,063,099	37,301	-	1,100,400	-
	<u>\$ 14,076,704</u>	<u>\$ 1,306,298</u>	<u>\$ 1,169,338</u>	<u>\$ 14,213,664</u>	<u>\$ 1,250,999</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2007 amount to \$10,370,252. 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 sent 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, 2007 follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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% (7.51% at June 30, 2007)	\$ 20,000
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%	83,000
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%	111,000
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% (5.62% at June 30, 2007)	125,000
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%	17,000
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% (6.05 % at June 30, 2007)	310,000
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% (3.54% at June 30, 2007)	355,000
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% (3.54% at June 30, 2007)	385,000
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%	627,000
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%	795,000
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%	956,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE H – LONG-TERM DEBT – Continued

	<u>Outstanding Amount</u>
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%	925,000
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%	1,206,000
1992 revenue bonds of \$690,000 due in annual installments of \$5,000 to \$25,000 through July 1, 2013; bearing interest at 9%	280,000
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% (4.17% at June 30, 2007)	500,000
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% (4.17% at June 30, 2007)	1,285,000
2005 special obligation note of \$748,000 due in annual installments of \$92,000 to 124,000 through July 1, 2012; bearing interest at rates ranging from 5.00% to 7.50% (6.60% at June 30, 2007)	656,000
2006 general obligation bonds of \$920,000 due in annual installments of \$20,000 to 70,000 through July 1, 2030; bearing interest at rates ranging from 4.17% to 5.31% (4.17% at June 30, 2007)	900,000
2007 general obligation bonds of \$840,000 due in annual installments of \$10,000 to 75,000 through July 1, 2031; bearing interest at rates ranging from 6.60% to 7.50% (6.60% at June 30, 2007)	840,000
	10,376,000
Less: deferred charges arising from debt refunding:	(5,748)
	\$ 10,370,252

The annual requirements to amortize general and special obligation bonds and notes as of June 30, 2007 follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE H – LONG-TERM DEBT – Continued

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 471,000	\$ 531,900
2009	479,000	496,544
2010	483,000	471,581
2011	504,000	445,493
2012	540,000	417,631
2013-2017	2,404,000	1,709,607
2018-2022	2,698,000	1,060,757
2023-2027	1,821,000	456,597
2028-2032	976,000	96,077
Totals	<u>\$ 10,376,000</u>	<u>\$ 5,686,187</u>
Less: deferred charges arising from debt refunding:	(5,748)	
	<u>\$ 10,370,252</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 will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center. Debt service requirements in future years are as follows:

**Outstanding
Amount**

\$136,442

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE H – LONG-TERM DEBT – Continued

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 27,288	\$ 7,583
2009	28,936	5,927
2010	30,684	4,171
2011	32,536	2,309
2012	16,998	421
Totals	<u>\$ 136,442</u>	<u>\$ 20,411</u>

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 non-revolving 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 were 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 was credited to the loan principal. After the 5 year period the loan outstanding balance was restructured for a 25 years period. 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. Debt service requirements in future years are as follows:

\$4,984

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 199	\$ 310
2009	199	297
2010	199	285
2011	199	273
2012	199	260
2013-2017	997	1,178
2018-2022	997	2,046
2023-2027	997	2,604
2028-2032	998	2,852
Totals	<u>\$ 4,984</u>	<u>\$ 10,105</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE H – LONG-TERM DEBT – Continued

Note Payable to Puerto Rico Treasury Department - As of June 30, 2005 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. On August 1, 2005 the Municipality refinanced this debt on a long term basis through a \$1,454,167 non-interest bearing note (imputed interest rate is 5.074%), from the Puerto Rico Department of the Treasury to extend the economic life of the obligation. The note is payable in annual installments of \$10,000 to \$31,131 (including interest) through November 1, 2011. The note balance as of June 30, 2007 is net of an unamortized discount of \$85,538 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:

\$1,039,490

June 30,	Principal	Interest
2008	\$ 313,661	\$ 45,533
2009	332,598	28,533
2010	362,228	11,343
2011	31,003	129
Totals	\$ 1,039,490	\$ 85,538

Note Payable to 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, 2007 is net of an unamortized discount of \$11,371 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:

\$177,828

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE H – LONG-TERM DEBT – Continued

June 30,	Principal	Interest
2008	86,696	7,903
2009	91,132	3,468
Totals	\$ 177,828	\$ 11,371

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	\$1,182,701
Christmas Bonus - represent the accrued portion corresponding to fiscal year 2006-2007 of the Christmas bonus to be paid in December 2007	\$194,067
Claims and judgments - represent the final settlement of legal cases paid subsequent to June 30, 2007. The awarded amount will be paid with unrestricted funds.	\$7,500
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)	\$1,100,400

NOTE I - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS

The Municipal 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

**NOTE I - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS –
Continued**

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 \$1,100,400 as of June 30, 2007, which is based on 51% usage of the landfill. It is estimated that an additional \$1,063,099 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, 2007. 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.

NOTE J - PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2007 are 7.03% for personal property and 9.03% for real property. The distribution of these rates follows:

<u>Description</u>	<u>Personal Property</u>	<u>Real Property</u>
Basic property tax rate, which is appropriated for general purposes and accounted in the Municipality's general fund:	4.00%	6.00%
Percent that belongs to the Commonwealth's debt service fund:	1.03%	1.03%
Percent that belongs to the Municipality's debt service fund:	2.00%	2.00%
Total tax rate:	<u>7.03%</u>	<u>9.03%</u>
Discount granted by law to the taxpayers but reimbursed to the Municipality by the P.R. Treasury Department:	<u>(.20%)</u>	<u>(.20%)</u>
Total percent to be paid by taxpayers:	<u><u>6.83%</u></u>	<u><u>8.83%</u></u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE J - PROPERTY TAXES – Continued

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. A receivable of \$152,733 resulting from the preliminary settlement for fiscal year 2006-2007 is recorded as deferred revenue in the fund statements since is not available as required by current standards.

NOTE K - INTERGOVERNMENTAL REVENUES

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

	Amount
Amount of municipal equalization fund sent by CRIM	\$ 3,094,387
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	914,253
P.R. Department of Labor – Law No. 52	175,000
P.R. Department of Labor – Law No. 82	34,920
Reimbursement from P.R. Department of Treasury - Christmas Bonus reimbursement	148,123
Amount of lottery and subsidy sent by CRIM	130,994
Other intergovernmental revenues	138,135
	\$ 4,635,812

NOTE L - FUND BALANCES AND NET ASSETS RESTATEMENTS

The following table disclosed the change to the balance of net assets at beginning of year as previously reported in the statement of net assets and to the fund balance of the Lavadero Sanitary Sewer System Fund at beginning of year as previously reported in the statement of revenues, expenditures and changes in fund balances. The changes resulted from the correction of an understatement of a Lavadero sanitary sewer grant receivable. The beginning balances have been restated as follows:

	Fund balance, Lavadero Sanitary Sewer System Fund	Net assets
Balance at beginning of year, as previously reported:	\$ 15,629	\$ 27,624,957
Correction of error, understatement of grant receivable	45,616	304,380
Balance at beginning of year, as restated:	\$ 61,245	\$ 27,929,337

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

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, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems. The system provides retirement pensions, death and disability benefits.

Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and non 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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE M - RETIREMENT PLAN – Continued

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
2007	<u>\$ 182,466</u>	<u>\$ 118,653</u>
2006	<u>\$ 192,038</u>	<u>\$ 99,677</u>
2005	<u>\$ 198,889</u>	<u>\$ 72,441</u>

NOTE N – POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note M, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas bonus and death benefits. Costs related to these post employment benefits amounted to \$44,969 for the year ended June 30, 2007 and \$93,024 for the previous fiscal year. These benefits are recorded as expenditures when paid in the general fund.

NOTE O- 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 to \$30,608. Management believes that the summary of the future minimum rental commitments under noncancelable operating leases with terms exceeding one year is not significant.

2. Construction

The Municipality has commitments at June 30, 2007 of \$2,525,247 for construction, improvements or renovation of certain municipal facilities.

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

June 30, 2007

NOTE P – FUND BALANCE DEFICITS

Certain special funds disclosed fund balance deficits as follows:

	Amount
Major Funds:	
CDBG	\$ 29,795
Lavadero Sanitary Sewer System	\$ 59,314
AFI Recreational Facilities	\$ 250,000
Other Governmental Funds:	
Homeland Security Grant	\$ 61,507
Lavadero Multipurpose Center	\$ 17,500

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

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 (\$950,182), which is composed of the following:

	Amount
Net change in fund balance, 01 Fund	\$ (300,389)
Net change in fund balance, other special funds (with self imposed restrictions) included as part of the general fund:	(649,793)
	\$ 950,182

Negative net change in fund balance in 01 Fund resulted of the effect of a fund balance readjustment of \$1,957,569. This represents a readjustment of current year budget with prior year's fund balance resources, approved by the Municipal Legislature. Resources to finance other special funds included as part of the general fund were provided in previous years but funds were expended in current year.

NOTE R - CONTINGENCIES

1. *Federal and Commonwealth grants*

Projects financed by Federal and Commonwealth 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE R – CONTINGENCIES - Continued

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, 2007 and not to be covered by insurance, the Municipality accrued \$7,500 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 S – SUBSEQUENT EVENTS

1. *Sales and use tax implementation*

On July 29, 2007 the Commonwealth Legislature approved Act No. 80 ("Act 80") which imposed to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007 1% of the 1.5% will be collected by the Municipalities and the remaining .5% of the 1.5% will be collected by the Puerto Rico Department of Treasury.

Act 80 also provides for restrictions on the use of the resources (including the .5 of 1.5% collected by the Commonwealth Government) to be invested in solid waste and recycling programs, capital improvements and health and public safety costs. Amounts collected by the Commonwealth Government will be deposited in accounts or special funds in the Governmental Development Bank of Puerto Rico ("GDB"), subject to restrictions imposed and distributed as follows:

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

The Municipal Legislature approved Ordinance No. 6 Series 2007-2008 to amend Municipal Ordinance No. 22 Series 2006-2007 to conform to dispositions of Act 80.

2. *Debt issuances*

On August 21, 2007 the Governmental Development Bank of Puerto Rico approved the issuance of a general obligation note series 2007-2008 of \$525,000 for acquisition of equipment. On October 24, 2007 the Governmental Development Bank of Puerto Rico (GDB) approved the Municipality's request to engage in a \$3,000,000 loan from private banking for the acquisition of land and construction of municipal recreational facilities. GDB will act as a fiscal agent in this transaction.

Required Supplementary Information

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2007

	Budgeted amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis) (See Note A)	Final Budget Positive (Negative)
Revenues:				
Taxes:				
Property taxes	\$ 2,734,676	\$ 2,764,486	\$ 2,796,295	\$ 31,809
Municipal license taxes	1,470,000	1,470,000	1,471,876	1,876
Sales and use taxes	200,000	917,022	1,437,594	520,572
Intergovernmental	3,287,353	3,301,276	3,390,428	89,152
Fees, fines and charges for services	725,590	781,228	772,191	(9,037)
Interest	200,000	451,854	493,697	41,843
Other	85,000	126,964	139,229	12,265
Total revenues	<u>8,702,619</u>	<u>9,812,830</u>	<u>10,501,310</u>	<u>688,480</u>
Expenditures:				
Current:				
General government	4,424,937	5,926,579	5,869,141	57,438
Public works and sanitation	1,885,193	3,315,652	3,251,986	63,666
Public safety	632,421	658,212	657,414	798
Culture and recreation	643,468	732,879	728,785	4,094
Health	357,528	357,528	356,890	638
Welfare and community development	609,472	619,277	601,998	17,279
Education	21,800	18,772	18,771	1
Total expenditures	<u>8,574,819</u>	<u>11,628,899</u>	<u>11,484,985</u>	<u>143,914</u>
Excess (deficiency) of revenues over expenditures	127,800	(1,816,069)	(983,675)	832,394
Other financing sources (uses):				
Transfers out	(127,800)	(141,500)	(141,492)	8
Total other financing sources (uses)	<u>(127,800)</u>	<u>(141,500)</u>	<u>(141,492)</u>	<u>8</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	-	(1,957,569)	(1,125,167)	832,402
Readjustment from prior year fund balance (note B)	-	1,957,569	-	(1,957,569)
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,125,167)</u>	<u>\$ (1,125,167)</u>

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, 2007

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 READJUSTMENT

The budgetary comparison schedule - general fund present a fund balance readjustment of \$1,957,569. This represents a readjustment of current year budget with prior year's budgetary surpluses, approved by the Municipal Legislature.

NOTE C - BUDGET TO GAAP RECONCILIATION

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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

June 30, 2007

NOTE C - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ (1,125,167)
Budget to GAAP differences:	
Entity differences:	
Non budgeted funds recorded as revenues for financial reporting purposes:	353,044
Non budgeted funds recorded as expenditures for financial reporting:	(1,002,979)
Non budgeted transfers in:	5,053
Non budgeted transfers out:	(4,911)
Basis of accounting differences:	
Revenues recorded for financial reporting purposes but not in budgetary basis:	195,221
Revenues recorded in budgetary basis but not for financial reporting purposes:	(127,324)
Expenditures recorded in budgetary basis but not for financial reporting purposes:	127,180
Expenditures recorded for financial reporting purposes but not in budgetary basis:	(31,776)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	784,939
Prior year encumbrances recorded as expenditures for financial reporting purposes:	(123,462)
Net change in fund balance (GAAP basis):	<u>\$ (950,182)</u>

Supplementary Information

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET INFORMATION
JUNE 30, 2007**

<u>Line Item Number</u>		Section 8 Housing Choice Vouchers 14,871
	ASSETS	
	Current Assets	
	Cash:	
111	Cash - unrestricted	\$ 44,450
113	Cash - other restricted	11,714
100	Total cash	56,164
	Accounts and notes receivables:	
121	Accounts receivable - PHA projects	2,337
126.2	Allowance for doubtful accounts - other	(516)
128	Fraud recovery	2,972
128.1	Allowance for doubtful accounts - fraud	(119)
120	Total receivables, net of allowance for doubtful accounts	4,674
150	Total Current Assets	60,838
	Noncurrent Assets	
	Fixed assets	
164	Furniture, equipment & machinery - administration	19,872
166	Accumulated depreciation	(18,938)
160	Total fixed assets, net of accumulated depreciation	934
180	Total Noncurrent Assets	934
190	TOTAL ASSETS	\$ 61,772
	LIABILITIES AND EQUITY	
	LIABILITIES	
	Current Liabilities	
312	Accounts payable < 90 days	6,713
322	Accrued compensated absences - current portion	3,154
310	Total Current Liabilities	9,867
	Noncurrent Liabilities	
353	Noncurrent liabilities- other	8,233
350	Total Noncurrent Liabilities	8,233
300	TOTAL LIABILITIES	18,100
	EQUITY	
508.1	Invested in Capital Assets, Net of Related Debt	934
512.1	Unrestricted Net Assets	42,738
513	TOTAL EQUITY/NET ASSETS	43,672
600	TOTAL LIABILITIES and EQUITY/NET ASSETS	\$ 61,772

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
STATEMENT OF REVENUES AND EXPENSES INFORMATION
FISCAL YEAR ENDED JUNE 30, 2007**

<u>Line Item Number</u>		<u>Section 8 Housing Choice Vouchers 14,871</u>
703		
	REVENUES:	
706	HUD PHA operating grants	\$ 470,600
714	Fraud recovery	3,726
715	Other revenue	12,588
700	TOTAL REVENUES	486,914
	EXPENSES:	
	Administrative	
911	Administrative salaries	30,748
912	Auditing fees	5,000
914	Compensated absences	1,824
915	Employee benefit contributions- administrative	9,571
916	Other operating- administrative	6,830
	Subtotal	53,973
	General expenses	
966	Bad debt - other	516
	Subtotal	516
969	TOTAL OPERATING EXPENSES	54,489
970	EXCESS OPERATING REVENUE OVER OPERATING EXPENSES	432,425
973	Housing assistance payments	441,051
974	Depreciation expense	985
900	TOTAL EXPENSES	496,525
1000	EXCESS (DEFICIENCY) OF TOTAL REVENUE OVER (UNDER) TOTAL EXPENSES	\$ (9,611)
MEMO account information		
1103	Beginning equity	54,613
1104	Prior period adjustments, equity transfers and correction of errors	(1,330)
1120	Unit months available	1,236
1121	Number of unit months leased	1,196

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE

June 30, 2007

NOTE A – BASIS OF PRESENTATION

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

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

SINGLE AUDIT SECTION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2007

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>			
Passed through the P.R. Department of Education: Child and Adult Care Food Program	10.558	CCC-029	\$ 14,826
Water and Waste Disposal System for Rural Communities Subtotal U.S. Department of Agriculture	10.760	N/A	<u>317,903</u> 332,729
<u>U.S. Department of Housing and Urban Development</u>			
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	\$ 783,143
Section 8 Housing Choice Vouchers Program Subtotal U.S. Department of Housing and Urban Development	14.871	N/A	<u>494,011</u> 1,277,154
<u>U.S. Department of Justice</u>			
Passed through the PR Department of Justice: Edward Byrne Justice Assistance Grant	16.738	2005-DJ-BX-0072	35,898
<u>U.S. Department of Transportation</u>			
Federal Transit Formula Grants	20.507	N/A	34,627
<u>U.S. Department of Health and Human Services</u>			
Passed through the P.R. Office of Elderly Affairs: National Family Caregiver Support, Title III, Part E	93.052	N/A	22,072
Nutrition Services Incentive Program	93.053	N/A	9,086
Passed through the P.R. Department of Family - Families and Children Administration: Child Care and Development Block Grant	93.575	2005-2006-030 2006-2007-040	<u>96,978</u> 128,136
Subtotal U.S. Department of Health and Human Services:			<u>128,136</u>
<u>U.S. Department of Homeland Security</u>			
Passed through the P.R. Department of Justice: Citizen Corps Program	97.053	2004-GE-T4-0008	3,823
Passed through the Puerto Rico Governor Office - (Office of Public Safety Affairs): Homeland Security Grant Program (SHSP)	97.067	2005-GE-T5-4009	<u>61,507</u> 65,330
Subtotal U.S. Department of Homeland Security			<u>65,330</u>
Total Expenditures of Federal Awards			<u><u>\$ 1,873,874</u></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, 2007

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

Description	Community Development Block Grant Fund	Lavadero Sanitary Sewer System Fund	Other Governmental Funds
10.558	\$ -	\$ -	\$ 14,826
10.760	-	317,903	-
14.228	783,143	-	-
14.871	-	-	494,011
16.738	-	-	35,898
20.507	-	-	34,627
93.052	-	-	22,072
93.053	-	-	9,086
93.575	-	-	96,978
97.053	-	-	3,823
97.067	-	-	61,507
Total federal awards expenditures	<u>783,143</u>	<u>317,903</u>	<u>772,828</u>
Total nonfederal awards expenditures	<u>-</u>	<u>154,454</u>	<u>1,981,838</u>
Total expenditures, fund statements	<u>\$ 783,143</u>	<u>\$ 472,357</u>	<u>\$ 2,754,666</u>

VALDES, GARCIA, MARIN & MARTINEZ, LLP

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 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

Mayor and Members of the 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, 2007, and have issued our report thereon dated December 21, 2007, 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 grant agreements, 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.

Internal Control Over Financial Reporting

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 reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. 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 solely for the information and use 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 black ink, appearing to read "Jose Garcia, Chair & Partnering UP". The signature is written in a cursive style with a large initial "JG".

San Juan, Puerto Rico
December 21, 2007

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to the original

VALDES, GARCIA, MARIN & MARTINEZ, LLP

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

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P.O. Box 364831
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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

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 program for the year ended June 30, 2007. 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, 2007.

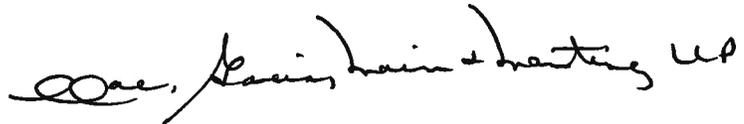
Internal Control Over Compliance

The management of the Municipality of Hormigueros is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality 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 caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. 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 management of the Municipality, Commonwealth and federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

San Juan, Puerto Rico
December 21, 2007



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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Audit Results

Year ended June 30, 2007

I. Summary of audit results:

Part I - Financial Statements

1. Type of audit report: Unqualified opinion Qualified opinion
Adverse opinion Disclaimer of opinion
2. Reportable conditions reported: Yes No
3. Reportable conditions reported as a material weakness: Yes None reported
4. Material noncompliance disclosed: Yes No

Part II - Federal Awards

1. Reportable conditions reported: Yes No
2. Reportable conditions reported as a material weakness: Yes None reported
3. Type of report on compliance on major programs: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
4. Audit findings required to be reported under Section 510(a) of Circular A-133: Yes No

5. Major programs:

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

6. Dollar threshold used to distinguish Type A and Type B programs: \$300,000
7. Low-risk auditee: Yes No

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

Section II - Financial statements Findings

Finding No matters reported.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

Section III - Federal Awards Findings and Questioned Costs

Finding No matters reported.