

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
ÁREA DE ASESORAMIENTO, REGLAMENTACIÓN E INTERVENCIÓN FISCAL
ÁREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE LARES
AUDITORÍA 2007-2008
30 DE JUNIO DE 2008**

COMISIONADO DEL GOBIERNO

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2008**

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

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INDEPENDENT AUDITORS' REPORT

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Lares as of June 30, 2008, and the respective changes in financial position, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2008, on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and

compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 14 and the Budgetary Comparison Schedule - General Fund on pages 39 and 40 are not a required parts of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
December 15, 2008

The stamp 2363630 was affixed
to the original of this report.



Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

The following discussion and analysis of the Municipality of Lares' financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2008. Please read it in conjunction with the financial statements which follow this section.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

The government-wide financial statements report information about the Municipality as a whole using the economic resources measurement focus and accrual basis of accounting:

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2008 by \$9,040,143 (net assets).
- Revenues increased by \$3,388,331 (26.7%) and expenses increased by \$2,275,641 (18.5%) in comparison with year 2007.
- Net change in net assets amounted to (\$2,174,329), a decrease of 230% with respect to prior year (2007) net change.

Highlights for Fund Financial Statements

The fund financial statements provide detailed information about the Municipality's most significant funds using the current financial resources measurement focus and modified accrual basis of accounting:

- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$3,884,625, a decrease of \$685,181 in comparison with the prior year.
- The General Fund reported an excess of revenues over expenditures and other financing uses of \$202,933 and an unreserved (deficit) fund balance of (\$5,552,699). Unreserved (deficit) fund balances decreased by \$163,394 from prior year.

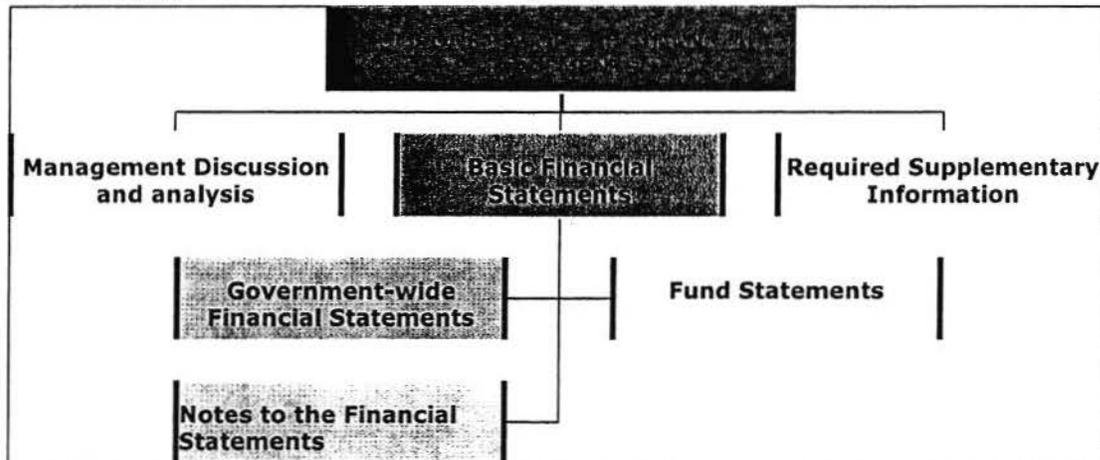
General Financial Highlights

- The investment in net capital assets as of June 30, 2008 was \$6,109,292 (net of related debt).
- Long term debt general and special obligations increased by \$1,424,000, approximately 39.7% with respect to prior year balance.
- Other long term debts increases and net reductions from payments amounted to \$12,146 and \$139,418, respectively.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$28,979.
- Revenues decrease was mainly due to over estimate of \$1,124,814 in construction tax revenues, although Municipality realized economies, principally in general administration (\$332,708).

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise three components: (1) management discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information.



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

Basic Financial Statements

- ***Government-Wide Financial Statements***

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

The government-wide statements reports as governmental activities the Municipality's basic services such as public safety, public works, health and sanitation, culture and recreation, solid waste disposal, human services and 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.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

- ***Fund Financial Statements***

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

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

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

- ***Notes to the financial statements***

Provides integral information needed to explain the basis for the numbers used within the Basic Financial Statements and provide more detailed data.

Required supplementary information

Provides additional information to better understand the financial position of the Municipality and contains the Budgetary Comparison Schedule for the General Fund.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

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

Tabla 1		
Commonwealth of Puerto Rico		
Municipality of Lares, Puerto Rico		
Statement of Net Assets		
As of June 30,		
	2008	2007
Current and non-current assets	\$ 10,945,258	\$ 10,765,252
Capital assets (as Restated)	<u>11,019,229</u>	<u>10,939,018</u>
Total Assets	<u>21,964,487</u>	<u>21,704,270</u>
Current liabilities	4,381,244	3,192,872
Deferred revenues	537,372	587,926
Long-Term liabilities	<u>8,005,728</u>	<u>6,709,000</u>
Total Liabilities	<u>12,924,344</u>	<u>10,489,798</u>
Net Assets:		
Investment in capital assets, Net of Related Debt	6,109,292	8,023,018
Restricted (as Restated)	8,050,331	8,463,802
Unrestricted	<u>(5,119,480)</u>	<u>(5,272,348)</u>
Total Net Assets	<u>\$ 9,040,143</u>	<u>\$ 11,214,472</u>

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year decreased 19.7% with respect to prior year as restated. The most significant changes were a decrease in restricted assets of \$413,471 and a decrease in Unrestricted (Deficit) of \$152,868.

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$6,109,292; total capital assets (\$15,163,370) less accumulated depreciation (\$4,144,141) and less any related outstanding debt (\$4,909,937) used to acquire or construct 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 purposes 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.

As of June 30, 2008 the Municipality presented unrestricted (deficit) net assets of (\$5,119,480). This balance was affected by long term obligations such as compensated absences \$1,451,328 and other debts for the amount of \$1,549,400 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.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Changes in net assets

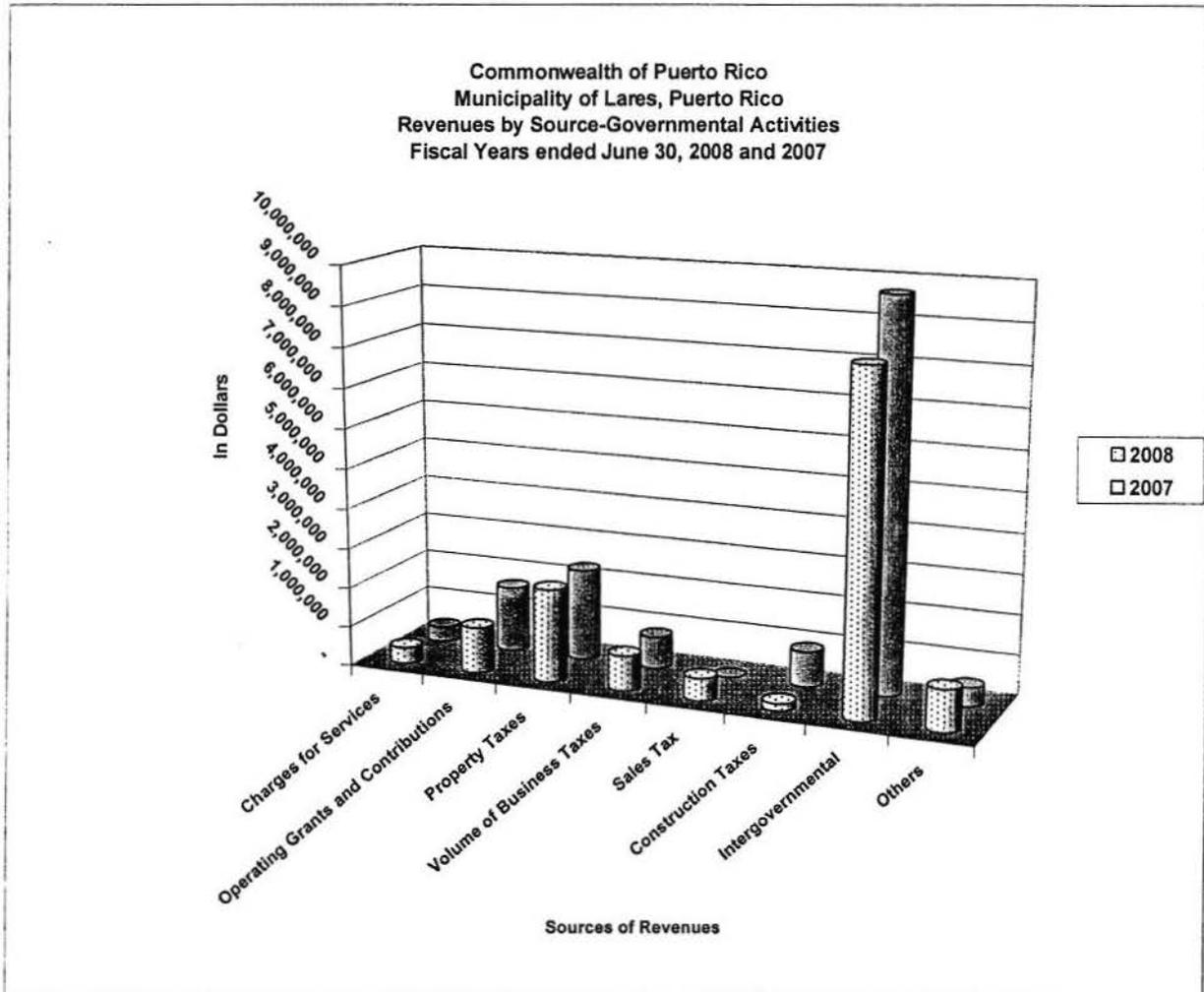
The following table summarizes the changes in net assets for the years ended June 30, 2008 and 2007:

Tabla 2		
Commonwealth of Puerto Rico		
Municipality of Lares, Puerto Rico		
Changes in Net Assets		
For Fiscal Year Ending June 30,		
	2008	2007
Revenues:		
Program Revenues:		
Charges for Services	\$ 400,140	\$ 382,160
Operating Grants and Contributions	1,142,973	1,652,729
General Revenues:		
Property Taxes	2,332,931	2,310,773
Volumen of Business Taxes	888,033	801,751
Sales Tax	567,320	-
Contruction Taxes	183,186	891,613
Intergovernmental	8,376,254	9,678,844
Other General Revenues	1,039,721	477,621
Total Revenues	<u>14,930,558</u>	<u>16,195,491</u>
Expenses:		
General Administration	7,279,792	6,901,784
Public Safety	1,015,480	1,095,683
Public Works	4,570,596	2,281,397
Culture and Recreation	465,867	621,906
Health and Sanitation	1,214,041	1,233,296
Solid Waste Disposal	197,500	387,800
Public Instruction	21,148	-
Human Services and Welfare	977,448	1,000,706
Urban Development	1,104,417	777,351
Interest Costs	258,598	234,619
Total Expenses	<u>17,104,887</u>	<u>14,534,542</u>
Changes in Net Assets	(2,174,329)	1,660,949
Net Assets-Beginning, as Restated	11,214,472	9,553,523
Net Assets-Ending	<u>\$ 9,040,143</u>	<u>\$ 11,214,472</u>

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Figure 1 presents revenues comparison by sources of the governmental activities during the past two years:

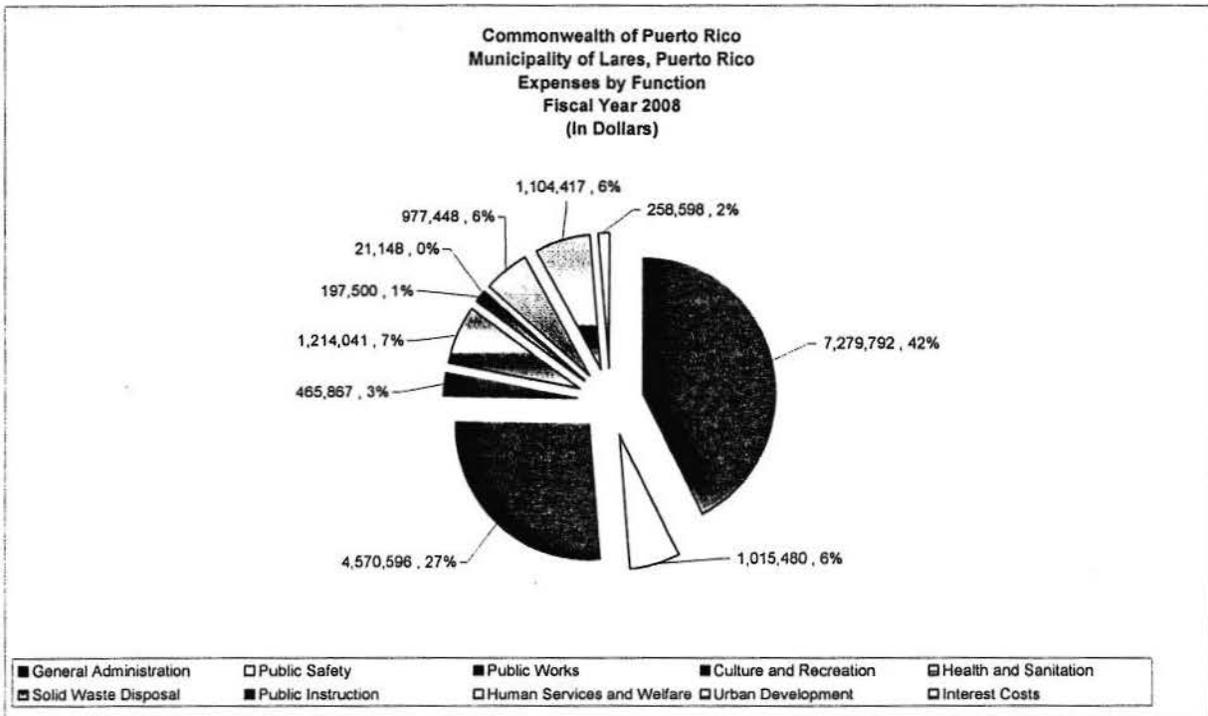
FIGURE 1



Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Figure 2 presents expenses by function of the governmental activities during the fiscal year 2008-2007:

FIGURE 2



Approximately 56.1% of the Municipality's revenues came from intergovernmental, 7.7% from grants and contributions, 15.6% from property taxes, and 20.6% from other sources. The Municipality's expenses cover a range of services. The largest expenses are general administration with 42.6%, public works with 26.7%, health and sanitation with 7.1%, public safety with 5.9%, urban development with 6.5% and human services and welfare with 5.7%. Program revenues of the Municipality covered 9% of total expenses.

With respect to prior year, revenues decreased by approximately \$1,265,000 or 7.8%, principally on intergovernmental.

Expenses increased 17.7% or \$2,570,000 in comparison with 2007 year. Significant increases were registered on fuel and electric power, urban development, public works and donations and services incurred for the benefit of the community.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

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

Tabla 3

Commonwealth of Puerto Rico
Municipality of Lares, Puerto Rico
Net Cost of Municipality's Governmental Activities
Fiscal Years ended June 30,

Functions/Programs	Total Cost of Services		Net Cost of Services	
	2008	2007	2008	2007
General Administration	\$ 7,279,792	\$ 6,901,784	\$ 6,879,652	\$ 6,519,624
Public Safety	1,015,480	1,095,583	1,015,480	1,066,517
Public Works	4,570,596	2,281,397	4,570,596	2,281,397
Culture And Recreation	465,867	621,906	465,867	621,906
Health and Sanitation	1,214,041	1,233,296	1,214,041	1,233,296
Human Services and Welfare	977,448	1,000,706	691,474	463,989
Urban Development	1,104,417	777,351	247,418	(178,649)
Others	477,246	622,419	477,246	622,419
Total	\$ 17,104,887	\$ 14,534,442	\$ 15,561,774	\$ 12,630,499

Some of the cost of governmental activities in 2008 was paid by those who directly benefited from the programs (\$400,140) and other governments and organizations that subsidized certain programs with grants and contributions (\$1,142,973). The \$15,561,774 net cost of services was substantially covered by other general revenues including property, volume of business license taxes, the new enacted sales tax and intergovernmental.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the Fiscal year ended June 30, 2008, the governmental funds reported combined ending fund balances of \$3,884,625, a net decrease of \$685,181 in comparison with the prior year. This decrease was caused primarily by a net change in the non-major funds corresponding to the uses of prior years fund balance of \$3,443,517, and proceeds of bonds of \$1,817,000. Of total combined fund balances, (\$5,246,554) constitutes unreserved (deficit) fund balance of general fund which was financed by the used of state assignments fund. The remainder of fund balance is reserved to indicate that is not available for new spending.

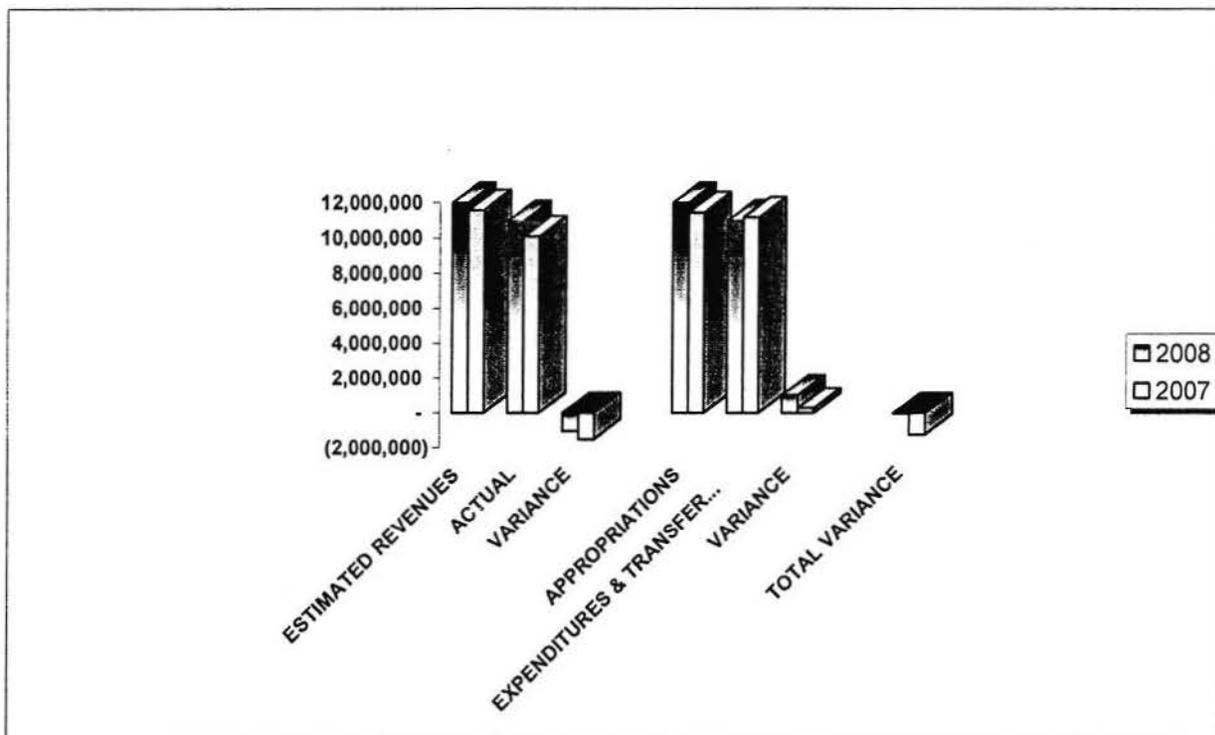
The general fund is the operating fund of the Municipality. Unreserved (deficit) fund balance of the general fund represents approximately 105.8% of total ending general fund balance (deficit). For the year ended June 30, 2008, the fund balance (deficit) of the general fund decreased by \$202,933 when compared with the prior year. The principal component of the net decreases is an excess of revenues over expenditures.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2008-2007 presented an increase of 3% with respect to prior year budget. During the fiscal year the Municipality does not revised the total budget revenues or appropriation, but the appropriation were revised at department level. The Municipality does not amend the budget for the reduction on projected revenues in property taxes, volume of business taxes, construction taxes and miscellaneous revenues, nor for the new enacted sales tax.

FIGURE 3



The negative variance of \$28,979 between revised budget and actual expenditures was due mainly to reduction in revenues as explained in the preceding paragraph in excess of economies in some functions. The Municipality reported less expenditure than appropriations in those functions for payments to purchase of supplies, professional and nonprofessional services, and solid waste disposal.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$11,019,229 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, construction in progress and equipment. This amount represents a net increase of \$80,211 or .7% from the prior year, as restated.

Tabla 4

Commonwealth of Puerto Rico
Municipality of Lares, Puerto Rico
Capital Assets (Net)
As of June 30,

	Governmental Activities	
	2008	2007
Non-depreciable assets:		
Land	\$ 2,940,134	\$ 2,940,134
Construction in Progress	2,060,726	1,653,020
Depreciable assets:		
Buildings	4,812,151	4,934,951
Equipment and Vehicles	698,581	836,410
Furniture and Fixtures	25,308	30,710
Heavy Equipment	228,118	285,011
Infrastructure	254,211	258,782
Total	\$ 11,019,229	\$ 10,939,018

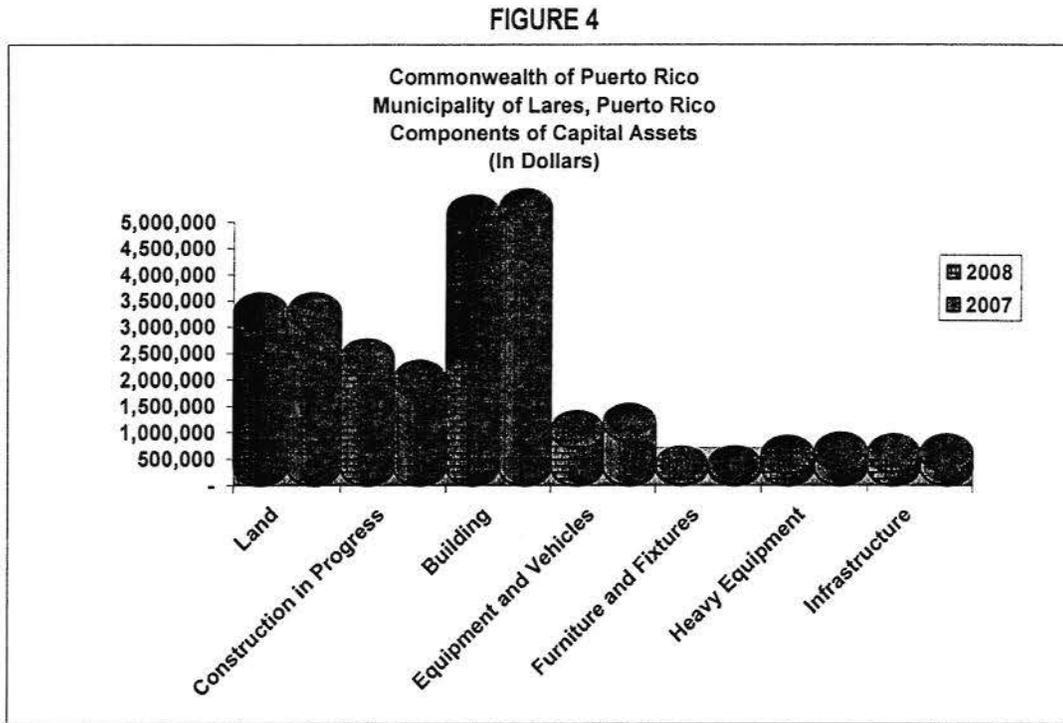
The Municipality acquired a total of \$460,360 of capital assets during the fiscal year 2007-2008 as follows:

- Construction in Progress – \$407,706
- Acquisition of Equipment and Vehicles – \$145,094

Other projects related to repair and maintenance of roads (not capitalized) was developed during the year 2008.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Figures 4 below present the components of capital assets during the fiscal years 2008 and 2007:



Long term debt

At year-end, the Municipality had \$5,005,000 in general and special obligation bonds, an increase of 39.7% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2008 and 2007:

Tabla 5

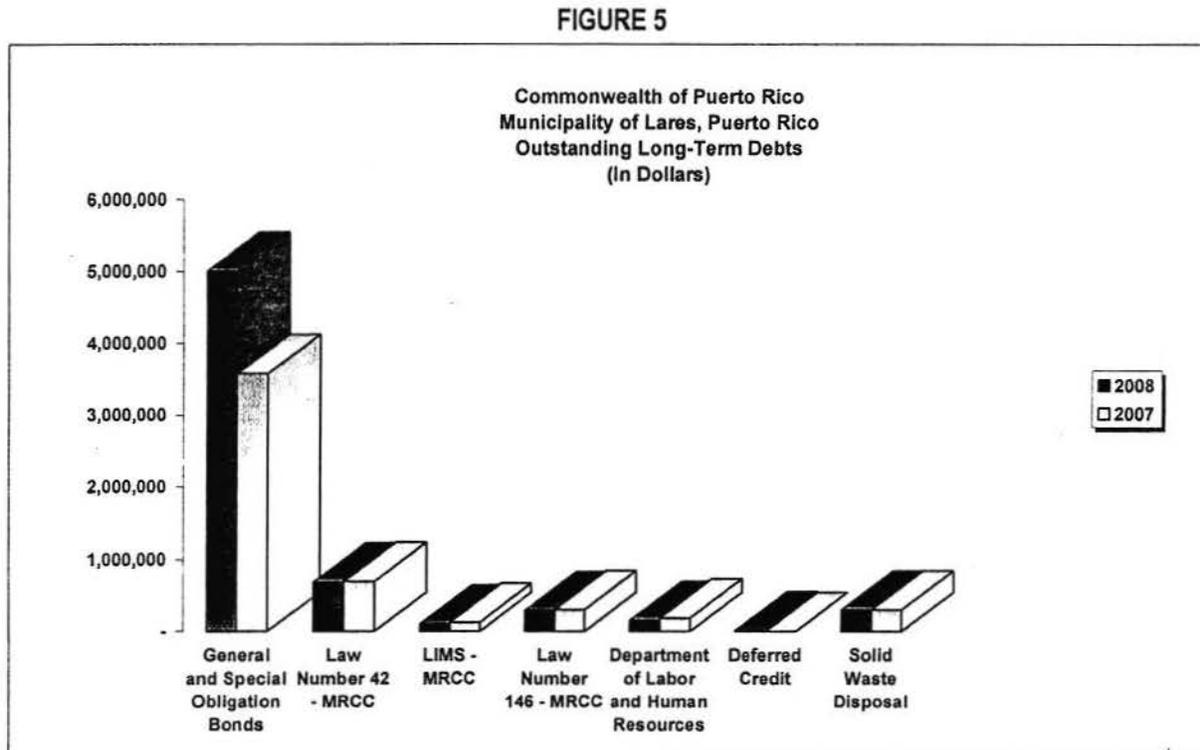
Commonwealth of Puerto Rico
 Municipality of Lares, Puerto Rico
 Outstanding Long-term Debt
 As of June 30,

	2008	2007
General and Special Obligation Bonds	\$ 5,005,000	\$ 3,581,000
Law Number 42 - MRCC	685,237	696,978
LIMS - MRCC	104,759	127,330
Law Number 146 - MRCC	292,986	305,194
Department of Labor and Human Resources	154,035	188,910
Deferred Credit	12,146	-
Solid Waste Disposal	300,237	300,237
Compensated Absences	1,451,328	1,509,351
Total	\$ 8,005,728	\$ 6,709,000

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

More detailed information about the Municipality's long term liabilities is presented in Note 9 to the financial statements.

Figure 5 present the components of long-term debts during the fiscal year 2008 and 2007:



ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2008-2007 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 15.5%, which compares with the Commonwealth rate of 12.7%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2008 are \$13.9 million, approximately \$900,000 more than the fiscal year 2007. The Municipality expects an increase in revenues for the next year due to a new sales tax enacted by state legislature (\$1.1 million). Budgeted expenditures are expected to stabilize accordingly to the projected revenues. Among planned projects, this budget may be adjusted in accordance with economic injection projected when the construction project promoted by the Municipality and others private projects were develop during the year.

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 Finance Department at [(787) 897-2300] or P.O. Box 395, Lares, Puerto Rico 00669.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2008

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash and Investments (Note 3).....	\$ 5,620,694
Cash with Fiscal Agent.....	1,718,098
Receivables (net):	
Property Taxes.....	8,116
Sales Tax.....	51,575
Federal Grants.....	2,089,882
Due from Local Government (Note 4).....	1,412,516
Others.....	<u>14,019</u>
Deferred Charges.....	<u>30,358</u>
Capital Assets (Note 8):	
Land, Improvement and Construction in Progress.....	5,000,860
Other Capital Assets [Net of Depreciation].....	<u>6,018,369</u>
Total Capital Assets.....	<u>11,019,229</u>
TOTAL ASSETS.....	<u>21,964,487</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses.....	3,608,058
Accrued Interest.....	66,894
Due to Governmental Units (Note 7).....	706,292
Deferred Revenues (Note 5).....	537,372
Long-Term Liabilities (Note 9):	
Due Within One Year.....	1,158,173
Due in More than One Year.....	<u>6,847,555</u>
TOTAL LIABILITIES.....	<u>12,924,344</u>
NET ASSETS:	
Investment in Capital Assets, Net of Related Debt.....	6,139,503
Restricted for:	
Capital Projects.....	2,040,949
Debt Service.....	755,838
Community Development Projects.....	1,937,558
Other Purposes.....	3,285,775
Unrestricted (Deficit).....	<u>(5,119,480)</u>
TOTAL NET ASSETS.....	<u>\$ 9,040,143</u>

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenues (See Next Page)
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
Mayor and Municipal Legislature.....	\$ 844,600	\$ -	\$ -	\$ -	\$ (844,600)
General Government.....	6,435,192	400,140	-	-	(6,035,052)
Public Safety.....	1,015,480	-	-	-	(1,015,480)
Public Works.....	4,570,596	-	-	-	(4,570,596)
Culture and Recreation.....	465,867	-	-	-	(465,867)
Health and Sanitation.....	1,214,041	-	-	-	(1,214,041)
Solid Waste Disposal.....	197,500	-	-	-	(197,500)
Public Instruction.....	21,148	-	-	-	(21,148)
Human Services and Welfare.....	977,448	-	285,974	-	(691,474)
Urban Development.....	1,104,417	-	856,999	-	(247,418)
Interest on Long-Term Debt.....	258,598	-	-	-	(258,598)
Total Governmental Activities.....	\$ 17,104,887	\$ 400,140	\$ 1,142,973	\$ -	(15,561,774)
General Revenues:					
Taxes:					
Property Taxes, levied for General Purposes.....					1,767,253
Property Taxes, levied for Debt Service.....					565,678
Sales Tax.....					567,320
Volume of Business Taxes.....					888,033
Construction Taxes.....					183,186
Intergovernmental.....					8,376,254
Rent.....					84,332
Miscellaneous.....					955,389
Total General Revenues and Transfers.....					13,387,445
CHANGES IN NET ASSETS.....					(2,174,329)
Net Assets - At Restated, at Beginning of Year (Note 17).....					11,214,472
NET ASSETS - ENDING OF YEAR.....					\$ 9,040,143

See accompanying Notes to Basic Financial Statements

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2008

	GENERAL FUND	SBGP FUND	STATE ASSIGNMENTS FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
ASSETS:					
Cash and Investment (Note 3).....	\$ 60,894	\$ 1,239	\$ 3,804,215	\$ 1,754,346	\$ 5,620,694
Cash with Fiscal Agent.....	-	-	-	1,718,098	1,718,098
Receivables:					
Property Taxes.....	-	-	-	8,116	8,116
Sales Tax.....	51,575	-	-	-	51,575
Federal Grants.....	-	2,058,600	-	31,282	2,089,882
Due from Other Funds (Note 6).....	17,178	-	2,962,401	-	2,979,579
Due from Governmental Units (Note 4).....	599,296	-	-	813,220	1,412,516
Other Receivables.....	14,019	-	-	-	14,019
Total Assets.....	\$ 742,962	\$ 2,059,839	\$ 6,766,616	\$ 4,325,062	\$ 13,894,479
LIABILITIES AND FUND BALANCES:					
Liabilities:					
Account Payable.....	\$ 2,109,782	\$ 105,103	\$ 309,220	\$ 1,204,953	\$ 3,729,058
Accrued Interest.....	-	-	-	66,894	66,894
Due to Governmental Units (Note 7).....	706,292	-	-	-	706,292
Due to Other Funds (Note 6).....	2,508,996	17,178	-	453,405	2,979,579
Deferred Revenues: (Note 5)					
Volume of Business Tax.....	537,372	-	-	-	537,372
Intergovernmental Deferred Revenue.....	127,074	-	-	-	127,074
Federal Grants.....	-	1,863,585	-	-	1,863,585
Total Liabilities.....	5,989,516	1,985,866	309,220	1,725,252	10,009,854
Fund Balances:					
Reserve For:					
Encumbrances.....	306,145	-	-	-	306,145
Debt Service.....	-	-	-	634,838	634,838
Other Purposes.....	-	-	-	1,881,396	1,881,396
Unreserved (Deficit).....	(5,552,699)	73,973	6,457,396	83,576	1,062,246
Total Fund Balances (Deficit).....	(5,246,554)	73,973	6,457,396	2,599,810	3,884,625
Total Liabilities and Fund Balances.....	\$ 742,962	\$ 2,059,839	\$ 6,766,616	\$ 4,325,062	\$ 13,894,479

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS

JUNE 30, 2008

Total Fund Balances – Government Funds (Page 17)		\$ 3,884,625
Amount reported for Governmental Activities in the Statement of Net Assets (Page 15) are different because:		
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:		
Non Depreciable Capital Assets.....	\$ 5,000,860	
Depreciable Capital Assets.....	9,888,248	
Infrastructure Assets.....	274,262	
Accumulated Depreciation.....	<u>(4,144,141)</u>	
Total Capital Assets.....		11,019,229
Other Assets used in governmental activities are not financial resources and therefore are not reported in the funds:		
Deferred Charges.....		30,358
Some of the Municipality's revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds:		
SBGP.....	1,863,585	
MRCC Liquidation.....	<u>127,074</u>	1,990,659
Total Deferred Revenues.....		
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
General Bonds and Special Bonds.....	4,884,000	
P.R. Department of Labor and Human Resources.....	154,035	
Deferred Charges Liabilities.....	12,146	
Note Payable – MRCC (LIMS).....	104,759	
Landfill Technologies.....	300,237	
Compensated Absences.....	1,451,328	
Law Number 146 - MRCC.....	292,986	
Law Number 42 - MRCC.....	<u>685,237</u>	
Total Long-Term Liabilities.....		<u>(7,884,728)</u>
Total Net Assets of Governmental Activities (Page 15)		\$ 9,040,143

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

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

	GENERAL FUND	SBGP FUND	STATE ASSIGNMENTS FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES:					
Property Taxes (Note 11).....	\$ 1,767,253	\$ -	\$ -	\$ 565,678	\$ 2,332,931
Volume of Business Taxes (Note 12).....	888,033	-	-	-	888,033
Sales Tax (Note 13).....	567,320	-	-	-	567,320
Federal Assistance.....	-	1,033,491	-	285,974	1,319,465
Intergovernmental (Note 14).....	6,201,395	-	985,166	1,245,056	8,431,617
Licenses and Permits.....	183,186	-	-	-	183,186
Rent.....	84,332	-	-	-	84,332
Miscellaneous.....	875,549	-	-	102,397	977,946
Total Revenues.....	10,567,068	1,033,491	985,166	2,199,105	14,784,830
EXPENDITURES:					
Current:					
Mayor and Municipal Legislature.....	632,195	-	-	207,158	839,353
General Government.....	3,391,925	109,323	448,314	2,418,040	6,367,602
Public Safety.....	795,088	-	-	181,457	976,555
Public Works.....	2,810,133	-	116,317	16,751	2,943,201
Culture and Recreation.....	454,943	-	-	-	454,943
Health and Sanitation.....	1,173,888	-	-	15,629	1,189,517
Public Instruction.....	-	-	-	21,148	21,148
Solid Waste Disposal.....	197,500	-	-	-	197,500
Human Services and Welfare.....	637,661	-	1,941	336,042	975,644
Urban Development.....	42,310	1,086,937	-	990,383	2,119,630
Capital Outlay.....	22,719	10,180	90,588	429,313	552,800
Debt Service:					
Principal.....	-	-	-	390,520	390,520
Interest and Other Charges.....	-	-	-	258,598	258,598
Total Expenditures.....	10,158,372	1,206,440	657,160	5,265,039	17,287,011
Excess of Revenues Over (Under) Expenditures.....	408,696	(172,949)	328,006	(3,065,934)	(2,502,181)
OTHER FINANCING SOURCES (USES):					
Proceed of Note.....	-	-	-	1,817,000	1,817,000
Transfers – In.....	377,583	-	-	583,346	960,929
Transfers – Out.....	(583,346)	-	-	(377,583)	(960,929)
Total Other Financing Sources and Uses.....	(205,763)	-	-	2,022,763	1,817,000
Net Change in Fund Balance.....	202,933	(172,949)	328,006	(1,043,171)	(685,181)
Fund Balance (Deficit) – Beginning.....	(5,449,487)	246,922	6,129,390	3,642,981	4,569,806
FUND BALANCE (DEFICIT) – ENDING.....	\$ (5,246,554)	\$ 73,973	\$ 6,457,396	\$ 2,599,810	\$ 3,884,625

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See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Net Change in Fund Balances – Government Funds (Page 19).....		\$ (685,181)
Amount reported for Governmental Activities in the Statement of Activities (Page 16) are different because:		
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:		
Capital Assets.....	\$ 552,800	
Depreciation Expense.....	<u>(472,589)</u>	
Excess of Capital Assets over Depreciation Expense.....		80,211
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds and vice versa.:		
Municipal Revenue Collection Center.....	(55,363)	
SBGP.....	<u>(176,492)</u>	
Total of Revenues.....		(231,855)
Bonds proceeds provide current financial resources to governmental funds, but issuing debt increase Long-Term Liabilities in the Statement of Net Assets. In the current period, proceeds received was.....		
		(1,817,000)
Repayment of long-term principal is expenditure in the governmental funds, but issuing debt reduced Long-Term Liabilities in the Statement of Net Assets. In the current period repayments were.....		
		390,520
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 governmental funds. These activities consist of:		
Decrease in Compensated Absences.....	58,023	
Bond Issue Costs Amortization.....	(3,922)	
Department of Labor and Human Resources.....	<u>34,875</u>	
Total Additional Expenses.....		<u>88,976</u>
Change in Net Assets of Governmental Activities (Page 16).....		\$ (2,174,329)

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 1 FINANCIAL REPORTING ENTITY

The Municipality of Lares, Puerto Rico (Municipality) was founded in the year 1827, and operates as a governmental unit of the Commonwealth of Puerto Rico, under Law Number 81 of August 30, 1991, known as "Autonomous Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services.

The accounting policies of the Municipality conform to accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations) constitutes GAAP for governmental units. The following is a summary of the more significant of such policies.

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the Municipality. In evaluating the Municipality as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14, as amended by GASBS No. 39, *Determining Whether Certain Organizations Are Component Units – an amendment of GASB Statement No. 14*.

GASBS No. 39 provided additional guidance to determine whether certain organization for which the primary government is not financially accountable should be reported as components units. A legally separate, tax-exempt organization should be discretely presented as a component unit 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, and; (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.

There are two methods of presentation of the component unit in the financial statements: blending – the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balance; and discrete – presentation of the component unit's financial data in column separate from the Municipality's balances and transactions.

The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the Municipality indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the Municipality as the reporting entity.

These financial statements present the respective financial position of the governmental and business type activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2008, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Statement Presentation

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Government-wide Financial Statements

The government-wide financial statements (the *Statement of Net Assets* and the *Statement of Activities*) report information of all the activities of the Municipality. For most part, the effect of interfund activity has been removed from these financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely, to a significant extent, on fees and charges for support.

The focus of the *Statement of Net Assets* is designed to be similar to bottom line results for the Municipality's governmental activities and business type activities. This statement combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations. The *Statement of Net Assets* presents the reporting entities' assets and liabilities, with the difference reported as net assets.

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

The *Statement of Activities* demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services, or privileges provided by a given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Governmental Funds Financial Statements

The fund financial statements [the *Balance Sheet*, the *Statement of Revenues, Expenditures, and Changes in Fund Balance*] provide information about the Municipality's funds. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. Non-major funds are summarized into a single column.

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and separate explanation for each differences.

The Municipality reports its financial position (Balance Sheet) and results of operations [Statement of Revenues, Expenditures and Changes in Fund Balance] in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grant and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Governmental Funds Financial Statements

The governmental funds financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purposes, the Municipality considers revenues to be available if they are collected within sixty (60) days of the end of the current fiscal period. Expenditures generally are recorded when liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, volume of business taxes, sales taxes, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the Municipality.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For the majority of grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met.

Expenditures are generally recognized when the related liability is incurred, as under accrual accounting. The exceptions to this general rule are the compensated absences and claims and judgments, if any, that are recorded only when payment is due.

The Municipality reports the following major governmental funds:

General Fund – This is the general operating fund of the Municipality. It is used to account for all financial resources, except those required to be accounted for in another fund.

State Assignments Fund – This is the fund used to account for all the transactions of the State Assignments by Legislature Resolutions. The primarily objectives of these assignments is the development of projects on communities, not-for-profit organizations, purchase of equipment and indirect assignment to persons of low and moderate income.

SBGP Fund – This is the fund used to account for all the transactions of the State Block Grant Program. The primarily objectives of this program is the development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

The non-major funds are combined in a single column in the fund financial statements.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

C. Stewardship, Compliance, and Accountability

Budgetary Information

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

Encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent year.

The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the Budgetary Comparison – General Fund Schedule:

Original Budget

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance to be effective on July 1.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

Final Budget

The final budgetary data presented in the Budgetary Comparison – General Fund Schedule reflects the following changes to the original budget:

1. Certain annual appropriations are budgeted on a project basis. If such projects are not completed at the end of the fiscal year, unexpended appropriations, including encumbered funds, and unexpended grant appropriations, are carried forward to the following year. In certain circumstances, other regular annual appropriations may be carried forward after appropriate approval. Annually appropriated funds, not authorized to be carried forward, lapse at the end of the fiscal year. Appropriations carried forward from the prior year are included in the final budgetary data.
2. Appropriations may be adjusted during the year with the approval of the Mayor and the Municipal Legislature, e.g. supplemental appropriations. Additionally, the Mayor is authorized to make certain transfer of surplus within the departments. Such adjustments are reflected in the final budgetary data.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

The Annual Appropriation Ordinance adopts the budget at the character level of expenditure within departments. As described above, the Mayor is authorized to make certain transfers of appropriations within departments. Accordingly, the legal level of budgetary control by the Municipal Legislature is the department Level.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. Interfund transactions of the General Fund are not included in the budgetary basis.
3. Certain accrued liabilities and other debts are not included in the budgetary basis.
4. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

The Special Revenue Fund has not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Financial Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily the same fiscal year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

D. Cash and Investment, and Cash with Fiscal Agent

The Director of Finance of the Municipality is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Cash with fiscal agent in the Debt Service Fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law. Cash with fiscal agent in other governmental funds consists of undisbursed proceeds of certain bonds and notes issued for the acquisition and construction of major capital improvements, or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico. This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with law.

E. Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statement as "interfund balances".

Receivable are shown net of an allowances for uncollectible, which are determined upon past collection experience and current economic conditions. Intergovernmental receivables in the general fund represent mostly property tax accounts that are levied by Municipal Revenue Collection Center (MRCC), a governmental entity created by the Commonwealth of Puerto Rico, from grant and contributions from Federal Government, and state appropriations.

Advance between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

F. Inventories

The Municipality used the purchase method to account for the purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. This method records items as expenditures, in the appropriate fund, when they are acquired and, accordingly, the inventory is not recorded in the basic financial statements.

G. Capital Assets

Capital assets, which include land, buildings and improvement, machinery and equipment, motor vehicles, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets, other than infrastructure assets, are defined by the government as assets with an initial, individual cost of more than \$500 (amount not rounded) and an estimated useful life in excess of two years. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. The government reports infrastructure assets on a network and subsystem basis. Accordingly, the amounts spent for the construction or acquisition of infrastructure assets are capitalized and reported in the government-wide financial statements regardless of their amount.

In the case of the initial capitalization of general infrastructure assets (i.e., those reported by governmental activities) the government chose to include all such items regardless of their acquisition date or amount. The government was able to estimate the historical cost for the initial reporting of these assets through back trending (i.e., estimating the current replacement cost of the infrastructure to be capitalized and using an appropriate price-level index to deflate the cost to the acquisition year or estimated acquisition year). As the government constructs or acquires additional capital assets each period, including infrastructure assets, they are capitalized and reported at historical cost. The reported value excludes normal maintenance and repairs which are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate. In the case of donations the government values these capital assets at the estimated fair value of the item at the date of its donation.

Capital outlay is recorded as expenditures of the General Fund and other governmental funds and as assets in the governmental-wide financial statements to the extent the Municipality capitalization threshold is met. Interest incurred during the construction phase of the capital assets of business-type activities is reflected in the capitalized value of the asset acquired under capital leases is included in depreciation. Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

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

H. Compensated Absences

The Municipality accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The Municipality's employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The Municipality accrued a liability for compensated absences, which meet the following criteria:

1. The Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.

CAPITAL ASSETS	YEARS
Buildings and Improvements	50
Infrastructure	60
Heavy	10
Furniture and Fixtures	5
Equipment and Vehicles	5-10

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASBS No. 16; the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees, including its share of social security and Medicare payments made on behalf of the employees in the accrual for vacation and sick leave pay. All vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations (see Note 9 on page X).

I. Risk Financing

The Municipality carries commercial insurance to cover property and casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Also, principal officials of the Municipality are covered under various surety bonds. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the MRCC for the year ended June 30, 2008 amounted to approximately \$204,509. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately \$259,866 for workers compensation insurance covering all municipal employees for the same period.

J. Long-Term Obligations, Bonds Issuance Costs, Premiums and Discounts

The liabilities reported in the government-wide financial statements include the general and special obligation bonds, long-term notes, other long-term liabilities (e.g., vacation, sick leave, claims and judgments, long-term liabilities to other governmental entities and third parties, and landfill postclosure care costs. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

In the fund financial statements, governmental fund types recognize bond premiums and discounts as other financing sources and uses, respectively, and bond issuance costs as debt service expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

K. Fund Equity/Net Assets

Reservations of Fund Equity

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. Following is a brief description of the nature of certain reserves.

- *Reserve for Encumbrances* – Encumbrances are recorded as reservations of fund balances because they do not constitute expenditures or liabilities. In certain other governmental funds, this accounting treatment results in a deficit unreserved fund balance. This deficiency is carried forward to the next fiscal year where it is applied against estimated revenues in the year the commitments are expended.
- *Reserve for Debt Service* – The fund balance of the debt service funds is reserved for the payment of debt service in the subsequent years.
- *Reserve for Other Purposes* – Certain assets, primarily cash and investments of grants and contributions that are authorized to be carried over and expended in the ensuing year.

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COMMONWEALTH OF PUERTO RICO
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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Restricted Net Assets

The governmental-wide and proprietary funds financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted, and unrestricted.

- *Invested in Capital Assets, Net of Related Debt* – These consists of capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and amortization, and the outstanding balances for debt that are attributable to the acquisition, construction, or improvement of these assets reduce the balance in this category.
- *Restricted Net Assets* – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Assets* – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

L. Interfund Transactions

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation. The Municipality has the following types of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds.

Intra-Entity Transactions – Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

M. Claims and Judgments

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The Long-Term Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

N. Use of Estimates

The preparation of the basic financial statements in conformity 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 disclosures of contingent assets and liabilities at the date of the basic financial statements and the reported revenue and expenses during the reporting period. Actual result could differ from those estimates.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

O. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) issued the following pronouncement that does not apply to the Municipality:

GASB Statement No. 49, *Pollution Remediation*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of *existing* pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the document excludes pollution *prevention or control* obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. This Statement are effective for financial statements for periods beginning after December 15, 2007, with measurement of pollution remediation liabilities required at the beginning of that period so that beginning net assets can be restated. However, governments that have sufficient objective and verifiable information to apply the expected cash flow technique to measurements in prior periods are required to apply the provisions retroactively for all such prior periods presented.

GASB Statement No. 51, *Intangible Assets*. This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This Statement is effective for financial statements for periods beginning after June 15, 2009. The provisions of this Statement generally are required to be applied retroactively. For governments that were classified as phase 1 or phase 2 governments for the purpose of implementing Statement 34, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated. Retroactive reporting of these intangible assets by phase 3 governments is encouraged but not required. Retroactive reporting is not required but is permitted for intangible assets considered to have indefinite useful lives as of the effective date of this Statement and those considered to be internally generated.

GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. This Statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value. This Statement is effective for financial statements for periods beginning after June 15, 2008.

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Statement 53 is intended to improve how state and local governments report information about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged.

NOTE 3 CASH AND CASH EQUIVALENTS

The Municipality's cash and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$250,000 in each bank, and the excess by collateral provided by the banks and held by the Puerto Rico Treasury Department pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 3 CASH AND CASH EQUIVALENTS (continuation)

During the year, the Municipality did not invest its funds in short-term certificates of deposit.

Custodial Credit Risk Related to Deposits

Custodial credit risk for cash and investments is the risk that, in the event of the failure of a depository financial institution, the Municipality will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Commonwealth adopted by GDB, the Municipality may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, among others.

The Municipality maintains its cash deposits in commercial banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. The following tables presented below discloses the level of custody risk assumed by the Municipality based upon how its deposits were insured or secured with collateral at June 30, 2008:

Category 1: Insured or collateralized with securities held by the Secretary of Treasury agent's in the Municipality's name.

Category 2: Collateralized with securities held by the pledging financial institution's trust department or its agents in the Municipality's name.

Category 3: Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent by not in the Municipality's name.

	CATEGORY			CARRYING AMOUNT	BANK BALANCE
	1	2	3		
Governmental Funds:					
Deposit in Commercial Banks	\$ 5,620,694	\$ -	\$ -	\$ 5,620,694	\$ 3,553,684
Deposit in Governmental Bank	-	-	1,718,098	1,718,098	1,718,098
Total	<u>\$ 5,620,694</u>	<u>\$ -</u>	<u>\$ 1,718,098</u>	<u>\$ 7,338,792</u>	<u>\$ 5,271,782</u>
Reconciliation to Government-Wide Statement of Net Assets:					
	UNRESTRICTED	RESTRICTED	TOTAL		
Carrying amount of deposits in Commercial Banks	\$ 5,620,694	\$ -	\$ 5,620,694		
Carrying amount of deposits in Governmental Bank	-	1,718,098	1,718,098		
Total	<u>\$ 5,620,694</u>	<u>\$ 1,718,098</u>	<u>\$ 7,338,792</u>		

As of June 30, 2008, the Municipality's custodial credit risk was approximately \$1.7 million, which is the bank balance of cash deposited at the Government Development Bank of Puerto Rico (GDB). These deposits are exempt from the collateral requirement established by the Commonwealth.

NOTE 4 DUE FROM GOVERNMENTAL UNITS

The due from governmental units for the fiscal year ended June 30, 2008 corresponds to the MRCC property tax liquidation (\$599,296) and for state agencies (\$813,220).

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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 5 DEFERRED REVENUES

Governmental funds report *deferred revenues* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of *deferred revenue* and *unearned revenue* reported in the governmental funds were as follows:

	UNAVAILABLE	UNEARNED
Governmental Funds:		
Volume of Business Taxes	\$ -	\$ 537,372
MRCC Liquidation	127,074	-
Total Deferred/ Unearned Revenues	<u>\$ 127,074</u>	<u>\$ 537,372</u>

NOTE 6 INTERFUND TRANSFER AND BALANCES

A. INTERFUND TRANSFERS

Transfers are indicative of funding for debt service.

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			
Sources	Transfer to	Amount	Purpose
General Fund	Other Funds	\$ 583,346	Debt Service Fund
Other Funds	General Fund	377,493	Reimbursement
		<u>\$ 960,839</u>	

B. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Interfund receivables and payables at June 30, 2008 are summarized as follows:

	INTERFUND RECEIVABLE	INTERFUND PAYABLE	AMOUNT
General Fund		State Assignments	\$ 2,508,996
Other Funds		State Assignments	453,405
SBGP		General Fund	17,178
TOTAL			<u>\$ 2,979,579</u>

NOTE 7 DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2008, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

	AMOUNT
Water and Sewer Authority	\$ 136,777
Retirement System Administration	320,943
Department of Treasury	49,381
General Service Administration	199,191
Total Due to Governmental Units	<u>\$ 706,292</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 8 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2008 was as follows:

DESCRIPTION	BALANCE JULY 1, 2007	ADJUSTMENTS	INCREASES	DECREASES	BALANCE JUNE 30, 2008
Non-Depreciable Capital Assets:					
Land	\$ 2,940,134	\$ -	\$ -	\$ -	\$ 2,940,134
Construction in Progress	<u>1,653,020</u>	<u>-</u>	<u>407,706</u>	<u>-</u>	<u>2,060,726</u>
Total Non-Depreciable Capital Assets	<u>4,593,154</u>	<u>-</u>	<u>407,706</u>	<u>-</u>	<u>5,000,860</u>
Depreciable Capital Assets:					
Buildings and Buildings Improvements	6,139,998	-	-	-	6,139,998
Equipment and Vehicles	2,924,218	7,576	145,094	-	3,076,888
Furniture and Fixtures	99,157	-	-	-	99,157
Heavy Equipment	572,205	-	-	-	572,205
Infraestructure	<u>296,181</u>	<u>(21,919)</u>	<u>-</u>	<u>-</u>	<u>274,262</u>
Total Depreciable Capital Assets	<u>10,031,759</u>	<u>(14,343)</u>	<u>145,094</u>	<u>-</u>	<u>10,162,510</u>
Less Accumulated Depreciation:					
Buildings and Buildings Improvements	(1,205,047)	-	(122,800)	-	(1,327,847)
Equipment and vehicles	(2,267,534)	172,150	(282,923)	-	(2,378,307)
Furniture and Fixtures	(84,606)	16,159	(5,402)	-	(73,849)
Heavy Equipment	(183,813)	(103,381)	(56,893)	-	(344,087)
Infraestructure	<u>(13,931)</u>	<u>(1,549)</u>	<u>(4,571)</u>	<u>-</u>	<u>(20,051)</u>
Total Accumulated Depreciation	<u>(3,754,931)</u>	<u>83,379</u>	<u>(472,589)</u>	<u>-</u>	<u>(4,144,141)</u>
Total Depreciable Capital Assets (Net)	<u>6,276,828</u>	<u>69,036</u>	<u>(327,495)</u>	<u>-</u>	<u>6,018,369</u>
CAPITAL ASSETS, NET	<u>\$ 10,869,982</u>	<u>\$ 69,036</u>	<u>\$ 80,211</u>	<u>\$ -</u>	<u>\$ 11,019,229</u>

Depreciation expenses were charged to governmental functions/programs as follows:

	AMOUNT
General Government	\$ 106,418
Mayor and Legislature	4,566
Public Safety	14,050
Public Works and Transportation	241,139
Culture	16,944
Sanitation	24,524
Health and Welfare	1,804
Urban Development	<u>63,144</u>
Total Depreciation Expenses	<u>\$ 472,589</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 9 GENERAL LONG-TERM DEBTS

A. General Obligations Bonds and Special Obligations Bonds

The principal long-term obligations of the Municipality are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 10).

General and special obligations bonds as of June 30, 2008, are comprised of the following individual issues:

Type of Obligation and Purpose	Maturity Date	Interest Rate	Amount
General Obligation Bonds:			
\$1,634,000, Series 2005 - Purchase of Equipment	2012	4.13%	\$ 993,000
\$937,000, Series 2008 - Payment of Debt to Suppliers	2017	7.50%	937,000
\$665,000, Series 2000 - Purchase of Land and Building	2031	7.00%	655,000
Total General Obligation Bonds			2,585,000
Special Obligation Bonds:			
\$750,000, Series 2002 - Purchase of Land	2026	8.00%	680,000
\$1,045,000, Series 2000 - General Construction	2022	6.00 tp 8.00%	860,000
\$880,000, Series 2008 - Purchase of Equipment	2014	7.50%	880,000
Total Special Obligation Bonds			2,420,000
Total General and Special Obligation Bonds			\$ 5,005,000

The annual requirements to amortize the general and special obligations bonds outstanding as of June 30, 2008 are as follows:

B. Other Long-Term Debts

Borrowing from MRCC

On July 1, 2002, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 42. The total amount of debt is \$741,794 to be paid during 25 years plus annual interest of 6.1875%.

On July 1, 2007, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 146. The total amount of debt is \$305,194 to be paid during 25 years plus annual interest of 6.22%.

YEAR ENDING Jun 30, 2008	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2009	\$ 354,000	\$ 228,644	\$ 582,644
2010	499,000	286,000	785,000
2011	530,000	257,301	787,301
2012	561,000	226,644	787,644
2013	318,000	194,017	512,017
2014-2018	1,223,000	637,521	1,860,521
2019-2023	915,000	315,775	1,230,775
2024-2028	410,000	128,660	538,660
2029-2033	195,000	28,525	223,525
TOTAL	\$ 5,005,000	\$ 2,303,087	\$ 7,308,087

On November 28, 2001, the Municipality entered into a repayment agreement with the GDB and MRCC to pay for the proportional debt to cover the Land Information Management System (LIMS), system established by MRCC with the capacity to maintaining cadastre and photos of all real property of Puerto Rico. The original debt was \$222,307 to be paid during 10 years plus annual interest of 5.95%.

Compensated Absences

This amount represents the estimated accrued vacation benefits, accrued sick leave benefits and payroll related benefits, representing the Municipality's commitment to fund such costs from future operations.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 9 GENERAL LONG-TERM DEBTS (continuation)

Following are the Other Long-Term Debts:

DESCRIPTION	BALANCE JULY 1, 2007	NEW ISSUES	RETIREMENTS AND ADJUSTMENTS	BALANCE JUNE 30, 2008
Law Number 42 - MRCC	\$ 696,978	\$ -	\$ (11,741)	\$ 685,237
LIMS - MRCC	127,330	-	(22,571)	104,759
Law Number 146 - MRCC	305,194	-	(12,208)	292,986
Department of Labor and Human Resources	188,910	-	(34,875)	154,035
Deferred Charges Liabilities		12,146		12,146
Solid Waste Disposal	300,237	-	-	300,237
Compensated Absences	1,509,351	-	(58,023)	1,451,328
TOTAL	\$ 3,128,000	\$ 12,146	\$ (139,418)	\$ 3,000,728

C. Changes in General Long-Term Debts

The following is a summary of changes in long-term debts for the year ended June 30, 2008:

DESCRIPTION	BALANCE JULY 1, 2007	NEW ISSUES	RETIREMENTS AND ADJUSTMENTS	BALANCE JUNE 30, 2008	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General	\$ 1,881,000	\$ 937,000	\$ (233,000)	\$ 2,585,000	\$ 76,000	\$ 2,509,000
Special	1,700,000	880,000	(160,000)	2,420,000	45,000	2,375,000
Other Debts	3,128,000	12,146	(139,418)	3,000,728	1,037,173	1,963,555
TOTAL	\$ 6,709,000	\$ 1,829,146	\$ (532,418)	\$ 8,005,728	\$ 1,158,173	\$ 6,847,555

D. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The Municipality believes it is in compliance with all significant limitations and restrictions.

NOTE 10 DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality (See Note 11).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 9). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 11 PROPERTY TAXES

The MRCC is responsible for the assessment of all real and personal property located within the Municipality and for the levy, administration and collection of the corresponding tax contribution.

The personal property tax is self assessed by the taxpayer on a return, which is to be filed and paid in full by May 15 of each year with the MRCC and based on current values as of December 31 of previous year. Real property tax is assessed by the MRCC on each piece of real estate and on each building or residence. The property tax contribution is levied each year over the appraised value of the real property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957.

The MRCC is responsible for the billing of real property taxes and collections of both, personal and real property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the MRCC informs the Municipality of the estimated amount of property taxes expected to be collected for the ensuing fiscal year. Throughout the year, the MRCC advances funds to the Municipality based on the initial estimated collections. The MRCC 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. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the MRCC remits to the Municipality property taxes advances, which are less than the tax actually collected, a receivable from the MRCC is recorded at June 30. However, if advances exceed the amount actually collected, a borrowing from MRCC is recorded at June 30. The difference between the advances and the final settlement from MRCC for the fiscal year 2008 resulted in a receivable of \$127,074.

The tax rate for fiscal year 2008 is 7.83% for real property and 5.83% for personal property of which 1.03% of both are for the redemption of public debt issued by the Commonwealth of Puerto Rico and 6.80% and 5.83%, respectively, belongs to the Municipality. The Commonwealth of Puerto Rico also contributes an annual tax rate of 0.20% of the property tax collected. The remaining percentage is distributed as follows: (a) 5.55% and 3.55%, respectively, represents the Municipality's basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. The remaining portion belonging to the Municipality of 1.25% represents the ad-valorem property taxes withheld by the MRCC and restricted for debt service, which is accounted for through the debt service fund (See Note 10).

The Municipality has not reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 has assessed valuation on residential units occupied by their owners. For such exempted amounts, the Puerto Rico Treasury Department 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. As part of Law No. 83 of August 30, 1991, as amended, the exempt amount to be paid by the Puerto Rico Treasury Department to the Municipality was frozen as of January 1, 1992.

In addition, the law grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with an annual net sales volume of less than \$150,000. The MRCC advances to the Municipality, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the MRCC from taxpayers. The MRCC periodically informs to the Municipality the amounts collected from taxpayers and applied to outstanding advances.

The Municipality records as revenue in the general fund the property tax contribution when received from monthly advances from MRCC. Due to the fact that collections of property tax are applied to the advances of property tax paid by the MRCC, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 12 VOLUME OF BUSINESS TAXES

The volume of business taxes is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due five working days after April 15 of each year. Entities with sales volume of \$1 million or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2008, the tax rates were as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.30% for all other organizations.

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration on or before the due date, the taxpayer is granted a 5% of discount. The volume of business tax receivable represents filed tax returns that were uncollected as of June 30, 2008. Collections of taxes during current fiscal year corresponding of the tax return based on the prior year gross sales, are applicable to the next fiscal year and recorded as deferred revenues in the General Fund.

NOTE 13 SALES TAXES

Municipality imposes a Sales and Usage Tax of 1.5% (1% to the Municipality and .5% to the Puerto Rico Department of Treasury) on the sales price of a taxable item or on the purchase price of all usage, storage or consumption of a taxable item. All merchants required to collect the Sales and Usage Tax, are required to file a monthly Sales and Use Tax Return Form, no later than the 20th of the following month from the month being reported.

Sales tax receivable represents filed sales tax returns that were collected subsequent to June 30, 2008, but pertaining to the current year period.

NOTE 14 INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consist primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the Quasi-public Corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

NOTE 15 PENSION PLAN

Employees of Municipality participate in the Employee's Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS). The ERS is cost-sharing multiple-employer defined benefit pension plan sponsored by the Commonwealth of Puerto Rico under the Act No. 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of the Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees. ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 15 PENSION PLAN (continuation)

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to contribute 5.775% for the first \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. The Municipality contributes to the system 9.275% of the participating employee's salaries.

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service or members who have attained at least 58 years of age and have completed at least 10 years of creditable service are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average salary, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average salary, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

Law Number 305 was enacted on September 24, 1999, amended the Act Number 447 for the purpose of establishing a new program (System 2000). System 2000 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 savings program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new 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 Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% up to a maximum of 10%) of their monthly salary, and will be invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employers' contributions (9.275% of the employees' salary) will be used to fund the current plan.

If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation of each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

All employees that do not elect to transfer for the new program and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows:

Disability retirement benefits are available to members for occupational and non-occupational disability up to a maximum benefit of 50% of the average salary, as defined. However, for non-occupational disability, a member must have at least 10 years of creditable service.

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS
30 or more	55 or more	65% of the average of the three years of highest salary during the employee's service period.
30 or more	58 or more	75% of the average of the three years of highest salary during the employee's service period.
30 or more	65 or more	75% of the average of the three years of highest salary during the employee's service period. (employees started working after April 1, 1990).

The Municipality follows the provisions of GASB Statement No. 27, *Accounting for Pensions Pension by State and Local*

Governmental Employers, which requires employers that participate in cost-sharing multi-employer defined-benefits plans to recognize pension expenditures/expense equal to the employer's contractually required contributions and a liability for unpaid contributions.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE 15 PENSION PLAN (continuation)

The total pension expenditures/expenses recorded in the category of administration for the Fiscal Year Ended June 30, 2005 through 2008 was as follow:

The Employee's Retirement System of the Commonwealth of Puerto Rico provides additional information of the ERS. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.

FISCAL YEAR	LAW NO. 447	SYSTEM 2000
2008	\$ 471,981	\$ 451,349
2007	468,382	356,091
2006	612,000	321,082
2005	483,258	308,703

NOTE 16 CONTINGENCIES

A. CLAIMS AND JUDGMENTS

The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. The legal counsel of the Municipality has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings that are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims. Accordingly, the financial statements do not include adjustment, if any, that could result from the resolution of these legal proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claimed amounts.

B. FEDERAL GRANTS

In the normal course of operations, the Municipality receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

NOTE 17 NET ASSETS RESTATEMENT

The following schedules reconcile the June 30, 2007 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2007.

	NET ASSETS
Net Assets, as Previously Reported, At June 30, 2007	\$ 11,014,590
Adjustment to Fixed Assets	69,036
Recognize SBGP Funds	<u>130,846</u>
Beginning Net Assets, as Restated, At July 1, 2007	<u>\$ 11,214,472</u>

END OF NOTES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	Budget Amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis) (See Note A)	Final Budget
BUDGETARY FUND BALANCE, JULY 1, 2007.....	\$ (5,497,059)	\$ (5,497,059)	\$ (5,497,059)	\$ -
Resources (Inflows):				
Property Taxes.....	1,922,942	1,922,942	1,767,253	(155,689)
Volume of Business Taxes.....	1,154,716	1,154,716	888,033	(266,683)
Intergovernmental Revenues.....	5,940,622	5,940,622	6,201,395	260,773
Sales Tax.....	-	-	567,320	567,320
License and Permits.....	1,308,000	1,308,000	183,186	(1,124,814)
Rent.....	90,325	90,325	84,332	(5,993)
Miscellaneous.....	1,578,766	1,578,766	875,639	(703,127)
Transfer from Other Funds.....	-	-	377,493	377,493
Total Resources (Inflows).....	11,995,371	11,995,371	10,944,651	(1,050,720)
Amounts Available for Appropriation.....	6,498,312	6,498,312	5,447,592	(1,050,720)
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature.....	725,436	642,125	641,684	441
General Government.....	3,782,636	3,732,802	3,400,535	332,267
Public Safety.....	1,185,507	844,887	795,098	49,789
Public Works.....	2,307,647	3,175,011	2,898,917	276,094
Culture and Recreation.....	723,830	666,567	489,934	176,633
Health and Sanitation.....	1,370,400	1,213,048	1,176,104	36,944
Human Services and Welfare.....	793,016	689,426	637,791	51,635
Solid Wasted Disposal.....	474,000	474,000	276,500	197,500
Urban Development.....	30,000	63,700	50,509	13,191
Capital Outlays.....	63,000	30,710	23,212	7,498
Transfer to Other Funds.....	539,899	463,095	583,346	(120,251)
Total Charges to Appropriations.....	11,995,371	11,995,371	10,973,630	1,021,741
BUDGETARY FUND BALANCE, JUNE 30, 2008....	\$ (5,497,059)	\$ (5,497,059)	\$ (5,526,038)	\$ (28,979)

See accompanying Notes to Required Supplementary Information.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

NOTE A Explanation of Differences Between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

	<u>General Fund</u>
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 39).....	\$ 5,447,592
Difference – Budget to GAAP:	
The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes.....	<u>5,497,059</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 19).....	<u>\$ 10,944,651</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 39).....	\$ 10,973,630
Difference – Budget to GAAP:	
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes.....	(306,145)
Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes.....	74,233
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes.....	<u>(583,346)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 19).....	<u>\$ 10,158,372</u>

NOTE B Explanation of Differences Between Budgetary Fund Balance and GAAP Fund Balance

Budgetary Fund Balance, June 30, 2008.....	\$ (5,526,038)
Timing Differences:	
Non-budgetary Items.....	205,251
Change in Encumbrances.....	<u>(231,912)</u>
Unreserved Fund Balance, June 30, 2008.....	<u>\$ (5,552,699)</u>

END OF THIS SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

FEDERAL GRANTOR / PASS-THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Housing and Urban Development:			
Direct Programs:			
Section 8 Housing Choice Vouchers.....	14.871		\$ 218,779
Indirect Programs:			
Pass-Through State -- Office of the Commissioner of Municipal Affairs:			
State Block Grant Program (SBGP).....	14.228	94-FD-37 95-FD-37 01-FD-37	
	01-FC-37	02-FC-37 02-AB-37 03-AB-37 03-FC-37 03-FE-37 04-AB-37	
	04-FC-37	05-AB-37 05-FC-37 05-FE-37 06-AB-37	
			<u>1,206,441</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$1,425,220</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

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MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2007

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activities of the **Municipality of Lares, Puerto Rico**. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The **Municipality** reporting entity is defined in Note (1) (A) to the general-purpose financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed through other government agencies are included on the Schedule.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. The accompanying Schedule of Expenditures of Federal Awards is prepared from **Municipality's** accounting records and is not intended to present financial position or the results of operations.
- B. The financial transactions are recorded by the **Municipality** in accordance with the terms and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America.
- C. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

NOTE 3 FEDERAL CFDA NUMBER

The CFDA numbers included in this Schedule were determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

NOTE 4 PASS THROUGH GRANTOR'S NUMBER

State or local government redistribution of federal awards to the **Municipality**, treated as if 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 identifying number assigned by the pass through entity for federal awards received as a subrecipient. Numbers identified as N/A are not available.

NOTE 5 MAJOR PROGRAMS

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

END OF NOTES

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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 Municipal Legislature
Municipality of Lares
Lares, 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 Lares as of and for the year ended June 30, 2008, which collectively comprise the Municipality of Lares' basic financial statements, and have issued our report thereon dated December 15, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control

deficiency, or combination of control deficiencies, that adversely affects the Municipality's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Municipality's financial statements that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting and include as items 08-A thru 08-B.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Lares' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect of 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 test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

This report is intended solely for the information and use of the management, Commissioner Office of Municipal Affairs, and the federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico
December 15, 2009

The stamp 2363631 was affixed
to the original of this report.



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

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

Compliance

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

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

In our opinion, Municipality of Lares complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 08-1 through 08-2.

Internal Control over Compliance

The management of Municipality of Lares is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of Lares' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

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

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

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

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

This report is intended solely for the information and use of the management, Commissioner Office of Municipal Affairs, and the 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.

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
December 15, 2008

The stamp 2363632 was affixed
to the original of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expresses an unqualified opinion on the basic financial statements of the Municipality of Lares.
- b. There were significant deficiencies on internal controls over financial reporting, some of which are considered material weaknesses.
- c. No instances of noncompliance material to the financial statements of Municipality of Lares were disclosed during the audit.
- d. There were no significant deficiencies on internal controls over major programs.
- e. The auditor's report on compliance with requirements applicable to federal award programs for Municipality of Lares express an unqualified opinion.
- f. There were audit findings relative to the major federal award programs for the Municipality of Lares.
- g. The program tested as major programs included:
State Block Grant Program - CFDA No. 14.228
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Lares was determined to be a high risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

08-A: General Fund Deficit

Condition

As of June 30, 2008, the Municipality closed with an accumulated deficit of \$5.2 million. This is the fifth consecutive year that the Municipality closed its operations reporting a deficit.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

Cause

The deficit is caused by the overestimation of budgeted revenues and by the incurrence of obligations without the proper consideration of current and future available resources. The mayor and the Finance Director did not follow adequate budgeting procedures.

Criteria

Article 7.011(a) of Autonomous Municipal Act (Law 81 of August 30, 1991), as amended, establishes that municipalities with deficits at their closing dates must provide for sufficient resources during the next fiscal year period in order to cover such deficit.

Section 3 of the Revised Regulation over Basic Standards for Municipalities of Puerto Rico (The Regulation) states that special care must be provided for the estimation of future revenues in order to avoid budget appropriations in excess of available resources.

Recommendation

The continuing deficit reported by the Municipality of Lares may harm the basic governmental services provided to its citizens. We strongly recommend that the necessary measures are taken in order to stop this trend. The Municipality must work on increasing actual revenues and/or substantially reducing expenditures.

08-B: Estimated Revenue Shortfall

Condition

As of June 30, 2008, the Municipality did not meet certain projected revenues by significant amounts, causing an increase in its General Fund deficit (see Finding 08-A). The following deficiencies were noted based on our comparison of budgeted revenues versus final operating results:

- a. For licenses and permits, the Municipality failed to meet its expectations by \$1,124,814 a 86% budget shortfall.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

- b. For Miscellaneous revenues, the Municipality failed to meet its expectations by \$703,127, a 45% budget shortfall.

Criteria

Section 3 of the Revised Regulation over Basic Standards for Municipalities of Puerto Rico (The Regulation) states that special care must be provided for the estimation of future revenues in order to avoid budget appropriations in excess of available resources.

Cause

The mayor and the Finance Director did not follow adequate budgeting procedures for establishing reasonable estimates.

Recommendation

The Municipality should revise and amend the budget as current information related to collections of budgeted revenues became available.

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM
AUDIT**

a. SBGP - CFDA No. 14.228

● **Condition 08-1**

The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.

Criteria

The 24CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

Cause

The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.

Effect

The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Questioned Cost

\$ -0-

● **Condition 08-2**

The Municipality has deficiencies in the execution of property management procedures. During our test of real property and equipment management, we found that the Municipality does not perform a reconciliation of the physical inventory with the accounting records. In addition, equipment acquired during the year is not properly labeled and identified.

Criteria

As per CFR 24, Part 85.32 (4)(d) property records shall be accurately maintained. The records should include, for each item of equipment, a description of the equipment including serial number, an identification

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

number, identification of the grant under which the recipient acquired the equipment, the information needed to calculate the federal share of the equipment, the acquisition date and unit acquisition cost, the location, use and condition of the equipment. In addition, states that every two years, at a minimum, a physical inventory should be conducted and the results should be reconciled with the property records to verify the existence, current utilization, and continued need for the equipment. Any discrepancies between quantities determined by the physical inspection and those shown in the accounting records should be investigated to determine the causes of the differences.

Cause

The Municipality does not maintain accurate records for acquisitions and dispositions for property acquired with federal awards.

Effect

The Municipality is exposed to the risk of possible unauthorized use and disposition of equipment due to the lack of internal controls and adequate property and equipment records. The possible misappropriation of the equipment acquired with federal funds could result in disallowed costs.

Recommendation

The Municipalities' management should determine that proper procedures are in place to ensure that property purchased with federal funds is identified and conduct periodic inventories and follow up on inventory discrepancies. In addition, the Municipality's management should review all dispositions of property to ensure appropriate valuation and reimbursement to federal awarding agencies.

Questioned Cost

\$ -0-

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
<p>State Block Grant Program CFDA No. 14.228</p>	<p>Condition 06-1</p> <p>The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.</p>	<p>Condition still continue.</p>
<p>State Block Grant Program CFDA No. 14.228</p>	<p>Condition 06-2</p> <p>The Municipality has deficiencies in the execution of property management procedures. During our test of real property and equipment management, we found that the Municipality does not perform a reconciliation of the physical inventory with the accounting records. In addition, equipment acquired during the year is not properly labeled and identified.</p>	<p>Condition still continue.</p>
<p>State Block Grant Program CFDA No. 14.228</p>	<p>Condition 07-1</p> <p>The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.</p>	<p>Condition still continue.</p>
<p>State Block Grant Program CFDA No. 14.228</p>	<p>Condition 07-2</p> <p>The Municipality has deficiencies in the execution of property management procedures. During our test of real property and equipment management, we found that the Municipality does not perform a reconciliation of the physical inventory with the accounting records. In addition, equipment acquired during the year is not properly labeled and identified.</p>	<p>Condition still continue.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
<p>Section 8 Housing Choice Voucher CFDA No. 14.871</p>	<p>Condition 07-3</p> <p>The Section 8 program internal controls relating to compliance with the cash management requirement are not effective since they are not minimizing the time elapsed between the receipt of funds and the final disbursement for payment.</p>	<p>Condition was corrected.</p>