



MUNICIPIO DE HORMIGUEROS
Estado Libre Asociado de Puerto Rico

Honorable Pedro J. García Figueroa
Alcalde

14 de enero de 2009

Oficina del Comisionado
O C A M
P. O. Box 70167
San Juan, P.R. 00936-8167

Estimado Comisionado:

Saludos cordiales de parte de los que componemos la gran familia del Municipio de Hormigueros, "Corazón del Oeste".

Incluimos copia del Estado Financiero correspondiente al año fiscal 2007-2008. Si necesita información adicional, llámenos al 787-849-4205.

Cordialmente,

Marinelda Acosta
Directora de Finanzas y Presupuesto

MA/clr

Anejo

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**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, 2008



Hon. Pedro J. García-Figueroa
Mayor

Mrs. Marinelda Acosta
Finance Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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FINANCIAL SECTION

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INDEPENDENT AUDITORS' REPORT

To the Honorable 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 (the Municipality) as of and for the year ended June 30, 2008, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over financing reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Hormigueros as of June 30, 2008 and 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 18, 2008, on our consideration of the Municipality's internal control over financial reporting and on 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 considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 14 and Budgetary Comparison Schedule - General Fund on page 52 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's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments and Non-Profit Organizations" and is not a required part of the basic financial statements. The Schedule of Expenditures of Federal Awards 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 "Eric, Davis & Associates, LLP". The signature is written in a cursive, flowing style.

San Juan, Puerto Rico
December 18, 2008

Stamp 2378892 was affixed
to the original.

Management Discussion and Analysis

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

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, 2008. We encourage readers to consider the information presented here in conjunction with the Municipality's financial statements, which follow this analysis.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

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

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2008 by \$32,717,038 (net assets). This represents an increase of 4% with respect to fiscal year 2007.
- Revenues and expenses increased by 2% and 17% respectively in comparison with previous year.
- Change in net assets decreased 61% compared to change in net assets of fiscal year 2007.

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, 2008, a net change of \$2,511,187 in the fund balances of the Municipality's governmental funds resulted in a reported combined ending fund balances of \$10,507,665. Approximately 25% of the total combined fund balances is unreserved.
- Total fund balance of the general fund decreased by 23% and the unreserved fund balance of 2007-2008 decreased 17% in comparison to fiscal year 2006-2007.

General Financial Highlights

- The investment in capital assets as of June 30, 2008 was \$40,592,144 (net of depreciation).
- Long-term debt increased to \$19,922,105, approximately 40% with respect to prior fiscal year.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$1,459,517.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

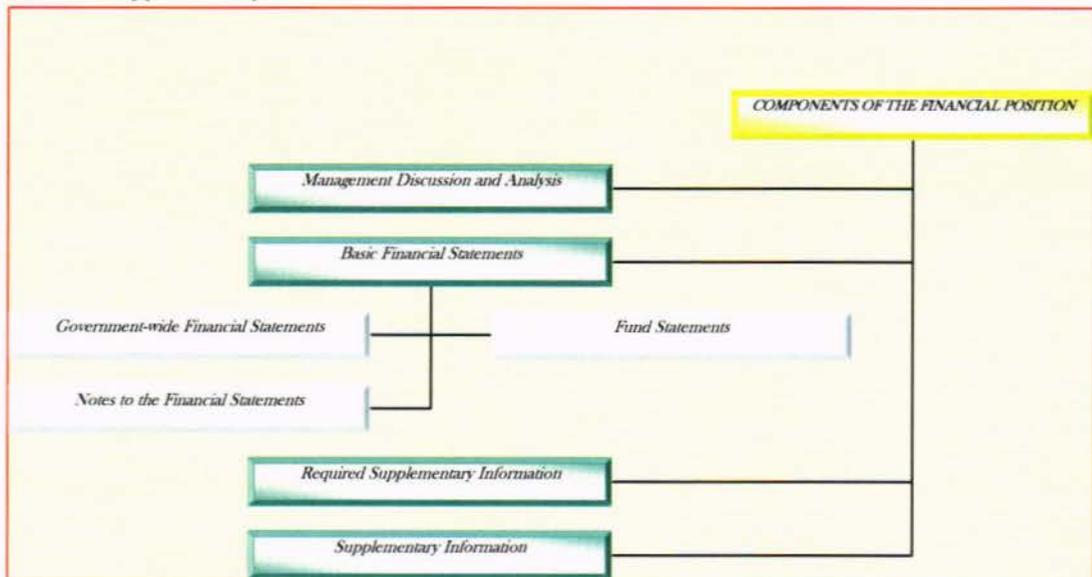
MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's financial report comprises four components:

- Management's 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 the 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 the cash is received or paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

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

➤ ***Fund Financial Statements***

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

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

The governmental fund statements focus on major funds. The Municipality's major funds are the general fund (which accounts for the main operating activities of the Municipality) and funds that 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'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

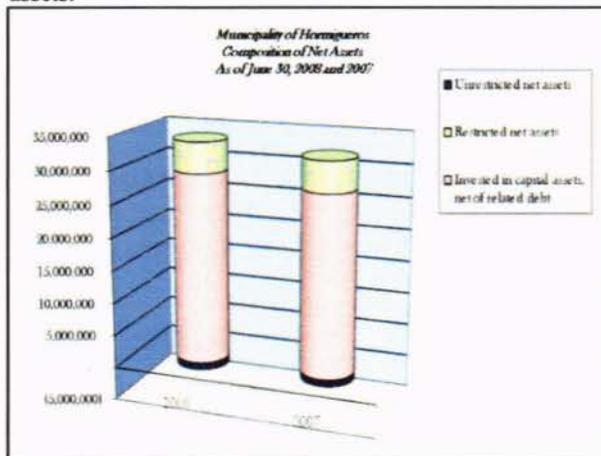
Net Assets

The following table presents a summary of the Statement of Net Assets as of June 30, 2008 and 2007:

TABLE 1

<i>Summary Statement of Net Assets As of June 30,</i>		
	Governmental Activities	
	2008	2007
Assets		
Current and other assets	\$15,305,763	\$12,616,273
Capital assets	40,592,144	35,786,270
Total assets	<u>\$ 55,897,907</u>	<u>\$ 48,402,543</u>
Liabilities		
Current and other liabilities	\$ 3,258,764	\$ 2,826,176
Long term liabilities	19,922,105	14,213,664
Total liabilities	<u>23,180,869</u>	<u>17,039,840</u>
Net assets		
Invested in capital assets, net of related debt	29,181,346	27,759,657
Restricted	4,650,211	4,664,772
Unrestricted	(1,114,519)	(1,061,726)
Total net assets	<u>\$ 32,717,038</u>	<u>\$ 31,362,703</u>

Net assets (assets over liabilities) may serve over the 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 \$32,717,038 representing an increase of 4% with respect to year 2007. The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure); less accumulated depreciation and less any related outstanding debt used to acquire those assets.



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'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

As of June 30 2008, the Municipality presented an unrestricted net assets deficit. This deficit primarily arises from long term obligations such as compensated absences and debts to CRIM for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay-as-you-go basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as invested in capital assets, net of related debt section of net assets. Therefore, 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 2008 and 2007:

TABLE 2

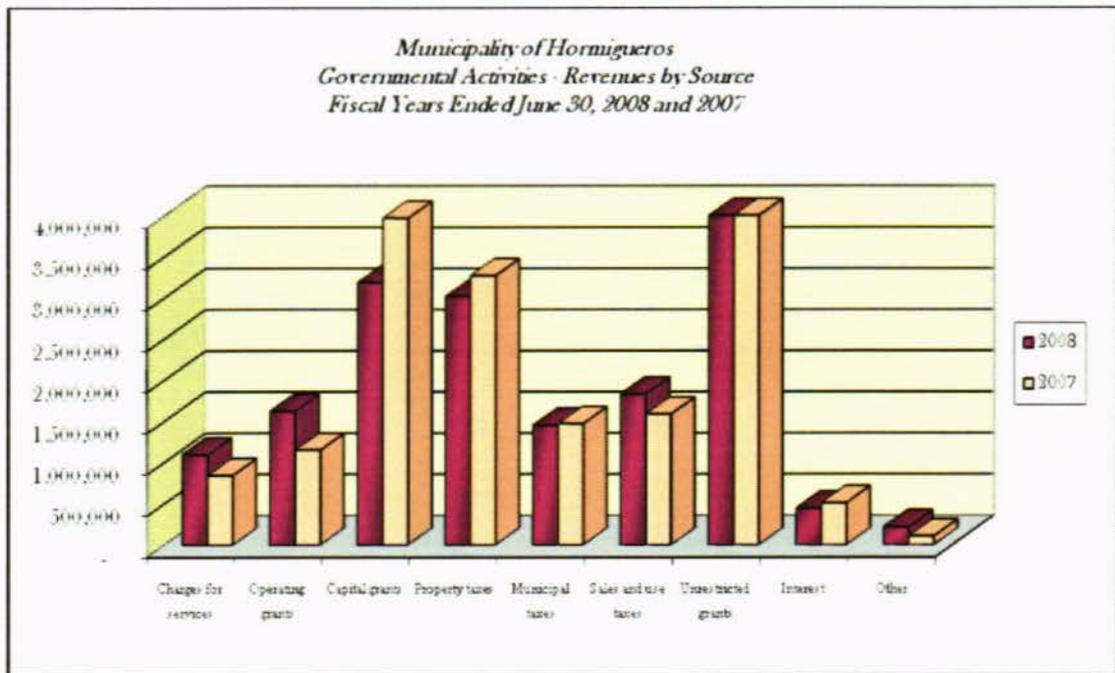
<i>Summary of Changes in Net Assets As of June 30,</i>		
	Governmental Activities	
	2008	2007
Program revenues:		
Fees, fines and charges for services	\$ 1,096,604	\$ 842,990
Operating grants and contributions	1,625,238	1,149,885
Capital grants and contributions	3,189,421	3,968,124
General revenues:		
Property taxes	3,018,725	3,270,654
Municipal license taxes	1,452,164	1,472,030
Sales and uses taxes	1,832,419	1,587,192
Grants and contributions not restricted to specific programs	4,766,135	4,391,662
Interest	446,005	509,837
Other	218,072	106,557
Total revenues	17,644,783	17,298,931
Expenses:		
General government	7,036,647	5,844,518
Public works and sanitation	3,803,846	3,326,409
Public safety	787,015	835,494
Culture and recreation	1,396,023	1,183,301
Health	370,919	362,325
Housing, welfare and community development	2,209,411	1,697,149
Education	33,323	29,888
Interest on long term debt	653,264	586,479
Total expenses	16,290,448	13,865,563
Change in net assets	1,354,335	3,433,367
Net assets-beginning of year	31,362,703	27,929,336
Net assets-end of year	\$ 32,717,038	\$ 31,362,703

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

FIGURE 1



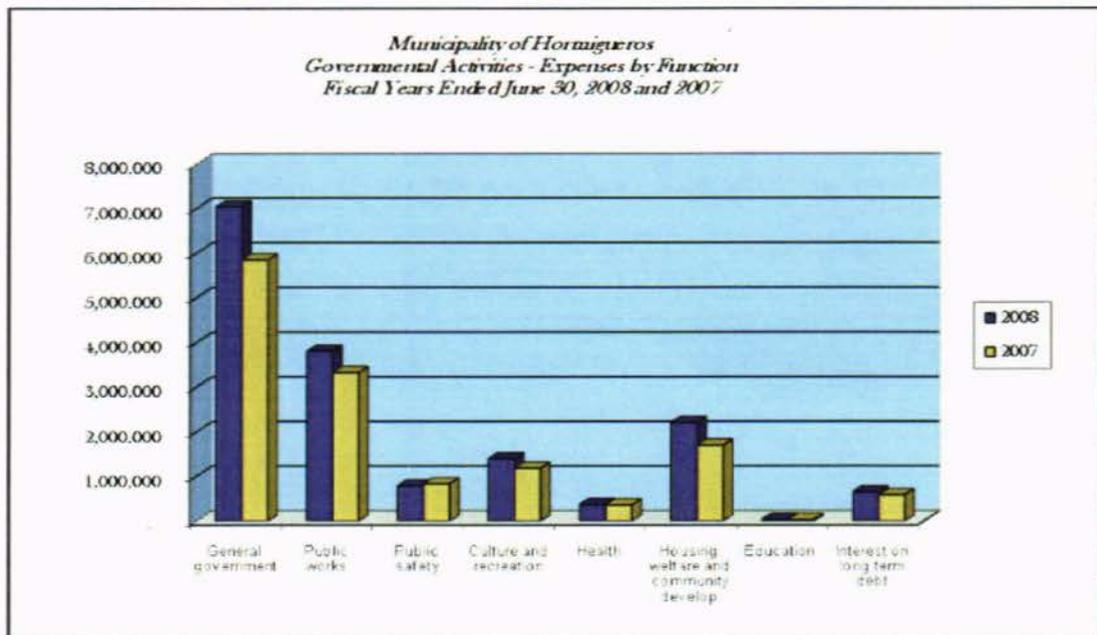
Approximately 27% of the Municipality's revenues came from operating and capital grants, 27% from grants and contributions not restricted to specific programs and 17% from property taxes. Revenues increased by 2% in comparison with fiscal year 2007. This net increase is mostly affected by a combination of the following: (1) a 41% increase in operating grants due to an increase in Law#52, Law #82, and FTA granted amounts, (2) a 30% increase in fees, fines and charges for services due to an increase in construction taxes collected, (3) a 20% decrease in capital grants mostly due to non recurrent revenues received for capital improvements in prior year and a reduction in Commonwealth Legislative Resolution revenues, and (4) a 15% increase in collections of sales and use taxes received from the municipal development fund and the debt redemption fund managed by the Puerto Rico Treasury Department.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

FIGURE 2



The Municipality's expenses cover a range of services. The largest expenses are general government representing approximately 43%, public works and sanitation with 23%, and housing, welfare and community development with 14%. Program revenues of the Municipality covered 36% of total expenses.

Expenses increased 17% in comparison with previous year. This includes an increase of 20% in general government (due to irregular employees salaries, Christmas and summer bonus, and electricity expenses), an increase of 30% in housing welfare and community development (due to the donation of a drinking - water well to the "Lavadero" community, and the administration of low rent family housing project), and an increase of 18% in culture and recreation (due to activities celebrated for the community).

As noted previously the increase in revenues combined with a higher increase in expenses caused the net change in net assets to decrease approximately 61% compared with the net change in net assets reported in the 2007 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):

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

TABLE 3

<i>Net Cost of Municipality's Governmental Activities Fiscal years ended June 30,</i>				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2008	2007	2008	2007
General government	\$ 7,036,647	\$ 5,844,519	\$ (5,276,536)	\$ (4,649,361)
Public works and sanitation	3,803,846	3,326,409	(1,064,215)	316,335
Public safety	787,015	835,494	(736,130)	(738,227)
Culture and recreation	1,396,023	1,183,301	(1,374,124)	(1,161,311)
Housing, welfare and community development	2,209,411	1,697,149	(870,674)	(693,308)
Other	1,057,506	978,692	(1,057,506)	(978,692)
	<u>\$ 16,290,448</u>	<u>\$ 13,865,563</u>	<u>\$ (10,379,185)</u>	<u>\$ 7,904,564</u>

Some of the cost of governmental activities was paid by those who directly benefited from the programs (\$1,096,604) and other governments and organizations that subsidized certain programs with grants and contributions (\$4,814,659). The \$10,379,185 net cost of services was fully covered by other general revenues including property, municipal license, and sales and use taxes.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2008, the governmental funds reported combined ending fund balances of \$10,507,665, a net increase of \$2,511,187 in comparison with the prior year. This net increase was caused primarily by net positive change in other governmental funds of \$2,564,292 due to general obligation bonds and notes issued during the current year and a decrease of (\$889,332) in General Fund. Of total combined fund balances, \$2,614,772 (25%) constitutes unreserved fund balance. The remainder of the fund balance is reserved to indicate that it is not available for new spending it.

The General Fund is the operating fund of the Municipality. Unreserved fund balance of the General Fund represents 25% of total combined ending fund balance. For the year ended June 30, 2008, the fund balance of the General Fund decreased by (\$889,332). The key factors of this change is an increase of 35% in construction permits revenue combined with an increase of 16% in general government expenses, 23% increase in housing, welfare and community development expenses and 22% increase in culture and recreation expenses with respect to 2007 year. In addition, this result includes the net effect of a fund balance readjustment of \$2,760,493. This represents a readjustment of current year budget with prior year's fund balance resources, approved by the Municipal Legislature.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

General fund budgetary highlights

The General Fund original budget for the fiscal period 2008-2007 presented an increase of 9% with respect to prior year budget due to an increase in the estimated amount of license taxes, interest revenue, 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 an amendment to budget expenditures of \$2,760,493 was approved, representing a readjustment of current year budget with prior year's budgetary surpluses. Actual revenues exceeded the revised budgeted revenues by \$1,382,940. The most significant variances were \$651,065 in sales and use taxes, \$426,956 from fees, fines and charges for services, and \$180,097 from intergovernmental subsidies. The Municipality reported a negative variance of (\$78,297) between revised budgeted appropriations and actual expenditures, but ended with a total net negative variance of (\$1,459,517).

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$40,592,144 in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of 13% over the prior year.

TABLE 4

	<i>Capital Assets As of June 30,</i>	
	Governmental Activities	
	2008	2007
Non-depreciable assets:		
Land	\$ 7,577,389	\$ 5,013,333
Construction in progress	7,065,033	6,858,398
Depreciable assets:		
Land improvements	729,726	765,728
Buildings and buildings improvements	15,308,633	13,243,920
Infrastructure	6,777,214	7,168,497
Vehicles, machinery and equipment	3,134,149	2,736,394
Total	\$ 40,592,144	\$ 35,786,270

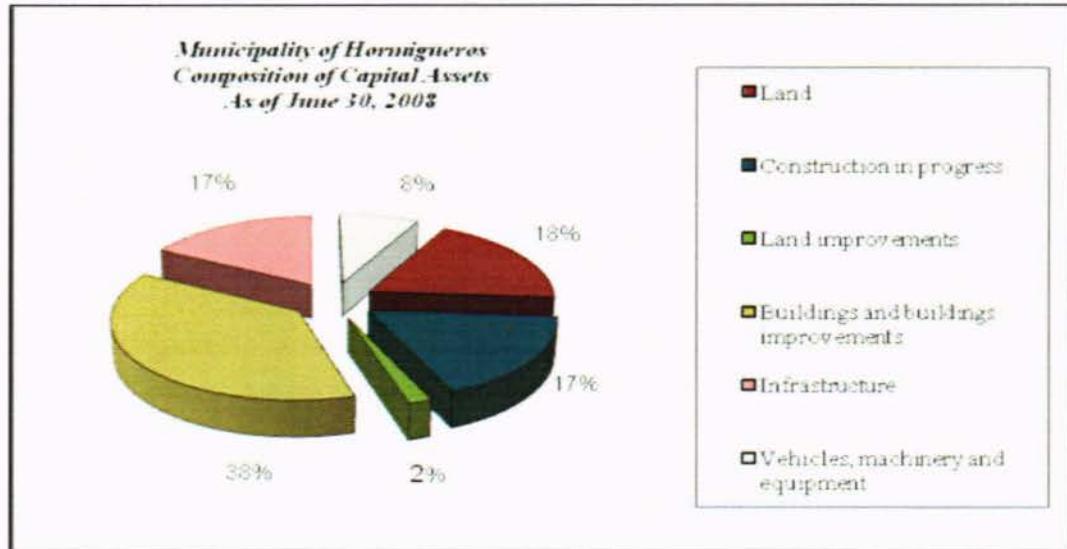
Certain projects are still in construction in progress as of June 30, 2008. The most significant of these projects are the construction of "Lavadero Sanitary Sewer System", the construction of the future Elderly Services Center, the construction of Lavadero's Multiuse Center and the construction of Valle Hermoso-Sur Community Center, with reported costs of \$4,090,113, \$972,044, \$842,140, and \$374,524 respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

Figure 3



The Municipality's fiscal year 2008-2009 capital budget calls for a significant amount of new and continuous projects including the construction of an Elderly Services Center in 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. Other projects that will be continued in this fiscal year are the construction of the Lavadero Multiple Purpose Center, and the remodeling of the School of Fine Arts building, with estimated costs of \$1,129,381 and 1,075,634, respectively. "Lavadero de Oro" is a significant project that is in progress 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 financed 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 San Romualdo and Estancias del Rio basketball courts, the construction of the 400mts athletic track, the construction of a recreational park for kids, the construction of an electronic library, the construction of a Taekwondo and Gymnastics' Pavilion, the purchase of a building to be used as a market place, and the relocation of the Municipal Library. All 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 G to the basic financial statements.

Long-term debt

At year-end, the Municipality has \$16,067,555 in general, special bonds and notes outstanding, an increase of 55% with respect to prior year. This increase was due to the addition of eight bonds' issuances during the current year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

TABLE 5

<i>Outstanding Long-term Debt Fiscal years ended June 30,</i>		
	Governmental Activities	
	2008	2007
General, special obligation bonds and notes	\$ 16,067,555	\$ 10,370,252
Compensated absences	1,329,275	1,182,701
Legal claims and judgments	40,000	7,500
Payable to CRIM – prior years doubtful accounts	4,785	4,984
Note payable-Puerto Rico Treasury Department	725,829	1,039,490
Christmas bonus payable	224,532	194,067
Payable to CRIM - LIMS	109,154	136,442
Estimated landfill closing costs	1,137,702	1,100,400
Note payable to FEMA	91,132	177,828
Property Taxes – current year	61,338	-
Payable to PREPA	130,803	-
Total	\$ 19,922,105	\$ 14,213,664

The Municipality reported an increase in the other long-term debts of \$11,138. This increase was primarily due to a new debt to the P.R. Electric Power Authority (PREPA), and a negative CRIM property tax liquidation for the amounts of \$130,803 and \$61,338, respectively as of June 30, 2008. More detailed information about the Municipality's long-term liabilities is presented in Note I to the basic financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's officials considered certain factors when setting the fiscal year 2008-2009 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 11.6% which compares with the Commonwealth rate of 11.8%.

For the fiscal year 2008-2009 the Municipality applied a conservative approach in the development of budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2008-2009 are \$10,932,940 representing an increase of approximately 15% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. If these estimates are realized, the Municipality's Budgetary General Fund balance is expected to increase modestly by the close of 2008-2009 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

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 00660-0097.

Basic Financial Statements

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**STATEMENT OF NET ASSETS
JUNE 30, 2008**

ASSETS	Governmental Activities
Cash and cash equivalents	\$ 3,732,069
Receivables, net:	
Municipal license taxes	42,242
Sales and use taxes	106,009
Lease (note D)	340,759
Other	24,987
Due from (note E):	
Commonwealth Government	818,914
Federal Government	843,414
Restricted assets:	
Cash and cash equivalents	3,446,294
Cash with fiscal agents	5,109,327
Investment held with fiscal agent (note C)	733,350
Deferred bond issuance costs	108,398
Capital assets (note G):	
Land and construction in progress	14,642,422
Other capital assets, net	25,949,722
Total capital assets, net	<u>40,592,144</u>
Total assets	<u><u>55,897,907</u></u>
 LIABILITIES	
Accounts payable and accrued liabilities	\$ 1,914,688
Interest payable	370,819
Due to:	
Commonwealth Government	22,071
Deferred revenues:	
Municipal license taxes:	921,907
Federal grants	29,279
Long-term liabilities (note I):	
Due within one year	2,047,808
Due in more than one year	17,874,297
Total liabilities	<u><u>23,180,869</u></u>
 NET ASSETS	
Invested in capital assets, net of related debt	29,181,346
Restricted for:	
Capital projects	2,582,588
Debt service	1,874,465
Other specified purposes	193,158
Unrestricted (deficit)	(1,114,519)
Total net assets	<u><u>\$ 32,717,038</u></u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2008

Functions	Expenses	Program Revenues			Net (Expenses) Revenues and Change in Net Assets
		Fees, Fines and Charges for services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
General government	\$ 7,036,647	\$ 1,005,336	\$ 637,654	\$ 117,121	\$ (5,276,536)
Public works and sanitation	3,803,846	67,278	49,162	2,623,191	(1,064,215)
Public safety	787,015	-	50,885	-	(736,130)
Culture and recreation	1,396,023	21,899	-	-	(1,374,124)
Health	370,919	-	-	-	(370,919)
Housing, welfare and community development	2,209,411	2,091	887,537	449,109	(870,674)
Education	33,323	-	-	-	(33,323)
Interest on long-term debt	653,264	-	-	-	(653,264)
Total	\$ 16,290,448	\$ 1,096,604	\$ 1,625,238	\$ 3,189,421	(10,379,185)

General revenues:

Taxes:

Property taxes	3,018,725
Municipal license taxes	1,452,164
Sales and use taxes	1,832,419
Grants and contributions not restricted to specific programs	4,766,135
Interest	446,005
Other	218,072

Total general revenues 11,733,520

Change in net assets 1,354,335

Net assets-beginning 31,362,703

Net assets-ending \$ 32,717,038

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2008

	Major Funds							Total Governmental Funds
	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Lavadero Sanitary Sewer System	\$ 3,000,000 Bond Issuance	Other Governmental Funds	
Assets								
Cash and cash equivalents	\$ 3,732,069	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,732,069
Receivables, net:								
Municipal license taxes	42,242	-	-	-	-	-	-	42,242
Sales and use taxes	106,009	-	-	-	-	-	-	106,009
Lease (Note D)	340,759	-	-	-	-	-	-	340,759
Other	17,879	-	-	-	-	-	7,108	24,987
Due from:								
Commonwealth Government (Note E)	679,170	-	15,288	87,636	-	-	36,820	818,914
Federal Government (Note E)	-	768,171	-	-	-	-	75,243	843,414
Other funds (note F)	363,798	-	-	-	-	-	-	363,798
Restricted assets:								
Cash and cash equivalents	-	1,062	2,235,180	-	629,678	-	580,374	3,446,294
Cash with fiscal agents	-	-	-	2,157,107	-	-	2,952,220	5,109,327
Investment held with fiscal agent (Note C)	-	-	-	-	-	733,350	-	733,350
Total assets	\$ 5,281,926	\$ 769,233	\$ 2,250,468	\$ 2,244,743	\$ 629,678	\$ 733,350	\$ 3,651,765	\$ 15,561,163
Liabilities and fund balances								
Liabilities:								
Accounts payable and accrued liabilities	\$ 566,803	\$ 544,795	\$ 35,036	\$ -	\$ 434,260	\$ -	\$ 333,794	\$ 1,914,688
Matured bonds and interest payable	-	-	-	748,169	-	-	-	748,169
Due to:								
Commonwealth Government	22,071	-	-	-	-	-	-	22,071
Other funds	-	243,650	11,000	-	-	-	109,148	363,798
Deferred revenues (notes D, H, and I.):								
Municipal license taxes	921,907	-	-	-	-	-	-	921,907
Lease	340,759	-	-	-	-	-	-	340,759
Intergovernmental-Commonwealth Government	373,828	-	5,795	24,101	-	-	36,819	440,543
Federal grants	-	265,053	-	-	-	-	36,510	301,563
Total liabilities	2,225,368	1,053,498	51,831	772,270	434,260	-	516,271	5,053,498
Fund balances (deficits):								
Reserved for:								
Encumbrances	327,243	-	-	-	-	-	-	327,243
Debt service	-	-	-	1,472,473	-	-	-	1,472,473
Capital projects	93,000	(284,265)	2,198,637	-	195,418	733,350	2,212,476	5,148,616
Other specified purposes	21,543	-	-	-	-	-	923,018	944,561
Unreserved								
Designated for subsequent years expenditures	343,374	-	-	-	-	-	-	343,374
Undesignated	2,271,398	-	-	-	-	-	-	2,271,398
Total fund balances (deficits)	3,056,558	(284,265)	2,198,637	1,472,473	195,418	733,350	3,135,494	10,507,665
Total liabilities and fund balances	\$ 5,281,926	\$ 769,233	\$ 2,250,468	\$ 2,244,743	\$ 629,678	\$ 733,350	\$ 3,651,765	\$ 15,561,163

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2008**

Total governmental fund balances:		\$ 10,507,665
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:		40,592,144
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:		
Deferred charges - bond issuance costs		108,398
Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:		
Receivable:		
Lease agreement	\$ 340,759	
Due from Commonwealth Government:		
P.R. Infrastructure Financing Authority	36,819	
P.R. Department of Treasury - Christmas bonus reimbursement	110,975	
P.R. Department of Labor - Law No. 52	16,613	
Commonwealth Legislature Resolutions	5,795	
P.R. Department of Education	10,600	
P.R. Department of Labor - Law No. 82	80,736	
P.R. Department of Treasury -Sales and use taxes (General Fund)	24,101	
P.R. Department of Treasury -Sales and use taxes (Debt Service Fund)	24,101	
P.R. Electric Power Authority (PREPA)	130,803	
Due from Federal Government:		
HSGP- Equipment Acquisition	1,547	
FTA	5,684	
CDBG	265,053	
	1,053,586	
Interest liabilities are not due and payable in the current period and therefore, are not reported in funds		(107,650)
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	15,582,555	
Note payable to CRIM-LIMS	109,154	
Note payable to CRIM-financing of delinquent accounts	4,785	
Note payable to P.R. Department of Treasury	725,829	
Note payable to FEMA	91,132	
Prior year property tax	61,338	
Compensated absences	1,329,275	
Christmas bonus payable	224,532	
P.R. Electric Power Authority (PREPA)	130,803	
Judgments and legal claims	40,000	
Estimated landfill closing costs	1,137,702	
	(19,437,105)	
Net assets of governmental activities:		<u>\$ 32,717,038</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES-
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2008

	Major Funds							Total Governmental Funds
	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Lavadero Sanitary Sewer System	\$ 3,000,000 Bond Issuance	Other Governmental Funds	
Revenues:								
Taxes:								
Property taxes (note K)	\$ 1,962,851	\$ -	\$ -	\$ 1,203,939	\$ -	\$ -	\$ -	\$ 3,166,790
Municipal license taxes (note L)	1,452,164	-	-	-	-	-	-	1,452,164
Sales and use taxes (note M)	1,476,380	-	-	307,837	-	-	-	1,784,217
Intergovernmental:								
Commonwealth government (note N)	5,208,695	-	56,924	-	-	-	825,594	6,091,213
Federal government	-	1,922,104	-	-	818,247	-	1,081,982	3,822,333
Fees, fines and charges for services	1,016,635	-	-	-	-	-	24,720	1,041,355
Interest	387,999	-	-	57,276	-	-	730	446,005
Other	135,975	-	-	-	-	-	2,828	138,803
Total revenues	11,640,699	1,922,104	56,924	1,569,052	818,247	-	1,935,854	17,942,880
Expenditures								
Current:								
General government	6,728,244	117,121	-	1,865	-	-	106,803	6,954,033
Public works and sanitation	2,479,007	140,002	17,502	-	-	5,000	160,804	2,802,315
Public safety	683,063	-	-	-	-	-	7,709	690,772
Culture and recreation	898,579	-	-	-	-	-	-	898,579
Health	358,999	-	-	-	-	-	-	358,999
Housing, welfare and community development	656,453	452,929	2,521	-	-	-	853,497	1,965,400
Education	17,225	-	-	-	-	-	-	17,225
Capital outlays	785,615	1,466,522	321,337	-	563,515	2,243,275	1,157,010	6,537,274
Debt service:								
Principal	-	-	-	706,000	-	-	-	706,000
Interest	-	-	-	642,504	-	-	-	642,504
Bond issuance costs	-	-	-	-	-	18,375	18,968	37,343
Total expenditures	12,607,185	2,176,574	341,360	1,350,369	563,515	2,266,650	2,304,791	21,610,444
Excess (deficiency) of revenues over expenditures	(966,486)	(254,470)	(284,436)	218,683	254,732	(2,266,650)	(368,937)	(3,667,564)
Other financing sources (uses):								
Lease principal payments (note D)	76,152	-	-	-	-	-	-	76,152
Payment of PREPA debt	(65,401)	-	-	-	-	-	-	(65,401)
Proceeds from general obligation bonds	-	-	-	-	-	3,000,000	3,168,000	6,168,000
Transfers in	463,942	-	6,265	378,324	-	-	17,554	866,085
Transfers out	(397,539)	-	(2,279)	(463,942)	-	-	(2,325)	(866,085)
Total other financing sources (uses)	77,154	-	3,986	(85,618)	-	3,000,000	3,183,229	6,178,751
Net change in fund balances	(889,332)	(254,470)	(280,450)	133,065	254,732	733,350	2,814,292	2,511,187
Fund balances (deficit) at beginning of year	3,945,890	(29,795)	2,479,087	1,339,408	(59,314)	-	321,202	7,996,478
Fund balances (deficit) at end of year	\$ 3,056,558	\$ (284,265)	\$ 2,198,637	\$ 1,472,473	\$ 195,418	\$ 733,350	\$ 3,135,494	\$ 10,507,665

The accompanying notes are an integral part of this statement.

*CHD
5/11/08*

**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, 2008**

Net change in fund balances-total governmental funds:	\$	2,511,187
Amounts reported for governmental activities in the Statement of activities are different because:		
Governmental funds report 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	\$ 6,537,274	
Less: current year depreciation	<u>(1,640,025)</u>	4,897,249
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:		
		(136,376)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
Intergovernmental - Commonwealth Government:		
P.R. Department of Treasury - Christmas bonus reimbursement (current)	110,975	
P.R. Department of Labor - Law No. 52	16,613	
P.R. Department of Labor - Law No. 82	80,736	
P.R. Department of Education	10,600	
P.R. Infrastructure Financing Authority	36,819	
P.R. Department of Treasury -Sales and use taxes (General Fund)	24,101	
P.R. Department of Treasury -Sales and use taxes (Debt Service Fund)	24,101	
Commonwealth Legislature Resolutions	5,795	
P.R. Electric Power Authority (PREPA)	196,204	
Intergovernmental - Federal Government:		
HSGP- Equipment Acquisition	1,547	
CDBG	265,053	
FTA	5,684	
Donated capital assets	<u>45,001</u>	823,229
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)	(186,963)	
P.R. Department of Treasury - other	(20,833)	
CRIM - Property taxes (General Fund - prior year)	(152,733)	
Federal Grants - HSGP	(61,507)	
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	(250,000)	
Commonwealth Legislature Resolutions	(54,860)	
P.R. Electric Power Authority (PREPA)	(65,401)	
Rural Development	(264,881)	
CDBG	(29,795)	
Capital lease principal payment	<u>(41,884)</u>	(1,303,286)
Proceeds from notes payable and general obligation bonds are another financing source in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:		
		(6,168,000)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		235,000
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	470,697	
Other long-term liabilities	<u>871,014</u>	1,341,711
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	37,342	
Amortization of deferred charges	<u>(6,816)</u>	30,526
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	(224,532)	
P.R. Electric Power Authority (PREPA)	(196,204)	
Judgment and claims	(32,500)	
Estimated Landfill Closing Costs	(37,302)	
Compensated Absences	(330,276)	
Prior Year Property Taxes	(61,338)	
Accrued interest (net change)	<u>5,247</u>	(876,905)
Change in net assets of governmental activities:	\$	<u>1,354,335</u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 unit's 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, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

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

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

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

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

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

Management's Discussion and Analysis

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

Basic financial statements

The basic financial statements include both government-wide and funds 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, 2008

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, 2008

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, Debt Service and \$3,000,000 Bond Issuance Funds) or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users (for Community Development Block Grant and Lavadero Sanitary Sewer System Funds).

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.

\$3,000,000 Bond Issuance Fund: This fund accounts for proceeds from a special obligation bond issuance for the acquisition of land and construction of sports facilities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

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 at the time of receipt or earlier if the susceptible to accrual criteria is met. Licenses and permits, charges for services, rent, fines and miscellaneous revenues are generally recorded as revenues when received or are recognized earlier if the susceptible to accrual criteria is met.

The Municipality reports in the governmental fund statements deferred revenues which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the 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, 2008

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 agent*

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition. 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 deposit. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law.

Restricted cash with fiscal agent in the debt service fund consists of the undisbursed balance of property and sales tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of the general and other governmental funds represents 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 and sales tax revenues of current fiscal year collected by the CRIM (property tax) and the Puerto Rico Department of Treasury (sales tax) on the subsequent fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. *Interfund receivables and payables*

Activity among the funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due from/to other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances among the 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, (i.e., 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 and construction in progress, 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, 2008

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, consist 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 of 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, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

a. Fund balances:

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

Fund balance unreserved-designated represents amounts that Management has identified for future spending and not legally segregated.

b. Net assets:

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

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 fiscal year-end the Municipality's bank balance in commercial banks amounts to \$7,379,904.

Deposits in governmental banks (all of which are uninsured and uncollateralized), are exposed to custodial credit risk. At fiscal year-end the Municipality's bank balance in governmental banks amounts to \$5,824,677.

NOTE C – INVESTMENT HELD WITH FISCAL AGENT

The investment held with fiscal agent consists of a non-participating investment contract (non-rated guaranteed investment contract, "GIC"). This represents the investment of the undisbursed proceeds of the \$3,000,000 special obligation bond under custody of GDB, the Municipality's fiscal agent, pursuant to the bond purchase agreement. The GIC, with an outstanding balance of \$733,350 as of June 30, 2008 earns interest at a variable rate (LIBOR minus .125%, 2.558% as of June 30, 2008) and matures on December 18, 2008. GIC outstanding balance is valued at cost.

NOTE D – RECEIVABLES - LEASE

The Municipality is a lessor of a property, which consists of a building facility, classified as direct financing lease. The lease term is for twenty years under a noncancelable lease agreement. The following in the composition of the net investment in direct financing lease as of June 30, 2008:

	<u>Amount</u>
Total minimum lease payments to be received	\$ 444,220
Less: Unearned income	<u>(103,461)</u>
Net investment in direct financing lease	<u>\$ 340,759</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE D – RECEIVABLES – LEASE – Continued

At June 30, 2008, minimum lease payments for each of the five succeeding fiscal years and thereafter are as follows:

Year	Amount
2009	\$ 76,152
2010	76,152
2011	76,152
2012	76,152
2013	76,152
Thereafter	63,460
	\$ 444,220

The net investment in direct financing lease in the amount of \$340,759 is recorded as deferred revenue in the governmental fund statements since it is not available as required by current standards.

NOTE E - DUE FROM (TO) GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2008 follows:

	Commonwealth Government	Federal Government
Municipal Revenue Collection Center (CRIM) – intergovernmental subsidy (general fund)	\$ 99,056	\$ -
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	19,579	-
P.R. Department of Treasury – Christmas bonus reimbursement	110,975	-
P.R. Department of Treasury – sales and use taxes- Municipal Development fund (general fund)	47,498	-
P.R. Department of Treasury – sales and use taxes (debt service fund)	68,058	-
P.R. Department of Education	26,600	-
P.R. Department of Labor – Law No. 52	147,863	-
P.R. Department of Labor – Law No. 82	107,874	-
Commonwealth Legislative Resolutions	15,288	-
P.R. Electric Power Authority (PREPA)	130,803	-
P.R. Infrastructure Financing Authority (PRIFA)	36,819	-
Others	8,501	33,963
Office of Commissioner of Municipal Affairs- CDBG	-	768,171
Office of Public Safety Affairs- Homeland Security Grant Program	-	41,280
	\$ 818,914	\$ 843,414

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

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

June 30, 2008

NOTE E - DUE FROM (TO) GOVERNMENTAL ENTITIES – Continued

2. Amounts due to governmental entities as of June 30, 2008 follows:

	Commonwealth Entities
P.R. Electric Power Authority (PREPA)	\$ 6,905
P.R. Aqueduct and Sewer Authority (PRASA)	7,776
State Insurance Fund Corporation	5,688
Others	1,702
	\$ 22,071

NOTE F - 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	\$ 243,650
	Major fund:	
	Commonwealth Legislature Resolutions	11,000
	Other governmental funds:	
	\$525,000 Bond Issuance	18,000
	Homeland Security Grant Program	41,280
	Infrastructure Financing Authority	36,819
	Others	13,049
Total:		\$ 363,798

2. *Transfers in (out)*

Transfers among individual funds were made for operational purposes. Transfers include interest earned on restricted cash with fiscal agents in the Debt Service Fund and operating and capital improvement loans in other governmental funds which are 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, 2008

NOTE G - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2008 are as follows:

	<u>Balance July 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2008</u>
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 5,013,333	\$ 2,564,056	\$ -	\$ 7,577,389
Construction in progress	6,858,398	2,914,717	2,708,082	7,065,033
Total capital assets not being depreciated:	11,871,731	5,478,773	2,708,082	14,642,422
Capital assets, being depreciated:				
Land improvements	1,046,506	-	-	1,046,506
Buildings and building improvements	19,386,578	2,640,108	-	22,026,686
Infrastructure	10,975,762	192,206	53,814	11,114,154
Vehicles, machinery and equipment	6,731,185	865,657	36,322	7,560,520
Total capital assets being depreciated	38,140,031	3,697,971	90,136	41,747,866
Less accumulated depreciation for:				
Land improvements	280,778	36,003	-	316,781
Buildings and building improvements	6,142,656	575,394	-	6,718,050
Infrastructure	3,807,267	563,735	34,060	4,336,942
Vehicles, machinery and equipment	3,994,791	464,893	33,313	4,426,371
Total accumulated depreciation	14,225,492	1,640,025	67,373	15,798,144
Total capital assets being depreciated, net	23,914,539	2,057,946	22,763	25,949,722
Governmental activities capital assets, net	<u>\$ 35,786,270</u>	<u>\$ 7,536,719</u>	<u>\$ 2,730,845</u>	<u>\$ 40,592,144</u>

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

<u>Governmental activities:</u>	
General government	\$ 166,197
Public works and sanitation	721,725
Public safety	96,242
Culture and recreation	497,445
Health	11,920
Welfare and community development	130,398
Education	16,098
Total depreciation expense, governmental activities	<u>\$ 1,640,025</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE H - 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
<u>Major fund - general fund:</u>		
P.R. Department of Treasury – Christmas bonus reimbursement	\$ 110,975	\$ -
P.R. Department of Treasury – sales and use taxes-Municipal Development fund (general fund)	24,101	-
P.R. Department of Labor – Law No. 52	16,613	-
P.R. Department of Labor – Law No. 52	80,736	-
P.R. Department of Education	10,600	-
P.R. Energy Power Authority	130,803	-
<u>Major fund – Commonwealth Legislature</u>		
<u>Resolutions fund:</u>		
Commonwealth Legislative Resolutions	5,795	-
<u>Major fund – debt service fund:</u>		
P.R. Department of Treasury – sales and use taxes (debt service fund)	24,101	-
<u>Major fund – Community Development Block Grant fund:</u>		
Office of commissioner of Municipal Affairs - CDBG	-	265,053
<u>Other governmental funds:</u>		
P.R. Infrastructure Financing Authority (PRIFA)	36,819	-
P.R. Public Housing Agency (PRPHA) - Public and Indian Housing	-	14,232
Others	-	22,278
	\$ 440,543	\$ 301,563

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT

1. Summary of long-term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2008:

	<u>Balance at July 1, 2007,</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2008</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 10,370,252	\$ 6,168,000	\$ 470,697	\$ 16,067,555	\$ 698,000
Note payable to CRIM-LIMS	136,442	-	27,288	109,154	28,936
Note payable to CRIM-financing of delinquent accounts	4,984	-	199	4,785	199
Note payable to FEMA	177,828	-	86,696	91,132	91,132
Note payable to Puerto Rico Treasury Department	1,039,490	-	313,661	725,829	725,829
Compensated absences	1,182,701	330,277	183,702	1,329,276	173,779
Christmas Bonus	194,067	224,532	194,067	224,532	224,532
Judgments and legal claims	7,500	32,500	-	40,000	40,000
Estimated Landfill Closing Costs	1,100,400	37,301	-	1,137,701	-
Payable to CRIM-property tax advances	-	61,338	-	61,338	-
Payable to PREPA	-	196,204	65,401	130,803	65,401
	<u>\$ 14,213,664</u>	<u>\$ 7,050,152</u>	<u>\$ 1,341,711</u>	<u>\$ 19,922,105</u>	<u>\$ 2,047,808</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2008 amount to \$16,067,555. 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 collect property taxes for payment of principal and interest on bonds and notes. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by law. Debt Service Fund has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of \$690,000 Revenue bonds are made through an "Interest Bearing Account" (IBA) maintained by GDB, which is financed with proceeds from lessee's rental payments.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

Principal and interest payments of certain long-term debt issued for operational purposes (special obligation note of \$748,000 and special obligation bonds of \$3,000,000 and \$203,000) 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). Principal and interest payments of special obligation notes of \$305,000, \$139,000; \$1,027,000 are made through the "Municipal Redemption Fund". A detail of the general, special obligation bonds and notes as of June 30, 2008 follows:

	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% (7.61% at June 30, 2008)	\$ 10,000
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%	78,000
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%	104,000
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 4.87% to 6.56% (5.69% at June 30, 2008)	120,000
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% (6.12 % at June 30, 2008)	295,000
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% (3.88% at June 30, 2008)	345,000
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% (3.88% at June 30, 2008)	375,000
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%	602,000
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%	763,000
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%	931,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – 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%	\$ 892,000
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%	1,149,000
1992 revenue bonds of \$690,000 due in annual installments of \$5,000 to \$25,000 through July 1, 2013; bearing interest at 9%	240,000
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 5.28% (4.24% at June 30, 2008)	480,000
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 3.28% to 5.31% (4.24% at June 30, 2008)	1,250,000
2005 special obligation notes of \$748,000 due in annual installments of \$92,000 to \$124,000 through July 1, 2012; bearing interest at rates ranging from 3.93% to 7.00% (6.48% at June 30, 2008)	561,000
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% (4.24% at June 30, 2008)	880,000
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 3.93% to 7.50% (6.48% at June 30, 2008)	830,000
2007 general obligation notes of \$525,000 due in annual installments of \$60,000 to \$90,000 through July 1, 2014; bearing interest at rates ranging from 3.93% to 7.50% (6.48% at June 30, 2008)	525,000
2008 general obligation notes of \$400,000 due in annual installments of \$45,000 to \$70,000 through July 1, 2014; bearing interest at rates ranging from 3.93% to 7.25% (3.93% at June 30, 2008)	400,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

	<u>Outstanding Amount</u>
2008 general obligation bonds of \$569,000 due in annual installments of \$40,000 to \$77,000 through July 1, 2017; bearing interest at rates ranging from 3.93% to 7.50% (3.93% at June 30, 2008)	\$ 569,000
2008 special obligation notes of \$305,000 due in annual installments of \$45,000 to \$60,000 through July 1, 2014; bearing interest at rates ranging from 3.93% to 7.50% (3.93% at June 30, 2008)	305,000
2008 special obligation notes of \$139,000 due in annual installments of \$2,000 to 11,000 through July 1, 2032; bearing interest at 7.25%	139,000
2008 special obligation notes of \$1,027,000 due in annual installments of \$16,000 to \$87,000 through July 1, 2032; bearing interest at rates ranging from 7.00% to 7.25% (7.00% at June 30, 2008)	1,027,000
2007 special obligation bond of \$3,000,000 due in annual installments of \$60,000 to \$205,000 through July 1, 2032; bearing interest at 5.83%	3,000,000
2007 special obligation bond of \$203,000 due in annual installments of \$14,000 to \$27,000 through July 1, 2017; bearing interest at rates ranging from 3.93% to 7.50% (3.93% at June 30, 2008)	203,000
	16,073,000
Less: deferred charges arising from debt refunding:	(5,445)
	\$ 16,067,555

The annual requirements to amortize general, special obligation bonds and notes as of June 30, 2008 follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG TERM DEBT – Continued

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 698,000	\$ 629,921
2010	785,000	837,707
2011	826,000	817,372
2012	883,000	766,715
2013	938,000	711,467
2014-2018	3,796,000	2,846,440
2019-2023	3,441,000	2,505,420
2024-2028	2,619,000	986,537
2029-2032	2,087,000	316,436
Totals	<u>\$ 16,073,000</u>	<u>\$ 10,418,015</u>
Less: deferred charges arising from debt refunding:	(5,445)	
	<u>\$ 16,067,555</u>	

3. Other long-term liabilities

Note payable to CRIM (LIMS) - On November 28, 2001 the Municipality entered into a financing agreement with the CRIM in the amount of \$261,009 for the payment of the Municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$17,503, including interest of 5.95% and is due on November 28, 2011. Amount is 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:

<u>Outstanding Amount</u>
\$ 109,154

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 28,936	\$ 5,927
2010	30,684	4,171
2011	32,536	2,309
2012	16,998	421
Totals	<u>\$ 109,154</u>	<u>\$ 12,828</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG TERM DEBT – Continued

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 provisions 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 is 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:

\$ 4,785

June 30,	Principal	Interest
2009	\$ 199	\$ 294
2010	199	282
2011	199	270
2012	199	257
2013	199	245
2014-2018	997	1,038
2019-2023	997	728
2024-2028	997	419
2029-2032	799	112
Totals	\$ 4,785	\$ 3,645

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG TERM DEBT – Continued

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 will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:

\$ 91,132

June 30,	Principal	Interest
2009	\$ 91,132	\$ 3,468

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, 2008 is net of an unamortized discount of \$40,004. The note balance would be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM).

\$ 725,829

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG TERM DEBT – Continued

On April, 2008 the Municipality issued general obligation bonds of \$569,000 and a special obligation bond of \$203,000 both bearing interest at rates ranging from 3.93% to 7.50% (3.93% at June 30, 2008), to refinance this debt balance as of June 30, 2008. Actual payments by GDB to the PRTD were made in September, 2008. The \$569,000 GOB will be repaid from the Municipality debt service fund maintained at GDB (“CAE”) and the \$203,000 SOB through unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM).

Compensated absences - include 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	\$	1,329,275
Christmas Bonus – represents the accrued portion corresponding to fiscal year 2007-2008 of the Christmas bonus to be paid in December 2008	\$	224,532
Claims and judgments - represent the final settlement of legal cases paid subsequent to June 30, 2008. The awarded amount will be paid with unrestricted funds.	\$	40,000
Estimated closure and post-closure care costs of Municipal Landfill - The Municipality owns and operates a MSW landfill in Barrio Jaguitas, Hormigueros since about 1977. The Municipality has recognized an estimated liability for future closure and post-closure care costs. (See note J)	\$	1,137,701
Payable to CRIM, property tax advances – represents amount reported by CRIM on preliminary settlement of excess of advances over actual collections of property taxes. (See related note K)	\$	61,338

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG TERM DEBT – Continued

Payable to PREPA - As required by Act No. 83 of May 2, 1941, the Puerto Rico Electric Power Authority ("PREPA") should annually pay to the Municipalities of Puerto Rico a contribution in lieu of tax ("CELI") based on certain requirements as specified by the mentioned Act. The amount of CELI obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. For Fiscal year 2006-2007 the Municipality's annual energy charges amounts to \$914,253 but the CELI obligation determined by PREPA amounted to \$718,049. As communicated by PREPA the excess amount of \$196,204 was recorded as a payable to the Municipality and will be amortized over a 3 year period against the corresponding receivable for the same amount. As of June 30, 2008 the outstanding amount of \$ 130,803 is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:

\$ 130,803

June 30	Principal
2009	\$ 65,401
2010	65,402
Totals	\$ 130,803

NOTE J- LANDFILL CLOSURE AND POST-CLOSURE CARE COSTS OBLIGATIONS

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

The Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations. As a result of this study, the Municipality has recognized an estimated liability for future closure and post-closure care costs. The recognition of this liability is based on the amount of the landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$1,137,701 as of June 30, 2008, which is based on 53% usage of the landfill. It is estimated that an additional \$1,025,798 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, 2008. 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE K - 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 generally 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, 2008 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:	7.03%	9.03%
Discount granted by law to the taxpayers but reimbursed to the Municipality by the P.R. Treasury Department	(.20%)	(.20%)
Total percent to be paid by taxpayers	<u>6.83%</u>	<u>8.83%</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.

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 payable of \$61,338 resulting from the preliminary settlement for fiscal year 2007-2008 is recorded as other long-term debt in the government-wide financial statements since it will not be paid with current available financial resources.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE L - 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, 2008 the tax rates were as follows:

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

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$921,907 are recorded as deferred revenues.

NOTE M - 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. 36 Series 2006-2007, effective on November 15, 2006.

On July 29, 2007 the Commonwealth Legislature approved Act No. 80 ("Act 80") which amend Act No. 117 of July 4, 2006 to impose to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007 1% of the 1.5% is collected by the Municipalities and the remaining .5% of the 1.5% is collected by the Puerto Rico Department of Treasury (PRDT). Act 80 also provides for restrictions on the use of the sales tax, which is required to be invested in solid waste and recycling programs, capital improvements and health and public safety costs.

The amount collected by the PRDT (the remaining .5% of the 1.5%) is deposited in accounts or special funds in the Governmental Development Bank of Puerto Rico ("GDB"), subject to restrictions imposed and distributed as follows:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE M - SALES AND USE TAXES - Continued

- .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.

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. A total \$106,009 sales and use tax receivable 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; \$47,408 and \$68,058 represent amounts of "Municipal Development Fund" and "Municipal Redemption Fund" respectively collected on June by individuals, organizations and entities but paid by the PRDT subsequent to June 30. The amounts of \$24,101 (related to Municipal Development Fund) and \$24,101 (related to Municipal Redemption Fund) are recorded as deferred revenue since they are not available as required by current standards.

NOTE N - INTERGOVERNMENTAL REVENUES

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

	<u>Amount</u>
Amount of municipal equalization fund sent by CRIM	\$ 3,320,650
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	1,131,077
P.R. Department of Labor – Law No. 52	433,920
P.R. Department of Labor – Law No. 82	99,015
Reimbursement from P.R. Department of Treasury - Christmas Bonus reimbursement	171,376
Other intergovernmental revenues	52,657
	<u>\$ 5,208,695</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE O - 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, 2008

NOTE O - 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
2008	<u>\$ 176,198</u>	<u>\$ 146,069</u>
2007	<u>\$ 182,466</u>	<u>\$ 118,653</u>
2006	<u>\$ 192,038</u>	<u>\$ 99,677</u>

NOTE P - POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note O, 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 postemployment benefits amounted to \$66,575 for the year ended June 30, 2008.

NOTE Q - 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 \$43,548. 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, 2008 of approximately \$3,195,811 for construction, improvements or renovation of certain municipal facilities.

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

June 30, 2008

NOTE R – FUND BALANCE DEFICITS

Certain special funds disclosed fund balance deficits as follows:

	Amount
Major Funds:	
CDBG	\$ 284,265
Other Governmental Funds:	
Infrastructure Financing Authority	\$ 44,396
Nutrition Services Incentive Program	\$ 11,080

The deficits result from the accrual of expenditures without accruing intergovernmental revenues for the reimbursement of expenditures. As required by current standards, the Municipality records 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 S – NET CHANGE IN FUND BALANCE – GENERAL FUND

The Statement of Revenues, Expenditures and Changes in Fund Balances reported a net change in fund balance for the general fund in the amount of (\$889,332), which is composed of the following:

Net change in fund balance, 01 Fund	\$ (1,335,921)
Net change in fund balance, other special funds (with self-imposed restrictions) included as part of the general fund	446,589
	\$ (889,332)

Negative net change in fund balance in 01 Fund resulted from the effect of a fund balance readjustment of \$2,764,193. 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 fiscal year.

NOTE T - 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 be performed.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE T – 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 case settled subsequent to June 30, 2008 and not to be covered by insurance, the Municipality accrued \$40,000 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsels that, based on their experience, such actions and the potential liabilities will not impair the Municipality's financial position.

NOTE U– SUBSEQUENT EVENT

1. *Debt issuance*

On October 30, 2008, the Municipal Legislature approved the Resolution No. 36 Series 2008-2009, authorizing the issuance of a \$385,000 special obligation note through the Governmental Development Bank of Puerto Rico for improvements to the Municipality's solid waste landfill.

Required Supplementary Information

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2008

	Budgeted amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Taxes:				
Property taxes	\$ 2,722,389	\$ 2,722,389	\$ 2,686,888	\$ (35,501)
Municipal license taxes	1,490,000	1,490,000	1,411,395	(78,605)
Sales and use taxes	732,500	732,500	1,383,565	651,065
Intergovernmental	3,562,422	3,562,422	3,742,519	180,097
Fees, fines and charges for services	580,000	580,000	1,006,956	426,956
Interest	309,000	309,000	451,406	142,406
Other	85,000	85,000	181,522	96,522
Total revenues	9,481,311	9,481,311	10,864,251	1,382,940
Expenditures:				
Current:				
General government	4,854,412	6,503,292	6,613,683	(110,391)
Public works and sanitation	2,040,846	2,796,095	2,784,756	11,339
Public safety	693,843	690,414	682,701	7,713
Culture and recreation	698,107	897,838	895,358	2,480
Health	357,528	376,228	375,911	317
Welfare and community development	671,700	662,206	651,962	10,244
Education	21,800	17,226	17,225	1
Total expenditures	9,338,236	11,943,299	12,021,596	(78,297)
Excess (deficiency) of revenues over expenditures	143,075	(2,461,988)	(1,157,345)	1,304,643
Other financing sources (uses):				
Transfers out	(143,075)	(302,205)	(302,172)	33
Total other financing sources (uses)	(143,075)	(302,205)	(302,172)	33
Excess of expenditures and other financing uses over revenues and other financing sources	-	(2,764,193)	(1,459,517)	1,304,676
Readjustment from prior year fund balance (note B)	-	2,764,193	-	(2,764,193)
Excess of expenditures and other financing uses over revenues and other financing sources	\$ -	\$ -	\$ (1,459,517)	\$ (1,459,517)

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, 2008

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 fund 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 presents a fund balance readjustment of \$2,764,193. 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, 2008

NOTE C - BUDGET TO GAAP RECONCILIATION - Continued

Excess of expenditures and other financing uses over revenues and other financing sources (budgetary basis):	\$	(1,459,517)
Budget to GAAP differences:		
Entity differences:		
Non budgeted funds recorded as revenues for financial reporting purposes:		698,935
Non budgeted funds recorded as expenditures for financial reporting:		(649,306)
Non budgeted transfers in:		415,485
Non budgeted transfers out:		(18,525)
Basis of accounting differences:		
Revenues recorded for financial reporting purposes but not in budgetary basis:		378,511
Revenues recorded in budgetary basis but not for financial reporting purposes:		(252,541)
Expenditures recorded in budgetary basis but not for financial reporting purposes:		121,363
Expenditures recorded for financial reporting purposes but not in budgetary basis:		(95,685)
Timing differences:		
Current year encumbrances recorded as expenditures for budgetary reporting purposes:		328,113
Prior year encumbrances recorded as expenditures for financial reporting purposes:		(356,165)
Net change in fund balance (GAAP basis):	\$	<u>(889,332)</u>

Supplementary Information

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET INFORMATION
JUNE 30, 2008

<u>Line Item Number</u>		<u>Section 8 Housing Choice Vouchers 14,871</u>
	ASSETS	
	Current Assets:	
	Cash:	
111	Cash - unrestricted	\$ 35,330
113	Cash - other restricted	58,061
100	Total cash	<u>93,391</u>
	Accounts and notes receivables:	
121	Accounts receivable - PHA projects	2,019
122	Accounts receivable - HUD other projects	3,863
126.2	Allowance for doubtful accounts - other	(204)
128	Fraud recovery	998
128.1	Allowance for doubtful accounts - fraud	(160)
120	Total receivables, net of allowance for doubtful accounts	<u>6,516</u>
	Current investments	
144	Interprogram - due from	11,265
150	Total Current Assets	<u>111,172</u>
	Noncurrent Assets:	
	Fixed assets	
164	Furniture, equipment & machinery - administration	19,872
166	Accumulated depreciation	(19,152)
160	Total fixed assets, net of accumulated depreciation	<u>720</u>
180	Total Noncurrent Assets	<u>720</u>
190	TOTAL ASSETS	<u>\$ 111,892</u>
	LIABILITIES AND EQUITY	
	LIABILITIES:	
	Current Liabilities	
312	Accounts payable < 90 days	6,298
322	Accrued compensated absences - current portion	3,453
310	Total Current Liabilities	<u>9,751</u>
	Noncurrent Liabilities	
353	Noncurrent liabilities- other	6,579
354	Accrued Compensated Absences - non current	5,250
350	Total Noncurrent Liabilities	<u>11,829</u>
300	TOTAL LIABILITIES	<u>21,580</u>
	EQUITY:	
508.1	Invested in Capital Assets, Net of Related Debt	720
509	Restricted Net Assets	50,976
512.1	Unrestricted Net Assets	38,616
513	TOTAL EQUITY/NET ASSETS	<u>90,312</u>
600	TOTAL LIABILITIES and EQUITY/NET ASSETS	<u>\$ 111,892</u>

The accompanying note is 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, 2008

<u>Line Item Number</u>		<u>Section 8 Housing Choice Vouchers 14.871</u>
	REVENUES:	
706	HUD PHA operating grants	\$ 566,238
706.1	Capital Grants	
708	Other government grants	
711	Investment income - unrestricted	360
715	Other revenue	2,828
720	Investment income - restricted	370
	TOTAL REVENUES	569,796
	EXPENSES:	
	Administrative	
911	Administrative salaries	39,244
912	Auditing fees	5,000
914	Compensated absences	5,550
915	Employee benefit contributions- administrative	12,478
916	Other operating- administrative	3,095
	Subtotal	65,367
	General expenses	
962	Other General Expenses	414
966	Bad debt - other	1,110
	Subtotal	1,524
969	TOTAL OPERATING EXPENSES	66,891
970	EXCESS OPERATING REVENUE OVER OPERATING EXPENSES	502,905
971	Extraordinary maintenance	
972	Casualty losses - non-capitalized	
973	Housing assistance payments	456,051
974	Depreciation expense	214
		456,265
900	TOTAL EXPENSES	523,156
1000	EXCESS (DEFICIENCY) OF TOTAL REVENUE OVER (UNDER) TOTAL EXPENSES	\$ 46,640
MEMO account information		
1103	Beginning equity	43,672
1104	Prior period adjustments, equity transfers and correction of errors	
1120	Unit months available	1,236
1121	Number of unit months leased	1,234

The accompanying note is an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTE TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE

June 30, 2008

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, 2008

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	\$ 11,354
Water and Waste Disposal Systems for Rural Communities	10.760	N/A	<u>563,515</u>
Subtotal U.S. Department of Agriculture			<u>574,869</u>
<u>U.S. Department of Housing and Urban Development</u>			
Passed through the Office of Commissioner of Municipal Affairs: Community Development Block Grants - State's Program	14.228	FD - 30 AF - 30 AB - 30 CD - 30	2,176,574
Shelter Plus Care	14.238	N/A	22,535
Passed through the P.R. Department of Health: Housing Opportunities for Persons with AIDS (HOPWA)	14.241	2008-DS 0616	11,265
Passed through the P.R. Department of Housing - (Puerto Rico Public Housing Agency "PRPHA"): Public and Indian Housing	14.850	N/AV	83,182
Section 8 Housing Choice Vouchers	14.871	N/A	<u>517,392</u>
Subtotal U.S. Department of Housing and Urban Development			<u>2,810,948</u>
<u>U.S. Department of Justice</u>			
Passed through the PR Department of Justice: Edward Byrne Memorial Justice Assistance Grant Program	16.738	2005-DJ-BX-0072	<u>9,605</u>
<u>U.S. Department of Transportation</u>			
Federal Transit Formula Grants (Urbanized Area Formula Program)	20.507	N/A	<u>122,321</u>
<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	28,346
Nutrition Services Incentive Program	93.053	N/A	25,305
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>112,817</u>
Subtotal U.S. Department of Health and Human Services:			<u>166,468</u>
<u>U.S. Department of Homeland Security</u>			
Passed through the Puerto Rico Governor Office - (Office of Public Safety Affairs): Homeland Security Grant Program	97.067	2005-GE-T5-4009	41,280
Total Expenditures of Federal Awards			<u>\$ 3,725,491</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, 2008

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	\$ -	\$ -	\$ 11,354
10.760	-	563,515	-
14.228	2,176,574	-	-
14.238	-	-	22,535
14.241	-	-	11,265
14.850	-	-	83,182
14.871	-	-	517,392
16.738	-	-	9,605
20.507	-	-	122,321
93.052	-	-	28,346
93.053	-	-	25,305
93.575	-	-	112,817
97.067	-	-	41,280
Total federal awards expenditures	2,176,574	563,515	985,402
Total nonfederal awards expenditures	-	-	1,319,389
Total expenditures, fund statements	<u>\$ 2,176,574</u>	<u>\$ 563,515</u>	<u>\$ 2,304,791</u>

VALDES, GARCIA, MARIN & MARTINEZ, LLP

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

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INDEPENDENT AUDITORS' 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

To the Honorable Mayor and
Members of the Municipal Legislature
Municipality of Hormigueros
Hormigueros, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Hormigueros (the Municipality) as of and for the year ended June 30, 2008, which collectively comprise the Municipality's basic financial statements, and have issued our report thereon dated December 18, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

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

Compliance and other matters

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

This report is intended solely for the information and use of the Municipality's management, the Honorable Mayor and Members of the Municipal Legislature, the Commonwealth of Puerto Rico, 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.



San Juan, Puerto Rico
December 18, 2008

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affixed to the original.

VALDES, GARCIA, MARIN & MARTINEZ, LLP

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

To the Honorable Mayor and
Members of the Municipal Legislature
Municipality of Hormigueros
Hormigueros, Puerto Rico

Compliance

We have audited the compliance of Municipality of Hormigueros (the Municipality) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2008. The Municipality's major federal programs are identified in the summary of auditors' 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's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, "Audits of States, Local Governments and Non-Profit Organizations". Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Municipality's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Municipality's 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, 2008. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2008 III-1.

Internal Control Over Compliance

The management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with the 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 the compliance, but not for the purpose of expressing our opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

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

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material non-compliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

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

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

This report is intended solely for the information and use of the Municipality's management, the Honorable Mayor and Members of the Municipal Legislature, the Commonwealth of Puerto Rico, 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.

San Juan, Puerto Rico
December 18, 2008

A handwritten signature in black ink, appearing to read "E. Garcia, Jr. + Partner UP".

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to the original.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Auditors' Results

FISCAL YEAR ENDED JUNE 30, 2008

A. Summary of auditors' results:

Part I - Financial Statements

1. Type of auditors' report issued: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion

Internal control over financial reporting:

2. Significant deficiencies identified? Yes No

3. Significant deficiencies reported as material weaknesses Yes None reported

4. Financial statements material noncompliance noted? Yes No

Part II - Federal Awards

1. Significant deficiencies Yes No

2. Significant deficiencies reported as material weaknesses Yes None reported

3. Type of auditors' report issued on compliance major programs Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion

4. Any audit findings required to be reported under Section 510(a) of OMB Circular A-133? Yes No

5. Identification of major programs (Section 520 (h) (i) of OMB Circular A-133):	<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
	14.228	Community Development Block Grants/States Program
	14.850	Public and Indian Housing
	14.871	Section 8 Housing Choice Vouchers

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

7. Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FISCAL YEAR ENDED JUNE 30, 2008

Section II - Financial Statements Findings

Finding	No matters reported.
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FISCAL YEAR ENDED JUNE 30, 2008

Section III – Federal Awards, Findings and Questioned Costs

Reference
Number : 2008 III-1

Agency : U.S. Department of Housing and Urban Development

Award : Public and Indian Housing

CFDA
Number : 14.850

Compliance
Requirement: Cash Management

Condition : During the cash management tests of compliance, we noted certain instances where the Municipality's Program officers did not follow procedures to minimize the time elapsing between the transfer of funds from the P. R. Department of Housing (the pass-through entity) and their disbursement to the suppliers.

Criteria : 24 US Code of Federal Regulations Subpart C Section 85.20 (b) (7) requires procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees' cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transaction reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making disbursements. Grantees must monitor cash drawdowns by their subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees.

Effect : The Municipality's Program did not comply with the federal regulation mentioned above in maintaining excess funds over its immediate needs.

Cause : Excess of funds advanced by the pass-through entity and the Municipality's lack of internal control over cash management process.

Questioned
Costs : None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FISCAL YEAR ENDED JUNE 30, 2008

Section III – Federal Awards, Findings and Questioned Costs

Reference
Number

2008 III-1 (Continued)

Recommendation

Management must establish proper internal controls over cash management to minimize the time elapsed between the receipt of funds and their disbursement to the suppliers. We recommend the Municipality to design written procedures for cash management for the Program that enables the Municipality to disburse funds promptly and minimize the time elapsing between the receipt of funds and its disbursement.

Management
Comments

As indicated by the Finance Director, management will take the necessary steps to design procedures to minimize the time elapsed after receiving the funds advanced from the pass-through entity and its disbursement. They will also train the Program's personnel that perform duties on those federal regulations related to cash management requirements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

**SCHEDULE OF STATUS OF PRIOR YEARS
AUDIT FINDINGS AND QUESTIONED COSTS**

FISCAL YEAR ENDED JUNE 30, 2008

None