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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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

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



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, 2010, 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial 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, as of June 30, 2010, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 18, 2011, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Budgetary Comparison Schedule on pages 3 through 14 and 51 through 53 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's financial statements as a whole. The accompanying Schedule of Expenditures of Federal Awards on page 57 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. The Schedule of Expenditures of Federal Awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The Financial Data Schedule supplementary information on pages 54 and 55 is required by the Uniform Reporting Standards of the Department of Housing and Urban Development. The Schedule of Expenditures of Federal Awards and the Financial Data Schedule supplementary information have been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

A handwritten signature in black ink, appearing to read "Oscar Garcia, CPA". The signature is written in a cursive style with a large initial "O".

San Juan, Puerto Rico
January 18, 2011

Stamp 2566416 was affixed
to the original.

MANAGEMENT'S DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

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, 2010. 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 2009 by \$33,383,125 (net assets). This represents an increase of 2% with respect to fiscal year 2009.
- Revenues and expenses decreased by 1% and 4% respectively in comparison with the previous year.
- Change in net assets increased 202% compared to change in net assets of fiscal year 2009.

Highlights for Fund Financial Statements

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

- A net change of (\$1,703,199) in the fund balances of the Municipality's governmental funds resulted in a reported combined ending fund balances of \$5,608,182 in fiscal year 2010. Approximately 10% of the total combined fund balances is unreserved.
- In comparison to fiscal year 2009 total fund balance of the general fund decreased by 19% but the unreserved fund balance increased 9%.

General Financial Highlights

- The investment in capital assets as of June 30, 2010 was \$45,042,123 (net of depreciation).
- Long-term debt increased to \$19,648,160 or approximately 3% with respect to the prior year.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$282,095.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

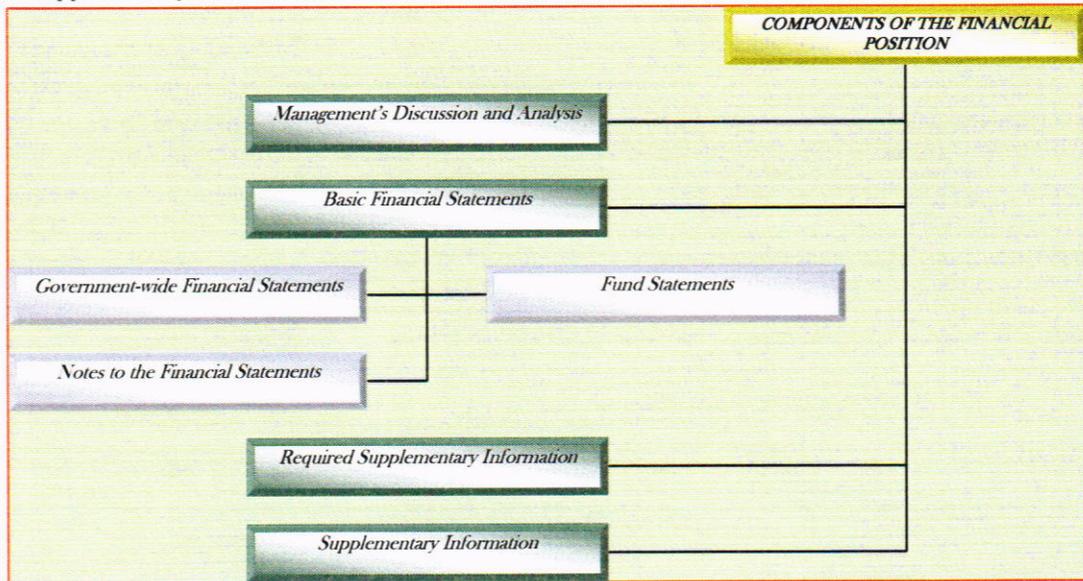
MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

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 time, increases or decreases in the Municipality's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's capital assets may need to be considered to assess the overall health of the Municipality. The second statement – the statement of activities – presents information showing how the net assets changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

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 as by bond covenants.

The Municipality's basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach the financial statements focus on near-term inflows and outflows of external resources, as well as 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 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, 2010

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

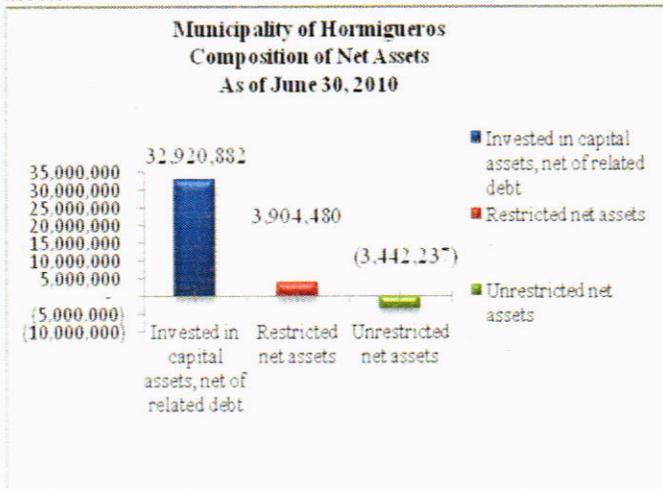
Net Assets

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

TABLE 1

<i>Summary Statement of Net Assets As of June 30,</i>		
	Governmental Activities	
	2010	2009
Assets		
Current and other assets	\$ 11,110,785	\$ 11,796,481
Capital assets	45,042,123	43,206,821
Total assets	\$ 56,152,908	\$ 55,003,302
Liabilities		
Current and other liabilities	\$ 3,121,623	\$ 2,969,059
Long-term liabilities	19,648,160	19,151,644
Total liabilities	22,769,783	22,120,703
Net assets		
Invested in capital assets, net of related debt	32,920,882	31,309,738
Restricted	3,904,480	4,843,166
Unrestricted	(3,442,237)	(3,270,305)
Total net assets	\$ 33,383,125	\$ 32,882,599

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. At the close of the fiscal year, the assets of the Municipality exceeded its liabilities by \$33,383,125, representing an increase of 2% with respect to fiscal year 2009. 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
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MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

As of June 30 2010, the Municipality presented an unrestricted net assets deficit. This deficit primarily arises from long-term obligations such as compensated absences and debts to CRIM for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a "pay as you go" basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as invested in capital assets, net of related debt. 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 2010 and 2009:

TABLE 2

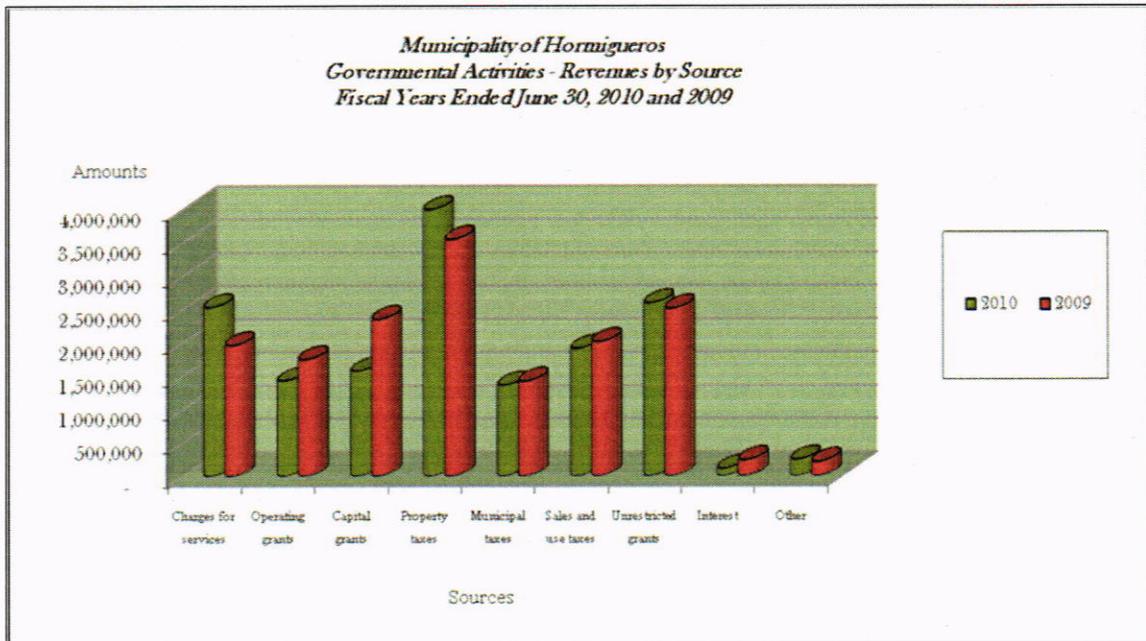
<i>Summary of Changes in Net Assets As of June 30,</i>		
	Governmental Activities	
	2010	2009
Program revenues:		
Fees, fines and charges for services	\$ 2,532,365	\$ 1,964,438
Operating grants and contributions	1,429,310	1,751,469
Capital grants and contributions	1,576,164	2,353,098
General revenues:		
Property taxes	4,041,139	3,552,363
Municipal license taxes	1,363,030	1,424,373
Sales and uses taxes	1,915,141	2,017,806
Grants and contributions not restricted to specific programs	2,595,611	2,517,068
Interest	111,103	239,038
Other	244,239	212,661
Total revenues	15,808,102	16,032,314
Expenses:		
General government	6,579,699	6,913,065
Public works and sanitation	3,521,556	3,257,302
Public safety	774,509	815,690
Culture and recreation	1,357,263	1,611,361
Health	370,703	385,630
Housing, welfare and community development	2,017,650	2,031,181
Education	31,369	31,606
Interest on long term debt	654,827	820,918
Total expenses	15,307,576	15,866,753
Change in net assets	500,526	165,561
Net assets-beginning of year	32,882,599	32,717,038
Net assets-end of year	\$ 33,383,125	\$ 32,882,599

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

FIGURE 1



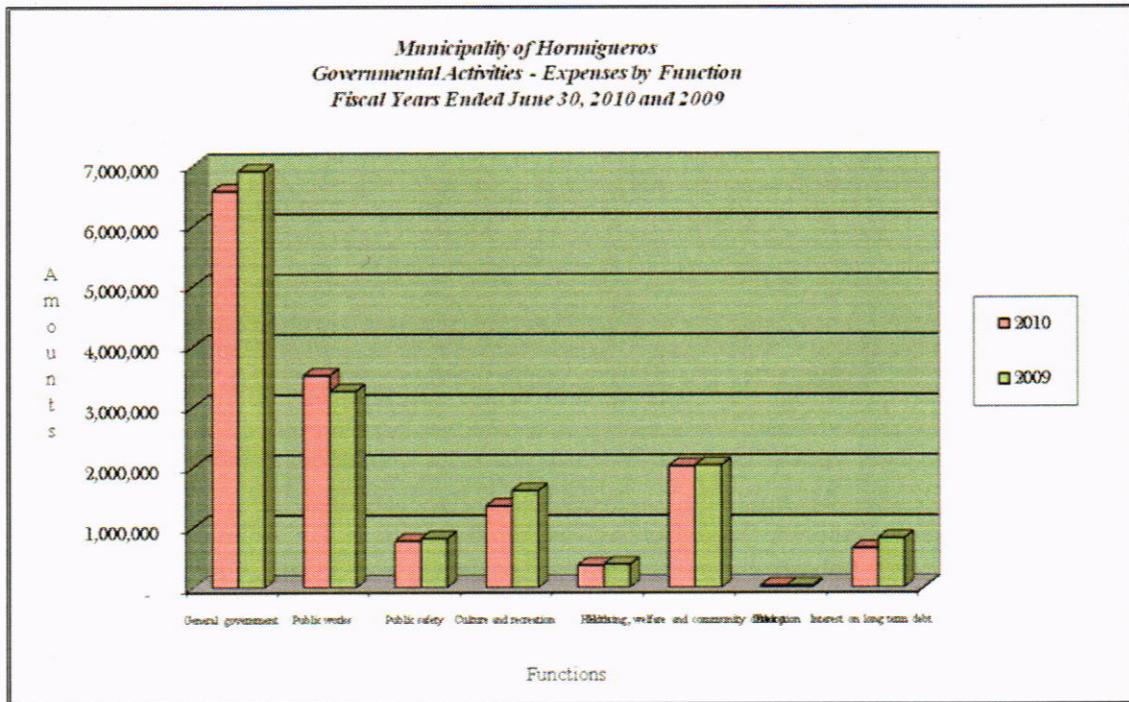
Approximately 26% of the Municipality's revenues came from property taxes, 19% from operating and capital grants and 16% from grants and contributions not restricted to specific programs. Revenues decreased by 1% in comparison with fiscal year 2009. This net decrease is mostly affected a combination of the following: (1) a 54% decrease in interest revenue due to the redemption of certificates of deposit; (2) a 33% decrease in capital grants mostly due to non recurrent revenues received from the Commonwealth in prior fiscal year reserved for specific projects; (3) a 29% increase in fees, fines and charges for services due to an increase in PREPA's compensation in lieu of taxes and an increase in construction taxes collected; (4) a 18% decrease in operating grants due to a decrease in Law No. 52 and No. 82 grant funds and a decrease in Homeland Security grant funds awarded; (5) and a 14% increase in property taxes collected.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

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 13% of total expenses. Program revenues of the Municipality covered 36% of total expenses.

Expenses decreased 4% in comparison with previous fiscal year. This includes a decrease of 20% in interest on long term debt (due to a reduction in bond's interest rates), an decrease of 16% in culture and recreation (due to reduction in expenses related to activities celebrated for the community such as Hormigueros' Patron Saint festivities and "Porta del Sol" tourism activities), an increase of 8% in public works and sanitation (due to an increase on non-capital expenditures such as paving of state roads), and a 5% decrease in public safety expenses (due to a reduction in payroll expenses related to this function).

As noted previously the decrease in revenues, combined with a higher decrease in expenses, resulted in an increase of net assets of 202% when compared with the net change in net assets reported in fiscal year 2009. 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, 2010

TABLE 3

<i>Net Cost of Municipality's Governmental Activities</i>				
<i>Fiscal years ended June 30,</i>				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2010	2009	2010	2009
General government	\$ 6,579,699	\$ 6,913,065	\$ (3,831,736)	\$ (5,674,381)
Public works and sanitation	3,521,556	3,257,302	(2,090,947)	(1,072,067)
Public safety	774,509	815,690	(769,613)	(663,300)
Culture and recreation	1,357,263	1,611,361	(1,323,483)	(1,496,976)
Housing, welfare and community development	2,017,650	2,031,181	(697,059)	(842,153)
Other	1,056,899	1,238,154	(1,056,899)	(1,238,154)
	<u>\$ 15,307,576</u>	<u>\$ 15,866,753</u>	<u>\$ (9,769,737)</u>	<u>\$ (10,987,031)</u>

Some of the cost of governmental activities was paid by those who directly benefited from the programs (\$2,532,365) and other governments and organizations that subsidized certain programs with grants and contributions (\$3,005,474). The \$9,769,737 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, 2010, the governmental funds reported ending fund balances of \$5,608,182, a net decrease of \$1,703,199 in comparison with the prior year. This net decrease was caused primarily by a decrease of (\$960,906) in the Other Governmental funds, and a decrease of (\$434,476) in the Commonwealth Legislative Resolutions funds due to amounts received on prior year for capital projects spent on current year. Of total fund balances, \$570,502 (or 10%) constitutes unreserved fund balance, including \$149,638 designated for subsequent year expenditures. The remainder of the fund balance is reserved to indicate that it is not available for new spending.

The general fund is the operating fund of the Municipality. The unreserved fund balance of the general fund represents 16% of total ending fund balance. For the year ended June 30, 2010, the fund balance of the general fund decreased by (\$255,289). The key combined factors of this change is an increase of 77% in other revenues, 72% decrease in interest revenues, 23% increase in construction permits revenue, combined with a decrease of 58% in capital outlays expenditures, a decrease of 21% in welfare expenditures, and a decrease of 14% in culture and recreation expenditures with respect to fiscal year 2009. In addition, this result includes the net effect of a fund balance readjustment of \$546,078. 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, 2010

General fund budgetary highlights

The general fund original budget for the fiscal period 2010 presented a decrease of 13% with respect to the prior year budget due to a decrease in the estimated amount of intergovernmental revenues, interest revenues, fees fines and charges for services, and other revenues.

Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year 2010 amendments to budget expenditures for a net amount of \$865,405 were approved. Of this net amount \$546,076 represented a readjustment of current year budget with prior year's budgetary surpluses, \$75,000 were transferred from deposits and sureties payable, \$72,678 were transferred from the public schools maintenance fund, and \$171,649 resulted from collections in excess of originally budgeted amount. Actual revenues exceeded the revised budgeted revenues by \$576,328. The most significant variances were \$475,481 from property taxes, \$336,151 from intergovernmental subsidies, (\$162,188) from municipal license taxes, and (\$95,459) from interest revenue. The Municipality reported a negative variance of (\$323,241) between revised budgeted appropriations and actual expenditures primarily due to a negative variance of (\$351,254) in general government expenditures, ending with a total net negative variance of (\$282,095).

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$45,042,123 in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of 4% over the prior year.

TABLE 4

<i>Capital Assets As of June 30,</i>		
	Governmental Activities	
	2010	2009
Non-depreciable assets:		
Land	\$ 7,702,495	\$ 7,702,495
Construction in progress	10,367,690	9,700,814
Depreciable assets:		
Land improvements	657,720	693,722
Buildings and buildings improvements	17,279,331	15,345,349
Infrastructure	6,114,474	6,440,813
Vehicles, machinery and equipment	2,920,413	3,323,628
Total	\$ 45,042,123	\$ 43,206,821

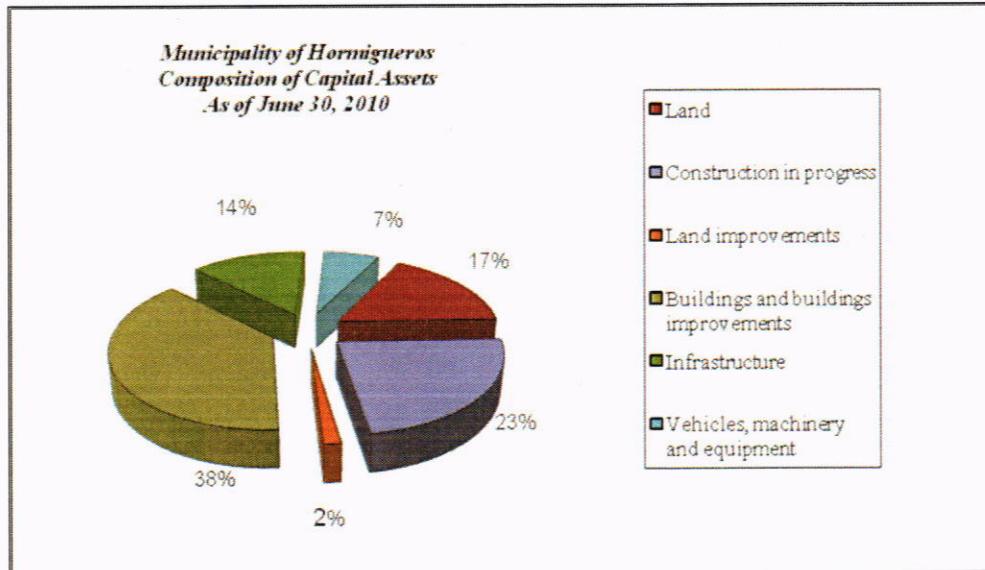
Certain projects are still in construction in progress as of June 30, 2010. The most significant of these projects are the construction of "Lavadero Sanitary Sewer System", the remodeling of the Fine Arts School building, the construction of Lavadero's Multiuse Center, and the construction of a 400 meters race track with reported costs of \$4,830,887; \$1,406,025; \$1,054,283; and \$727,001 respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

Figure 3



The Municipality's fiscal year 2010-2011 capital budget calls for a significant amount of new and continuous projects including the continuance of the construction of Lavadero Sanitary Sewer system, which is being financed through grants from USDA Rural Development, P.R. Water and Sewer Authority and Commonwealth's stimulus plan funds. Other projects still in progress in this fiscal year 2011 will include the improvements to the municipal landfill, the construction of the access ramp to Hormigueros Plaza building, the construction of the "Segundo Ruiz Belvis" recreational park, and the reconstruction of various basketball courts in different communities.

Other projects that will be developed in the next fiscal year include the reconstruction of "San Romualdo" and "Hoya Grande" community centers, the construction of "Vista a la Bahia" square in "Hoya Grande" community, the construction of a recycling workshop in "El Hoyo" community, the conclusion of the improvements of the "Hermanos Miura" baseball stadium and the Natural History Museum in the restored antique Fire Station. The Municipality will continue its public policy of land acquisition for the development of necessary projects (such as the extension of the Municipal Graveyard) and to promote the development of low cost housing, and commercial spaces. The "Hormigueros Auto Parts" building lease agreement with a private investor for the development of commercial spaces will provide additional rental income and encourage the employment opportunities for the citizenship. The "Lavadero de Oro" project is a significant one that comprises the construction of eight housing buildings of social interest requiring an investment of \$6,000,000. This project will be financed through grants from the Puerto Rico Department of Housing. Finally, the Municipality is engaged in the development of an Ecotourism Center in the Eureka Station. All these projects will be financed through Commonwealth and Federal grants, Commonwealth Legislature and Municipal funds. More detailed information about the Municipality's capital assets and future projects is presented in Note G to the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2010

Long term debt

At year-end, the Municipality has \$ 16,160,000 in general and special bonds and notes outstanding, an increase of 3% with respect to fiscal year 2009. This increase was due to four additional general obligation bonds and notes issued for the acquisition of equipment and capital improvements.

TABLE 5

<i>Outstanding Long-term Debt</i>		
<i>Fiscal years ended June 30,</i>		
	Governmental Activities	
	2010	2009
General and special obligation bonds and notes	\$ 16,160,000	\$ 15,760,000
Compensated absences	1,315,771	1,370,107
Payable to CRIM – prior years doubtful accounts	4,387	4,586
Christmas bonus payable	177,402	235,134
Payable to CRIM - LIMS	49,534	80,218
Estimated landfill closing costs	1,212,306	1,175,004
Note payable to SIFC	94,711	-
Property Taxes – current year	311,847	360,297
Payable to PREPA	322,202	166,298
Total	\$ 19,648,160	\$ 19,151,644

The Municipality reported an increase in other long term debts of \$96,516. This increase was primarily due to new debt issued to the P.R. State Insurance Fund Corporation and a net increase in the amount payable to PREPA of \$94,711 and \$155,904, respectively. More detailed information about the Municipality's long term liabilities is presented in Note I to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's officials considered certain factors when setting the fiscal year 2010-2011 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 15.6% which compares with the Commonwealth rate of 16.6%.

For fiscal year 2010-2011 the Municipality applied a conservative approach in development budget estimates. Amount available for appropriations in the General Fund totals \$10,591,135, an increase of approximately 11% with respect to prior fiscal year estimates. Budgeted expenditures are expected to rise according to the increase of budgeted revenues. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase modestly by the close of 2011 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, 2010

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

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

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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

ASSETS	Governmental Activities
Cash and cash equivalents	\$ 1,754,988
Receivables, net:	
Municipal license taxes	30,896
Sales and use taxes	116,285
Lease (note C)	239,796
Other	68,168
Due from (note D):	
Commonwealth Government	1,186,989
Federal Government	438,445
Restricted assets:	
Cash and cash equivalents	1,483,347
Cash with fiscal agents	4,641,094
Investment held with fiscal agent (note B)	460,482
Deferred bond issuance costs, net of accumulated amortization of \$69,640	105,394
Other assets (note F)	584,900
Capital assets, net (note G):	
Land and construction in progress	\$ 18,070,185
Other capital assets, net	26,971,938
	45,042,123
Total assets	\$ 56,152,907
LIABILITIES	
Accounts payable and accrued liabilities	\$ 1,747,979
Interest payable	331,477
Due to:	
Commonwealth Government	33,224
Deferred revenues:	
Municipal license taxes	946,088
Intergovernmental - Federal grants	62,854
Long term liabilities (note I):	
Due within one year	1,896,713
Due in more than one year	17,751,447
Total liabilities	22,769,782
NET ASSETS	
Invested in capital assets, net of related debt	32,920,882
Restricted for:	
Capital projects	1,343,194
Debt service	2,383,277
Other specified purposes	178,009
Unrestricted (deficit)	(3,442,237)
Total net assets	33,383,125
	\$ 56,152,907

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, 2010

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	\$ 6,579,699	\$ 2,410,619	\$ 254,403	\$ 82,941	\$ (3,831,736)
Public works and sanitation	3,521,556	82,911	106,230	1,241,468	(2,090,947)
Public safety	774,509	-	4,896	-	(769,613)
Culture and recreation	1,357,263	33,780	-	-	(1,323,483)
Health	370,703	-	-	-	(370,703)
Housing, welfare and community developm	2,017,650	5,055	1,063,781	251,755	(697,059)
Education	31,369	-	-	-	(31,369)
Interest on long-term debt	654,827	-	-	-	(654,827)
Total	\$ 15,307,576	\$ 2,532,365	\$ 1,429,310	\$ 1,576,164	(9,769,737)

General revenues:

Taxes:

Property taxes	4,041,139
Municipal license taxes	1,363,030
Sales and use taxes	1,915,141
Grants and contributions not restricted to specific programs	2,595,611
Interest	111,103
Other	244,239
Total general revenues	10,270,263

Change in net assets

Net assets-beginning	500,526
Net assets-ending	32,882,599
\$	\$ 33,383,125

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
BALANCE SHEET -
GOVERNMENTAL FUNDS
JUNE 30, 2010**

	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	\$ 1,754,988	-	-	\$ -	-	-	\$ -	\$ 1,754,988
Receivables, net:								
Municipal license taxes	30,896	-	-	-	-	-	-	30,896
Sales and use taxes	116,285	-	-	-	-	-	-	116,285
Lease	239,796	-	-	-	-	-	-	239,796
Other	54,558	-	-	-	-	-	13,611	68,169
Due from:								
Commonwealth Government	828,096	-	182	82,669	95,699	102	180,241	1,186,989
Federal Government	-	327,118	-	-	-	-	111,327	438,445
Other funds (note E)	183,279	-	-	-	-	-	-	183,279
Restricted assets:								
Cash and cash equivalents	-	2,307	855,656	-	202,300	-	381,777	1,442,040
Cash with fiscal agents	-	-	-	2,643,164	20,375	-	2,018,862	4,682,401
Investment held with fiscal agent	-	-	-	-	-	460,482	-	460,482
Total assets	\$ 3,207,898	\$ 329,425	\$ 855,838	\$ 2,725,833	\$ 318,374	\$ 460,584	\$ 2,705,818	\$ 10,603,770
Liabilities and fund balances (deficit)								
Liabilities:								
Accounts payable and accrued liabilities	\$ 364,074	\$ 264,112	\$ 139,955	\$ -	\$ 441,593	\$ 153,080	\$ 385,165	\$ 1,747,979
Matured bonds and interest payable	-	-	-	912,517	-	-	-	912,518
Due to:								
Commonwealth Government	33,224	-	-	-	-	-	-	33,224
Other funds	-	63,004	-	11,325	990	-	107,960	183,279
Deferred revenues (notes C, H, and I):								
Municipal license taxes	946,088	-	-	-	-	-	-	946,088
Lease	239,796	-	-	-	-	-	-	239,796
Intergovernmental - Commonwealth Government	559,161	-	182	16,361	-	-	34,896	610,600
Intergovernmental - Federal grants	-	209,076	-	-	-	-	113,028	322,104
Total liabilities	2,142,343	536,192	140,137	940,203	442,583	153,080	641,049	4,995,588
Fund balances (deficits):								
Reserved for:								
Encumbrances	122,192	-	-	-	-	-	-	122,192
Debt service	-	-	-	1,785,630	-	-	-	1,785,630
Capital projects	35,000	-	715,701	-	-	307,504	1,936,276	2,994,481
Other specified purposes	6,884	-	-	-	-	-	128,493	135,377
Unreserved (deficit)								
Designated for subsequent years expenditures								
General fund	149,638	-	-	-	-	-	-	149,638
Undesignated (deficit)								
General fund	751,840	-	-	-	-	-	-	751,840
Capital project funds	-	(206,767)	-	-	(124,209)	-	-	(330,976)
Total fund balances (deficits)	1,065,554	(206,767)	715,701	1,785,630	(124,209)	307,504	2,064,769	5,608,182
Total liabilities and fund balances (deficits)	\$ 3,207,897	\$ 329,425	\$ 855,838	\$ 2,725,833	\$ 318,374	\$ 460,584	\$ 2,705,818	\$ 10,603,770

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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

Total governmental fund balances		\$	5,608,182
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:			-
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:			
Deferred charges - bond issuance costs, net	\$	105,394	
Other assets - cash deposit		<u>584,900</u>	690,294
Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:			
Receivable:			
Lease agreement		239,796	
Due from Commonwealth Government:			
P.R. Infrastructure Financing Authority		16,093	
P.R. Infrastructure Financing Authority - PINI Funds		18,803	
P.R. Department of Treasury - Christmas bonus reimbursement		147,940	
P.R. Department of Labor - Law No. 52		33,371	
Commonwealth Legislature Resolutions		182	
P.R. Department of Education		16,600	
CRIM - Property tax preliminary settlement		39,048	
P.R. Department of Treasury -sales and use taxes (Debt service fund)		16,361	
P.R. Electric Power Authority (PREPA)		322,202	
Due from Federal Government:			
P.R. Department of Health - HOPWA		33,002	
INSEC-ARRA - Community Services Block Grant		9,510	
P.R. Office of the Ombudsman for the Elderly - Titles III-D and E		7,662	
OCAM - CDBG and CDBG - ARRA		<u>209,076</u>	1,109,646
Interest liabilities are not due and payable in the current period and, therefore, are not reported in the funds			(97,960)
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		(15,481,000)	
Note payable to CRIM-LIMS		(49,534)	
Note payable to CRIM-financing of delinquent accounts		(4,387)	
Note payable to State Insurance Fund Corporation (SIFC)		(94,711)	
Compensated absences		(1,315,771)	
Christmas bonus payable		(177,402)	
Prior year property tax		(311,847)	
Estimated landfill closing costs		(1,212,306)	
P.R. Electric Power Authority (PREPA)		<u>(322,202)</u>	(18,969,160)
Net assets of governmental activities			<u>\$ (11,658,998)</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 (DEFICIT) -
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2010

	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)	\$ 3,025,950	\$ -	\$ -	\$ 1,015,192	\$ -	\$ -	\$ -	\$ 4,041,142
Municipal license taxes (note L)	1,363,030	-	-	-	-	-	-	1,363,030
Sales and use taxes (note M)	1,540,877	-	-	430,285	-	-	-	1,971,162
Intergovernmental:								
Commonwealth government (note N)	3,816,496	-	5,468	-	327,093	-	745,106	4,894,163
Federal government	-	931,855	-	-	-	-	1,105,387	2,037,242
Fees, fines and charges for services	934,135	-	-	-	-	-	32,545	966,680
Interest	60,781	-	-	8,919	-	1,771	39,632	111,103
Other	191,342	-	-	-	-	-	27,672	219,014
Total Revenues	10,932,611	931,855	5,468	1,454,396	327,093	1,771	1,950,342	15,603,536
Expenditures:								
Current:								
General government	5,786,835	109,175	-	-	-	-	145,919	6,041,929
Public works and sanitation	2,154,158	122,114	310	-	-	-	474,126	2,750,708
Public safety	618,012	-	-	-	-	-	14,991	633,003
Culture and recreation	836,006	-	-	-	-	-	-	836,006
Health	358,352	-	-	-	-	-	-	358,352
Housing, welfare and community development	567,748	239,015	6,276	-	-	-	1,063,123	1,876,162
Education	15,017	-	-	-	-	-	-	15,017
Capital outlays	420,923	498,635	433,337	-	263,982	425,949	2,271,466	4,314,292
Debt service:								
Principal	-	-	-	901,000	-	-	-	901,000
Interest	-	-	-	654,865	-	-	-	654,865
Bond issuance costs	-	-	-	-	-	-	9,313	9,313
Total expenditures	10,757,051	968,939	439,923	1,555,865	263,982	425,949	3,978,938	18,390,647
Excess (deficiency) of revenues over expenditures	175,560	(37,084)	(434,455)	(101,469)	63,111	(424,178)	(2,028,596)	(2,787,111)
Other financing sources (uses):								
Lease principal payments (note C)	76,152	-	-	-	-	-	-	76,152
Payment of long term debt to P. R. Electric Power Authority	(65,401)	-	-	-	-	-	-	(65,401)
Payment of long term debt to P. R. Department of Treasury	(211,550)	-	-	-	-	-	-	(211,550)
Proceeds from general obligation bonds	-	-	-	-	-	-	1,190,000	1,190,000
Transfers in	126,460	-	100,476	451,220	-	-	-	678,156
Transfers out	(451,222)	-	(100,497)	(959)	-	(3,168)	(122,310)	(678,156)
Total other financing sources (uses)	(430,850)	-	(21)	450,261	-	(3,168)	1,067,690	1,083,913
Net change in fund balances (deficit)	(255,289)	(37,084)	(434,476)	348,792	63,111	(427,346)	(960,906)	(1,703,199)
Fund balances (deficit) at beginning of year	1,320,843	(169,683)	1,150,177	1,436,838	(187,320)	734,850	3,025,675	7,311,380
Fund balances (deficit) at end of year	\$ 1,065,554	\$ (206,767)	\$ 715,701	\$ 1,785,630	\$ (124,209)	\$ 307,504	\$ 2,064,769	\$ 5,608,182

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

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

Net change in fund balances (deficit) - total governmental funds		\$ (1,703,199)
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	\$ 3,729,393	
Less: current year depreciation	<u>(1,807,540)</u>	1,921,853
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 balances by the cost of the disposed asset:		
		(86,551)
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)	141,253	
P.R. Department of Labor - Law No. 52	33,371	
P.R. Department of Education	16,600	
P.R. Infrastructure Financing Authority	16,093	
P.R. Infrastructure Financing Authority - PINI Funds	18,803	
CRIM - Property tax preliminary settlement	39,048	
P.R. Department of Treasury - sales and use taxes (Debt service fund)	16,361	
Commonwealth Legislature Resolutions	182	
P.R. Electric Power Authority (PREPA)	288,570	
Intergovernmental - Federal Government:		
OCAM - CDBG and CDBG - ARRA	209,076	
INSEC-ARRA - Community Services Block Grant	9,510	
P.R. Department of Health - HOPWA	33,002	
P.R. Office of the Ombudsman for the Elderly - Titles III-D and E	<u>7,662</u>	829,531
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)	(109,212)	
P.R. Public Housing Administration (PRPHA)	(45,000)	
P.R. Infrastructure Financing Authority	(37,443)	
P.R. Department of Education	(10,600)	
P.R. Department of Treasury - sales and use taxes (General Fund)	(36,191)	
P.R. Department of Treasury - sales and use taxes (Debt Service Fund)	(36,191)	
P.R. Infrastructure Financing Authority - PINI Funds	(25,611)	
Commonwealth Legislature Resolutions	(5,488)	
P.R. Electric Power Authority (PREPA)	(132,666)	
OCAM - CDBG	(170,700)	
Capital lease principal payment	<u>(50,927)</u>	(660,009)
Proceeds from general obligation bonds are other financing sources in the governmental funds, but increase in long-term liabilities in the Statement of Net Assets		
		(1,190,000)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)	111,000	
Other assets	<u>584,900</u>	695,900
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	790,000	
Other Long Term Liabilities	<u>778,192</u>	1,568,192
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	9,313	
Amortization of deferred charges - bond issuance costs	<u>(8,375)</u>	938
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:		
P.R. Department of Labor - Law No. 52	(766)	
P.R. Department of Recreation and Sports - "P.R en Forma"	(5,303)	
Christmas Bonus	(177,402)	
P.R. Electric Power Authority (PREPA)	(432,855)	
Estimated landfill closing costs	(37,302)	
Compensated Absences	(132,438)	
Note payable to State Insurance Fund Corporation (SIFC)	(94,711)	
Accrued interest (net change)	<u>4,648</u>	(876,130)
Change in net assets of governmental activities		\$ 500,526

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

1. *Financial reporting entity*

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

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

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

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

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

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

Management Discussion and Analysis

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

Basic financial statements

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Government-wide statements

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

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

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed 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, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues or expenditures or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users (for Commonwealth Legislature Resolutions, Lavadero Sanitary Sewer System and \$3,000,000 Bond Issuance 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 (including CDBG - ARRA) is used to account for revenue 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, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

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. *Deposits and investments*

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

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

4. *Restricted assets*

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. *Receivables and due from governmental entities*

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property and sales tax revenues of current fiscal year collected by the CRIM (property tax) and the Puerto Rico Department of Treasury (sales tax) on the subsequent fiscal year.

6. *Interfund receivables and payables*

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

7. *Inventories*

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

8. *Capital assets*

Capital assets reported in the governmental activities in the Statements of Net Assets include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items). The Municipality defines capital assets (except for infrastructure assets) as assets that have an individual cost of \$1,000 or more and have a useful life of one or more years. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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.

9. *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.

10. *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.

11. *Compensated absences*

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness). The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

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

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

12. Fund balances and Net Assets

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

Encumbrances:	Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.
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 assigned by Management for future spending to finance operational costs which are not legally segregated.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

13. *Interfund transactions*

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

14. *Risk financing*

The Puerto Rico Treasury Department (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of Hormigueros consists of professional, public responsibility, property and theft, auto and fidelity bond coverage. Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality’s insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

15. *Use of estimates*

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

16. *Future adoption of accounting pronouncements*

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

	<u>Statement</u>	<u>To be Adopted in Fiscal year ended,</u>
54	Fund Balance Reporting and Governmental Fund Type Definition	June 30, 2011
57	OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans	June 30, 2012
59	Financial Instruments Omnibus	June 30, 2011

The impact of these statements in the Municipality’s basic financial statements has not yet been determined.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE B – DEPOSITS AND INVESTMENT

1. 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 depository insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name.

At year-end, the Municipality's bank balance of deposits in commercial banks amounting to \$3,435,117 was covered by federal depository insurance or by collateral held by the Secretary of Treasury of Puerto Rico in the Municipality's name. Deposits in governmental banks (all of which are uninsured and uncollateralized), are exposed to custodial credit risk. At year-end the Municipality's bank balance in governmental banks amounts to \$4,538,695.

2. Investment

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 \$460,482 as of June 30, 2010 earns interest at a variable rate (LIBOR minus .125%, .412% as of June 30, 2010) and matures on September 13, 2010. GIC outstanding balance is valued at cost.

NOTE C – RECEIVABLES - LEASE

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

	Amount
Total minimum lease payments to be received	\$ 285,570
Less: Unearned income	(45,774)
Net investment in direct financing lease	\$ 239,796

At June 30, 2010, minimum lease payments for each of the four succeeding fiscal years are as follows:

Year	Amount
2011	76,152
2012	76,152
2013	76,152
2014	57,114
	\$ 285,570

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE D - DUE FROM (TO) GOVERNMENTAL ENTITIES

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

	Commonwealth Government	Federal Government
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 322,202	\$ -
Municipal Revenue Collection Center (CRIM) – property taxes	227,531	-
P.R. Department of Treasury – Christmas bonus reimbursement	147,940	-
P.R. Department of Education	28,600	-
P.R. Department of Treasury – sales and use taxes- Municipal Development fund	21,458	-
P.R. Department of Labor – Law No. 52	64,621	-
Others	15,744	-
<u>Major fund – CDBG fund:</u>		
Office of Commissioner of Municipal Affairs – CDBG and CDBG-AR	-	327,118
<u>Major fund – Commonwealth Legislature</u>		
<u>Resolutions fund:</u>		
Commonwealth Legislative Resolutions	182	-
<u>Major fund – Debt service fund:</u>		
Municipal Revenue Collection Center (CRIM) – property taxes	19,317	-
P.R. Department of Treasury – sales and use taxes- Municipal Redemption Fund	63,352	-
<u>Major fund – Lavadero Sanitary Sewer System</u>		
<u>fund:</u>		
P.R. Infrastructure Financing Authority (PRIFA) – “Brisas de Lavadero”	55,699	-
P.R. Aqueduct and Sewer Authority (PRASA)	40,000	-
<u>Major fund – \$3,000,000 Bond issuance fund:</u>		
Government Development Bank - interest	102	-
<u>Other governmental funds:</u>		
P.R. Infrastructure Financing Authority (PRIFA)	16,090	-
P.R. Infrastructure Financing Authority (PRIFA) – PINI Funds	59,465	-
Solid Waste Authority-Landfill improvements	85,819	-
P.R. Office of the Ombudsman for the Elderly – Title III-D and E; NSIP	-	19,097
INSEC	-	22,522
P.R. Energy Affairs Administration	-	29,500
P.R. Department of Health – HOPWA	-	33,002
Others	18,867	7,206
	\$ 1,186,989	\$ 438,445

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, 2010

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

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

	Amount
P.R. Aqueduct and Sewer Authority (PRASA)	\$ 31,887
General Services Administration	1,232
Others	105
	\$ 33,224

NOTE E - INTERFUND TRANSACTIONS

1. Due from/to other funds

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

Receivable Fund	Payable Fund	Amount
General Fund	<u>Major fund:</u> CDBG	\$ 63,004
	<u>Major fund:</u> Debt Service	11,325
	<u>Major fund:</u> Lavadero Sanitary Sewer	990
	<u>Other governmental funds:</u> \$510,000 Bond Issuance	19,842
	Infrastructure Financing Authority- (PINI)	8,138
	Infrastructure Financing Authority	2,141
	INSEC	22,522
	FTA	6,103
	HOPWA	33,002
	Others	16,212
Total:		\$ 183,279

2. Transfers in (out)

Transfers among individual funds were made for operational purposes. Transfers includes interest earned on restricted cash with fiscal agent in the debt service fund and operating and capital improvement loans in other governmental funds which are transferred to the general fund; and principal and interest payments of general long-term debt transferred from the general fund to the debt service fund.

NOTE F- OTHER ASSETS

Other assets include a cash deposit of \$584,900 held in custody of a Commonwealth's court of law for the acquisition of a parcel of land under litigation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE G - CAPITAL ASSETS

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

	Balance July 1, 2009	Increases	Decreases	Balance June 30, 2010
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 7,702,495	\$ -	\$ -	\$ 7,702,495
Construction in progress	9,700,814	3,341,482	2,674,606	10,367,690
Total capital assets not being depreciated:	17,403,309	3,341,482	2,674,606	18,070,185
Capital assets, being depreciated:				
Land improvements	1,046,506	-	-	1,046,506
Buildings and building improvements	22,677,804	2,644,098	196,614	25,125,288
Infrastructure	11,352,856	261,925	10,720	11,604,061
Vehicles, machinery and equipment	8,224,232	156,495	127,547	8,253,180
Total capital assets being depreciated	43,301,398	3,062,518	334,881	46,029,035
Less accumulated depreciation for:				
Land improvements	352,783	36,003	-	388,786
Buildings and building improvements	7,332,456	635,302	121,802	7,845,956
Infrastructure	4,912,043	587,907	10,363	5,489,587
Vehicles, machinery and equipment	4,900,605	548,328	116,165	5,332,768
Total accumulated depreciation	17,497,887	1,807,540	248,330	19,057,097
Total capital assets being depreciated, net	25,803,511	1,254,978	86,551	26,971,938
Governmental activities capital assets, net	\$ 43,206,820	\$ 4,596,460	\$ 2,761,157	\$ 45,042,123

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

Governmental activities:

General government	\$ 231,503
Public works and sanitation	743,083
Public safety	141,506
Culture and recreation	521,257
Health	12,351
Welfare and community development	141,488
Education	16,352
Total depreciation expense, governmental activities	\$ 1,807,540

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE H - DEFERRED REVENUES – GOVERNMENTAL FUNDS

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

	Commonwealth Government	Federal Grants
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 322,202	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	147,940	-
P.R. Department of Education	16,600	-
Municipal Revenue Collection Center (CRIM) – property taxes	39,048	
P.R. Department of Labor – Law No. 52	33,371	-
<u>Major fund – CDBG fund:</u>		
Office of Commissioner of Municipal Affairs – CDBG and CDBG-AR	-	209,076
<u>Major fund – Commonwealth Legislature</u>		
<u>Resolutions fund:</u>		
Commonwealth Legislative Resolutions	182	-
<u>Major fund – Debt service fund:</u>		
P.R. Department of Treasury – sales and use taxes – Municipal Redemption Fund	16,361	-
<u>Other governmental funds:</u>		
P.R. Infrastructure Financing Authority (PRIFA)	16,093	-
P.R. Infrastructure Financing Authority (PRIFA) - PINI	18,803	-
P.R. Department of Housing (PRPHA) – PIH	-	4,374
P.R. Department of Health – HOPWA	-	33,002
P.R. Department of Family – INSEC	-	9,510
P.R. Department of Family – ARRA - Child Care	-	25,752
P.R. Department of Family – ARRA - HPRP	-	19,769
P.R. Department of Family – Title III-D and E	-	7,724
P.R. Department of Education – Food Program	-	12,897
	\$ 610,600	\$ 322,104

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I – LONG-TERM DEBT

1. Summary of long-term debt activity

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

	<u>Balance at July 1, 2009</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2010</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 15,760,000	\$ 1,190,000	\$ 790,000	\$ 16,160,000	\$ 911,000
Note payable to CRIM- LIMS	80,218	-	30,684	49,534	32,536
Note payable to CRIM- financing of delinquent accounts	4,586	-	199	4,387	200
Note payable to SIFC	-	94,711	-	94,711	94,711
Compensated absences	1,370,107	132,438	186,774	1,315,771	191,101
Christmas Bonus	235,134	177,402	235,134	177,402	177,402
Estimated Landfill Closing Costs	1,175,004	37,302	-	1,212,306	-
Payable to CRIM- property tax advances	360,297	-	48,450	311,847	311,847
Payable to PREPA	166,298	432,855	276,951	322,202	177,916
	<u>\$ 19,151,644</u>	<u>\$ 2,064,708</u>	<u>\$ 1,568,192</u>	<u>\$ 19,648,160</u>	<u>\$ 1,896,713</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2010 amount to \$16,160,000. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to collect property taxes for payment of principal and interest on bonds and notes. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by law. Debt service funds has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of \$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, 2010

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 send 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 and \$385,000 are made through the "Municipal Redemption Fund". A detail of the general and special obligation bonds and notes as of June 30, 2010 follows:

	Outstanding Amount
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%	\$ 67,000
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%	87,000
1997 general obligation bonds of \$175,000 due in annual installments of \$5,000 to 15,000 through July 1, 2021; bearing interest at rates ranging from 4.865% to 6.56% (5.86% at June 30, 2010)	110,000
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% (6.30 % at June 30, 2010)	265,000
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% (4.30% at June 30, 2010)	325,000
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% (4.30% at June 30, 2010)	355,000
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%	549,000
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%	694,000
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%	878,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I – LONG-TERM DEBT – Continued

	Outstanding Amount
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%	822,000
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%	1,027,000
1992 revenue bonds of \$690,000 due in annual installments of \$5,000 to \$25,000 through July 1, 2013; bearing interest at 9%	160,000
2004 general obligation bonds of \$530,000 due in annual installments of \$15,000 to \$40,000 through July 1, 2024; bearing interest at rates ranging from 3.28% to 5.00% (4.50% at June 30, 2010)	440,000
2004 general obligation bonds of \$1,355,000 due in annual installments of \$35,000 to \$85,000 through July 1, 2029; bearing interest at rates ranging from 3.50% to 5.00% (4.50% at June 30, 2010)	1,170,000
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 1.53% to 6.60% (1.54% at June 30, 2010)	354,000
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% (4.50% at June 30, 2009)	840,000
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 1.53% to 7.50% (1.54% at June 30, 2010)	800,000
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 1.53% to 7.50% (1.54% at June 30, 2009)	400,000
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 1.53% to 7.25% (1.54% at June 30, 2009)	305,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

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 1.53% to 7.50% (1.54% at June 30, 2010)	486,000
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 1.53% to 7.50% (1.54% at June 30, 2010)	260,000
2008 special obligation notes of \$139,000 due in annual installments of \$2,000 to 11,000 through July 1, 2032; bearing interest at rates ranging from 1.53% to 7.50% (1.54% at June 30, 2010)	137,000
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 1.54% to 7.25% (1.54% at June 30, 2010)	1,011,000
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%	2,875,000
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 1.53% to 7.50% (1.54% at June 30, 2010)	173,000
2008 special obligation notes of \$385,000 due in annual installments of \$5,000 to 30,000 through July 1, 2033; bearing interest at rates ranging from 1.53% to 7.50% (1.54% at June 30, 2010)	380,000
2010 general obligation bonds of \$510,000 due in annual installments of \$35,000 to 65,000 through July 1, 2019; bearing interest at 6.50%	510,000
2010 general obligation bonds of \$285,000 due in annual installments of \$5,000 to 25,000 through July 1, 2034; bearing interest at 6.50%	285,000
2010 general obligation notes of \$160,000 due in annual installments of \$15,000 to 30,000 through July 1, 2016; bearing interest at rates ranging from 6.0% to 7.50% (6.00% at June 30, 2010)	160,000
2010 municipal obligation notes of \$235,000 due in annual installments of \$25,000 to 40,000 through July 1, 2016; bearing interest at rates ranging from 6.0% to 6.50% (6.00% at June 30, 2010)	235,000
	\$ 16,160,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I – LONG-TERM DEBT – Continued

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

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2011	\$ 911,000	\$ 816,986
2012	983,000	836,897
2013	1,043,000	774,332
2014	948,000	714,112
2015	970,000	656,402
2016-2020	3,987,000	3,283,702
2021-2025	3,473,000	1,551,363
2026-2030	2,557,000	738,369
2031-2035	1,288,000	89,428
Totals	<u>\$ 16,160,000</u>	<u>\$ 9,461,591</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. The amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of the municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center. Debt service requirements in future years are as follows:

Outstanding
Amount

\$ 49,534

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2011	\$ 2,536	\$ 2,309
2012	16,998	421
Totals	<u>\$ 49,534</u>	<u>\$ 2,730</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

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 provision of Law No. 146 of October 11, 2001. The agreement is in the form of a non-revolving line of credit bearing interest of 6.5% for the first five years and variable for the next twenty-five years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first five years were financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Also, during the first five years any collection from those delinquent accounts was credited to the loan principal. After the five-year period the loan outstanding balance was restructured for a twenty-five years period. Amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of the municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center. Debt service requirements in future years are as follows:

\$ 4,387

June 30,	Principal	Interest
2011	\$ 200	\$ 270
2012	199	257
2013	199	245
2014	199	232
2015	199	220
2016-2020	997	914
2021-2025	997	605
2026-2030	997	295
2031-2034	400	31
Totals	\$ 4,387	\$ 3,069

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE I – LONG-TERM DEBT – Continued

<p>Note Payable to SIFC – On February 26, 2010 the Municipality entered into a financing agreement with the State Insurance Fund Corporation (“SIFC”) in the amount of \$94,711 for the payment of employer contributions owed by the Municipality related to workers’ compensation and disability insurance. This final settlement is the result of an audit of employer contributions related to fiscal years 2008 and 2009. The agreement is in the form of a non-interest bearing note (imputed interest of 6.5%) payable in twelve monthly installments of \$7,893 and due in June 30, 2011. Amount will be totally repaid in fiscal year 2010-2011 with unrestricted funds through withholdings from the advances of property tax and amounts of the municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center.</p>	<p>\$ 94,711</p>
<p>Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time; represents the Municipality’s commitment to fund such costs from future operations. The amount is paid with unrestricted funds</p>	<p>\$ 1,315,771</p>
<p>Christmas Bonus - represents the accrued portion corresponding to fiscal year 2010 of the Christmas bonus to be paid in December 2010 with unrestricted funds.</p>	<p>\$ 177,402</p>
<p>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)</p>	<p>\$ 1,212,306</p>
<p>Payable to CRIM, property tax advances – represent amount reported by CRIM as a result of the settlement of excess of advances over actual collections of property taxes applicable to fiscal year 2009. Amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of the municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center. (See related note K)</p>	<p>\$ 311,847</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

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 2008-2009 the Municipality’s annual energy charges amounts to \$1,088,387 but the CELI obligation amounted to \$655,533. The excess amount of \$432,854 was recorded as a payable and a receivable for the same amount and will be amortized over a three-year period. As of June 30, 2010 the outstanding amount of \$322,202 includes a balance of \$33,632 from fiscal year 2008 and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:

\$ 322,202

<u>June 30</u>	<u>Principal</u>
2011	\$ 177,917
2012	144,285
Totals	<u>\$ 322,202</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE J - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS

The Municipality operates a landfill since 1977. Commonwealth and Federal laws and regulations require the Municipality to place a final cover on its landfill when it stops accepting waste and perform certain maintenance and monitoring functions at the landfill site for thirty years after closure. In addition to operating expenses related to current activities of the landfill, an expense provision and related liability should be recognized based on the future closure and post closure care costs that will be incurred near or after the date the landfill no longer accepts waste. The Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations. As a result of this study, the Municipality has recognized an estimated liability for future closure and post-closure care costs. The recognition of this liability is based on the amount of the landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$1,212,306 as of June 30, 2010, which is based on 54% usage of the landfill. It is estimated that an additional \$951,193 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, 2010. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations.

NOTE 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 general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2010 are 7.03% for personal property and 9.03% for real property. The distribution of these rates follows:

<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>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE K - PROPERTY TAXES – Continued

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

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. A net payable of \$311,847 resulting from the settlement for fiscal year 2009 is recorded as other long-term debt in the government wide financial statements since it will not be paid with current available financial resources. A net receivable of \$39,048 resulting from the settlement for fiscal year 2010 is recorded in the general fund is recorded as a deferred revenue since is not available as required by current standards.

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, 2010 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 \$946,088 is 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE M - SALES AND USE TAXES - Continued

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained in Subtitle BB of the Code. The municipal sales and use tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The municipal sales and use tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within Municipal limits. The Municipal Legislature approved the imposition of the municipal sales and use tax on November 1, 2006 with Ordinance No. 22 Series 2006-2007, effective on November 15, 2006.

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

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

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

The Municipal Legislature approved an amendment to 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. The tax is due the 10th day of each month based on the tax collected in the preceding month. A total \$116,285 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; \$21,458 and \$63,352 represents 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 amount of \$16,361 (related to Municipal Redemption Fund) is recorded as deferred revenue since is not available as required by current standards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

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	\$ 2,135,353
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	1,403,781
P.R. Department of Labor – Law No. 52	90,386
Reimbursement from P.R. Department of Treasury - Christmas Bonus reimbursement	155,566
Other intergovernmental revenues	31,410
	<u><u>\$ 3,816,496</u></u>

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE O - RETIREMENT PLAN - Continued

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

2. Funding policy

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

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

<u>Fiscal year ended:</u>	<u>Law No. 447</u>	<u>System 2000</u>
2010	\$ 162,034	\$ 181,676
2009	<u>\$ 170,972</u>	<u>\$ 177,720</u>
2008	<u>\$ 176,198</u>	<u>\$ 146,069</u>

NOTE P – POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note P, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas bonus and death benefits. For the fiscal year 2010, costs related to these post employment benefits amounted to \$92,926. These benefits are recorded as expenditures in the general fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

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 \$47,730. Management believes that the summary of the future minimum rental commitments under non-cancelable operating leases with terms exceeding one year is not significant.

2. Construction

The Municipality has commitments at June 30, 2010 of \$4,066,588 for construction, improvements or renovation of certain municipal facilities.

NOTE R – FUND BALANCE DEFICITS

Certain special funds disclosed fund balance deficits as follows:

	Amount
Major Funds:	
CDBG	\$ 206,767
Lavadero Sanitary Sewer System	\$ 124,209
Other Governmental Funds:	
INSEC	\$ 9,510
HOPWA	\$ 33,002
Title III E and D	\$ 7,718
Infrastructure Financing Authority	\$ 16,093
Infrastructure Financing Authority - PINI	\$ 18,803

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

NOTE S – NET CHANGE IN FUND BALANCE – GENERAL FUND

The Statement of revenues, expenditures and changes in fund balance reported a net change in fund balance for the general fund in the amount of (\$255,289), which is composed of the following:

	Amount
Net change in fund balance, 01 Fund	\$ (66,468)
Net change in fund balance, other special funds (with self imposed restrictions) included as part of the general fund:	(188,821)
	\$ (255,289)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO FINANCIAL STATEMENTS

June 30, 2010

NOTE S – NET CHANGE IN FUND BALANCE – GENERAL FUND - Continued

Negative net change in fund balance in 01 Fund resulted of the effect of a fund balance readjustment of \$546,078. This represents a readjustment of current year budget with prior year's fund balance resources, approved by the Municipal Legislature. Resources to finance other special funds included as part of the general fund were provided in previous years but funds were expended in current year.

NOTE 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 that the expenditures comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. *Litigations*

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. However, it is the opinion of the Municipality and the legal counsels that, based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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

	Budgeted amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Taxes:	\$ 2,550,469	\$ 2,550,469	\$ 3,025,950	\$ 475,481
Property taxes	1,500,000	1,500,000	1,337,812	(162,188)
Municipal license taxes	1,564,000	1,572,000	1,544,484	(27,516)
Sales and use taxes	2,865,934	2,921,869	3,258,020	336,151
Intergovernmental	741,500	838,214	855,736	17,522
Fees, fines and charges for services	200,000	200,000	104,541	(95,459)
Interest	62,500	148,500	180,837	32,337
Other	9,484,403	9,731,052	10,307,380	576,328
Total revenues				
Expenditures:				
Current:	4,320,613	5,253,984	5,605,238	(351,254)
General government	2,250,155	2,286,365	2,279,737	6,628
Public works and sanitation	673,361	618,524	617,875	649
Public safety	815,652	830,701	830,424	277
Culture and recreation	378,719	374,819	358,627	16,192
Health	623,815	569,525	568,843	682
Welfare and community development	24,800	18,601	15,017	3,584
Education	9,087,115	9,952,520	10,275,761	(323,241)
Total expenditures				
Excess (deficiency) of revenues over expenditures	397,288	(221,468)	31,619	253,087
Other financing sources (uses):		72,678	72,678	-
Transfers in	(397,288)	(397,288)	(386,392)	10,896
Transfers out	(397,288)	(324,610)	(313,714)	10,896
Total other financing sources (uses)				
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	-	(546,078)	(282,095)	263,983
Readjustment from prior year fund balance (note B)	-	546,078	-	(546,078)
\$ -	\$ -	\$ -	\$ (282,095)	\$ (282,095)

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, 2010

NOTE C - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ (282,095)
Entity differences:	
Non-budgeted funds recorded as revenues for financial reporting purposes:	156,552
Non-budgeted funds recorded as expenditures for financial reporting:	(354,287)
Basis of accounting differences:	
Revenues recorded for financial reporting purposes but not in budgetary basis:	888,758
Revenues recorded in budgetary basis but not for financial reporting purposes:	(195,455)
Expenditures recorded in budgetary basis but not for financial reporting purposes:	102,208
Expenditures recorded for financial reporting purposes but not in budgetary basis:	(511,792)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	117,226
Prior year encumbrances recorded as expenditures for financial reporting purposes:	(185,318)
Net change in fund balance (GAAP basis):	<u>\$ (255,289)</u>

SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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

**Section 8 Housing
Choice Vouchers
14.871**

Line Item No.		
	ASSETS	
	Current Sheet	
	Cash:	
111	Cash - unrestricted	\$ 42,431
113	Cash - other restricted	62,128
100	Total cash	<u>104,559</u>
	Accounts and notes receivables:	
121	Accounts receivable - PHA projects	9,680
122	Accounts receivable - HUD other projects	761
125	Accounts receivable - miscellaneous	897
126.2	Allowance for doubtful accounts - other	(470)
128	Fraud recovery	948
128.1	Allowance for doubtful accounts - fraud	(160)
120	Total receivables, net of allowance for doubtful accounts	<u>11,656</u>
	Current investments	
144	Inter program - due from	-
150	Total Current Assets	<u>116,215</u>
	Noncurrent assets	
	Fixed assets	
164	Furniture, equipment and machinery - administration	19,872
166	Accumulated depreciation	(19,480)
160	Total capital assets, net of accumulated depreciation	<u>392</u>
180	Total Non-current Assets	<u>392</u>
190	TOTAL ASSETS	<u>\$ 116,607</u>
	LIABILITIES AND EQUITY	
	LIABILITIES	
	Current Liabilities	
312	Accounts payable < 90 days	\$ 7,171
322	Accrued compensated absences - current portion	3,019
324	Accrued contingency liability	
325	Accrued interest payable	
331	Accounts payable - HUD PHA programs - Other	-
332	Accounts Payable - PHA Projects	-
333	Accounts payable - other government	-
341	Tenant security deposits	-
342	Deferred revenue	-
343	Current portion of Long-Term debt-capital projects/mortgage revenue bonds	-
344	Current portion of Long-Term debt-operating borrowings	-
345	Other current liabilities	934
347	Inter-program - due to	-
348	Loan Liability - current	-
310	Total Current Liabilities	<u>11,124</u>
	Noncurrent Liabilities	
353	Non-current liabilities - other	7,056
354	Accrued compensated absences - non current	7,781
350	Total Non-current Liabilities	<u>14,837</u>
300	Total Liabilities	<u>25,961</u>
	EQUITY	
508.1	Invested in Capital Assets, Net of Related Debt	392
511.1	Restricted Net Assets	53,897
512.1	Unrestricted Net Assets	36,357
513	Total Equity/Net Assets	<u>90,646</u>
600	Total Liabilities and Equity/Net Assets	<u><u>116,607</u></u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

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

Line Item No.	Income Statement	Section 8 Housing Choice Vouchers 14.871
	REVENUES:	
70600-010	Housing assistance payments	495,174
70600-020	Ongoing administrative fees earned	70,649
70600-070	Admin fee calculation description	
70600	HUD PHA operating grants	565,823
71500	Other revenue	27,663
700	Total Revenue	593,486
	EXPENSES	
	Administrative	
91100	Administrative salaries	53,495
91200	Auditing fees	5,000
91500	Employee benefit contributions- administrative	15,197
91600	Office expenses	12,031
91800	Travel	254
91000	Total Operating - Administrative	85,977
	General expenses	
96200	Other general expenses	335
96210	Compensated absences	676
96600	Bad debt - other	-
	Subtotal	1,011
96900	TOTAL OPERATING EXPENSES	86,988
97000	EXCESS OPERATING REVENUE OVER OPERATING EXPENSES	506,498
97300-020	Home-Ownership	1,590
97300-050	All Other	472,697
97300	Housing assistance payments	474,287
97350	HAP Portability-in	22,139
97400	Depreciation expense	164
900	Total Expenses	583,578
10000	EXCESS (DEFICIENCY) OF TOTAL REVENUE OVER (UNDER) TOTAL EXPENSES	9,908
	MEMO account information	
1103	Biginning equity	80,738
1104	Prior period adjustments, equity transfers and correction of errors	-
1120	Unit months Available	1,236
1121	Number of units months leased	\$ 1,200

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTE TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE

June 30, 2010

NOTE A – BASIS OF PRESENTATION

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

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

SINGLE AUDIT SECTION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

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

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Entity Identifying Number (note B)	Federal Expenditures (notes A and B)
U.S. Department of Agriculture			
Passed-through program from:			
<u>P.R. Department of Education</u>			
Child and Adult Care Food Program	10.558	CCC-029	\$ 16,833
U.S. Department of Housing and Urban Development			
Direct programs:			
Shelter Plus Care	14.238	PR46C603010	38,667
Section 8 Housing Choice Vouchers Program	14.871	RQ035	565,823
Passed-through programs from:			
<u>Office of Commissioner of Municipal Affairs:</u>			
CDBG - State-Administered Small Cities Program Cluster:			
Community Development Block Grant / State's Program (State-Administered Small Cities Program)	14.228	FC-30, AB-30 ADM-30	799,345
ARRA - Community Development Block Grant / State's Program (State-Administered Small Cities Program)	14.255	AR - 30	169,594
Total CDBG - State-Administered Small Cities Program Cluster:			968,939
<u>P.R. Department of Health:</u>			
Housing Opportunities for Persons with AIDS (HOPWA)	14.241	2010-DS 0268	33,002
<u>P.R. Department of Family:</u>			
ARRA - Homeless Prevention and Rapid Re-Housing Program Technical Assistance	14.262	122-2010-000229	25,877
<u>P.R. Department of Housing - (Puerto Rico Public Housing Administration "PRPHA"):</u>			
Public and Indian Housing	14.850	RQ-00500106D	151,560
Subtotal U.S. Department of Housing and Urban Development			1,783,868
U.S. Department of Transportation			
Direct program:			
Federal Transit_Formula Grants	20.507	PR-90	59,607
U.S. Department of Energy			
Passed-through program from:			
<u>P.R. Energy Affairs Administration:</u>			
ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	FOA-00013-11	29,500
U.S. Department of Health and Human Services			
Passed-through programs from:			
<u>P. R. Office of the Ombudsman for the Elderly:</u>			
Special Programs for the Aging_Tittle III Part D_ Disease Prevention and Health Promotion Services	93.043	100385R2, 1090293R2	2,841
National Family Caregiver Support, Title III, Part E	93.052	100058R2	35,637
Nutrition Services Incentive Program	93.053	100299R2	20,002
<u>P.R. Department of Family - Families and Children Administration:</u>			
CCDF Cluster:			
Child Care and Development Block Grant	93.575	2008-2009-039, 2009-2010-053	118,882
ARRA - Child Care and Development Block Grant	93.713	G-0901-PRCCD7	3,936
Total CCDF Cluster:			122,818
<u>"Instituto Socio-economico Comunitario, Inc.":</u>			
ARRA - Community Services Block Grant	93.710	VII-35-09-10-EMP-ARRA-009	22,522
Subtotal U.S. Department of Health and Human Services:			203,820
Total Expenditures of Federal Awards			\$ 2,093,628

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, 2010

NOTE A – BASIS OF PRESENTATION

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

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

<u>Description</u>	<u>Community Development Block Grant Program Fund</u>	<u>Other Governmental Funds</u>
10.558	\$ -	\$ 16,833
14.238	-	38,667
14.871	-	565,823
14.228	799,345	-
ARRA – 14.255	169,594	-
14.241	-	33,002
ARRA – 14.262	-	25,877
14.850	-	151,560
20.507	-	59,607
ARRA – 81.128	-	29,500
93.043	-	2,841
93.052	-	35,637
93.053	-	20,002

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2010

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

<u>Description</u>	<u>Community Development Block Grant Program Fund</u>	<u>Other Governmental Funds</u>
93.575	-	118,882
ARRA – 93.713	-	3,936
ARRA – 93.710	-	22,522
Total federal awards expenditures:	968,939	1,124,689
Total non-federal awards expenditures:	-	2,854,249
Total expenditures, fund statements:	<u>\$ 968,939</u>	<u>\$ 3,978,938</u>

VALDES, GARCIA, MARIN & MARTINEZ, LLP

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

P.O. Box 364831
SAN JUAN, P.R. 00936-4831

TELEPHONE: (787) 725-1600
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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, 2010, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated January 20, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of 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 *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

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

This report is intended solely for the information and use of the Municipality's management, the Honorable Mayor, Members of the Municipal Legislature, the Commonwealth of Puerto Rico, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

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San Juan, Puerto Rico
January 18, 2011

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to the original.

VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

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

Compliance

We have audited the Municipality of Hormigueros's (the Municipality) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Municipality's major federal programs for the year ended June 30, 2010. 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. 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 complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs identified in the accompanying schedule of findings and questioned costs for the year ended June 30, 2010.

Internal Control Over Compliance

Management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with the compliance 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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

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

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

This report is intended solely for the information and use of the Municipality's management, the Honorable Mayor, 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
January 18, 2011

A handwritten signature in dark ink, appearing to read "C. Garcia, Director & Partnering UP". The signature is written in a cursive style.

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to the original.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Audit Results

FISCAL YEAR ENDED JUNE 30, 2010

A. Summary of audit results:

Part I - Financial Statements

1. Type of audit report: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
2. Significant deficiencies Yes No
3. Significant deficiencies reported as material weaknesses Yes None reported
4. Material noncompliance disclosed 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 on compliance major programs Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
4. Audit findings required to be reported under Section 510(a) of Circular A-133 Yes No

5. Major programs

CFDA Number(s)	Name of Federal Program or Cluster
14.228	Community Development Block Grants/State Program
14.850	Public and Indian Housing
14.871	Section 8 Housing Choice Vouchers
14.255	ARRA-Community Development Block Grant

6. Dollar threshold used to distinguish 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

Section II - Financial Statements Findings

FISCAL YEAR ENDED JUNE 30, 2010

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section III - Federal Awards Findings and Questioned Costs

FISCAL YEAR ENDED JUNE 30, 2010

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

SCHEDULE OF PRIOR YEARS AUDIT FINDINGS
AND QUESTIONED COSTS

FISCAL YEAR ENDED JUNE 30, 2010

Finding 2009 III-1

Condition:

In testing the Housing Quality Standards Enforcement procedures we noted that inspections were not performed.

Audit Finding Status

Action was taken. The situation was corrected.