

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL
AREA DE ARCHIVO DIGITAL

MUNICIPIO DE NAGUABO
AUDITORIA 2004-2005
30 DE JUNIO DE 2005

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO
SINGLE AUDIT REPORT
YEAR ENDED JUNE 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2005

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2005

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

**To the Honorable Mayor and
the Municipal Legislature
Municipality of Naguabo
Naguabo, 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 Naguabo, Puerto Rico (Municipality)**, as of and for the year ended June 30, 2005, which collectively comprise the **Municipality's** basic financial statements as listed in the table of contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express 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, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of the Office of Management and Budget 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 the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 12 to the financial statements, the **Municipality** has not maintained evidence of ownership in certain capital assets. Also, the **Municipality's** accounting system and records of capital assets did not reconcile at the beginning of the fiscal year in the governmental activities and, accordingly, has not recorded depreciation expense on those assets. Accounting principles generally accepted in the United States of America require that capital assets be capitalized and depreciated, which would increase the assets and expenses of the governmental activities. The amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonably determinable.

In our opinion, because of the effects of the matter discussed in the third paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the **Municipality of Naguabo, Puerto Rico**, as of June 30, 2005, and the changes in financial position, thereof for the year then ended.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of each major fund, and the aggregate remaining fund information of the **Municipality of Naguabo, Puerto Rico**, as of June 30, 2005, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule-General Fund on page 41 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2005 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of the **Municipality of Naguabo**, taken as whole. 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 not a required part of the respective financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.

Lopez Vega, CPA, PSC

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
November 21, 2005

Stamp No. 2106088 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC
Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2005

This discussion and analysis of the Municipality of Naguabo (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2005. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2004. This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. asses management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2005 deserve special mention:

1. Total assets of the Municipality amounted to \$29,013,495 which represents an increase of 12% compared to prior fiscal year;
2. At the end of fiscal year 2005, total liabilities amounted to \$10,843,959. Out of said amount, \$9,200,246 corresponded to long-term liabilities of which \$6,148,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
3. Total net assets of the Municipality amounted to \$18,169,536 which represents an increase of 16% compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$14,921,840, derived from the following sources: \$251,558 charges for services; \$1,674,835 from operating grants and contributions; \$1,441,629 from capital grants and contributions obtained from other sources, and \$11,553,818 from general revenues available;

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$12,401,314;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$2,520,526;
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$1,300,387;
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$200,283, compared to a fund deficit of (\$2,775,254) in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in a favorable balance of \$1,497,197 which is indicative of full compliance with the balanced budget principle applicable to all municipalities of the Commonwealth Government of Puerto Rico as required by the Municipal Autonomous Act enacted in August 1991.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2005. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds. This in turn will benefit the welfare of Naguabo constituents.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2005, shows total expenses incurred to afford the cost of all functions and programs amounted to \$12,401,314. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$3,368,022 was derived from the following sources: \$251,558 charges for services; \$1,674,835 from operating grants and contributions; and \$1,441,629 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$11,553,818. When such figure is added to the \$3,368,022 previously mentioned, total revenues available for the financing of activities amounted to \$14,921,840. There was an excess of revenues over expenses in the amount of \$2,520,526 which contributed with an increase to the figure of net assets attained at the end of the fiscal year.

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Naguabo, total assets exceeded government liabilities by \$18,169,536 at the end of 2005, compared to \$15,649,010 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

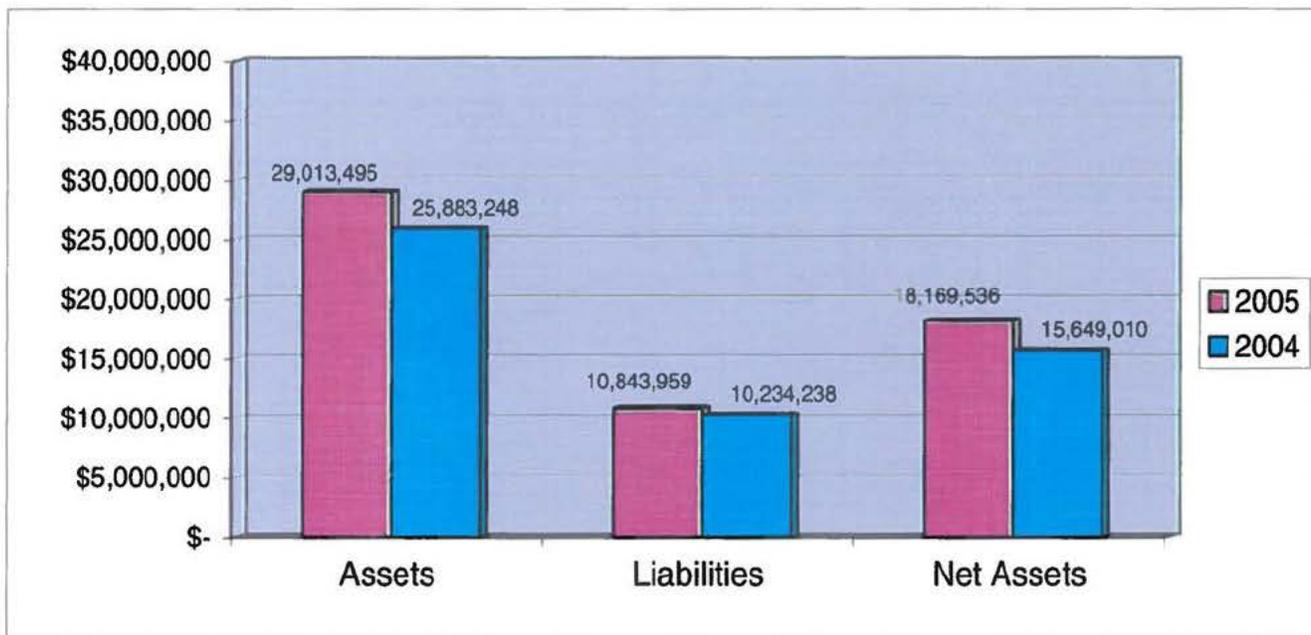
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Condensed Statement of Net Assets	2005	2004	Change	%
Current and other assets	\$ 5,210,725	\$ 4,386,964	\$ 823,761	19%
Capital assets	23,802,770	21,496,284	2,306,486	11%
Total assets	29,013,495	25,883,248	3,130,247	12%
Current and other liabilities	1,643,713	3,123,456	(1,479,743)	(47%)
Long-term liabilities	9,200,246	7,110,782	2,089,464	29%
Total liabilities	10,843,959	10,234,238	609,721	6%
Invested in capital assets, net of related debt	20,284,770	19,064,284	1,220,486	6%
Restricted	3,366,729	4,260,856	(894,127)	(21%)
Unrestricted deficit	(5,481,963)	(7,676,130)	2,194,167	(29%)
Total net assets	\$ 18,169,536	\$ 15,649,010	\$ 2,520,526	16%



Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2005, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$2,520,526 increase in the Municipality's net assets. Approximately 51 percent of the Municipality's total revenue came from taxes, while 46 percent resulted from grants and contributions, including federal aid. Charges for Services provided 2 percent of the total revenues.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

The Municipality's expenses cover a range of services. The largest expenses were for general government, public safety, public works, culture and recreation, health and welfare services, and community development. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

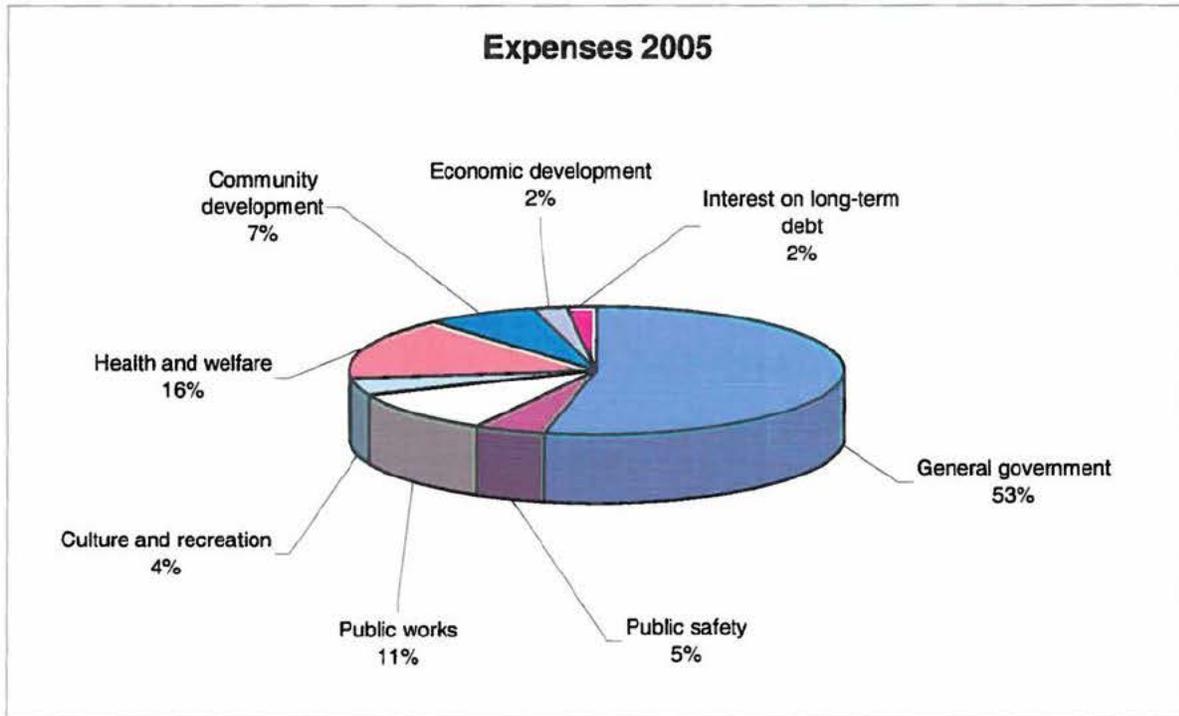
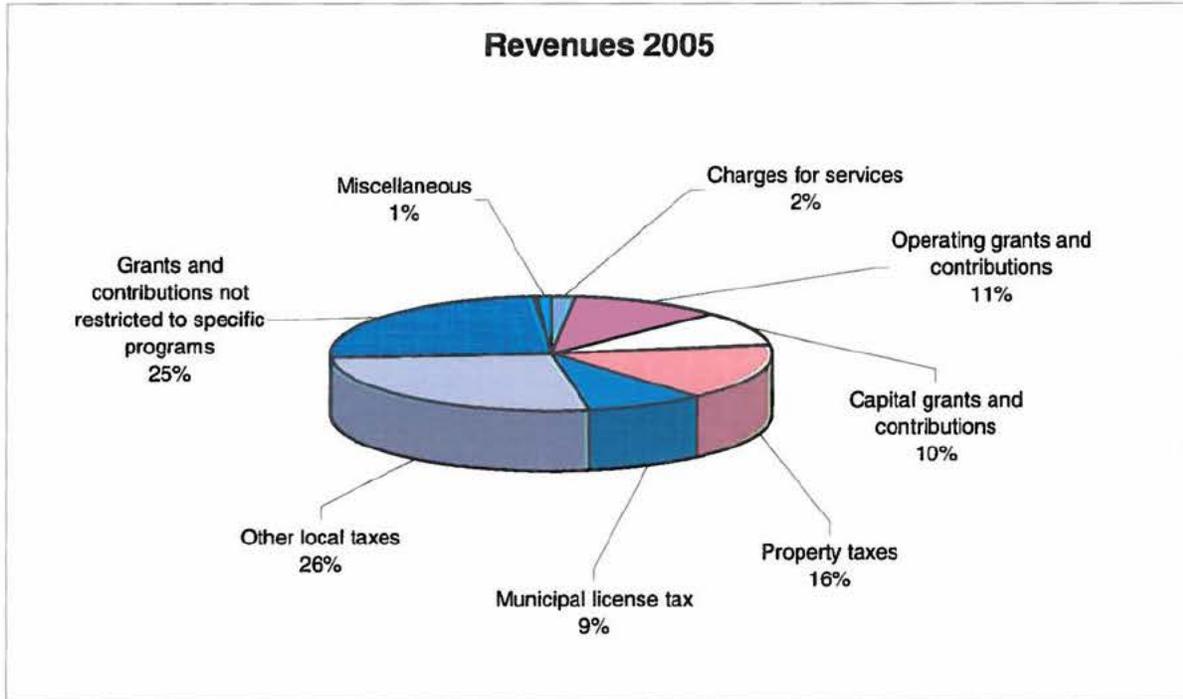
Condensed Statement of Activities	2005	2004	Change	%
Program revenues:				
Charges for services	\$ 251,558	\$ -	\$ 251,558	100%
Operating grants and contributions	1,674,835	2,675,854	(1,001,019)	(37%)
Capital grants and contributions	1,441,629	747,689	693,940	93%
General revenues:				
Property taxes	2,395,455	2,235,583	159,872	7%
Municipal license tax	1,270,606	718,902	551,704	77%
Other local taxes	4,000,729	411,000	3,589,729	873%
Grants and contributions not restricted to specific programs	3,679,732	11,011,266	(7,331,534)	(67%)
Rent		99,102	(99,102)	(100%)
Interest and investment earnings	32,314		32,314	100%
Miscellaneous	174,982	259,711	(84,729)	(33%)
Total revenues	14,921,840	18,159,107	(3,237,267)	(18%)
Expenses				
General government	6,622,542	4,458,200	2,164,342	49%
Public safety	576,541	449,393	127,148	28%
Public works	1,317,135	981,744	335,391	34%
Culture and recreation	526,849	164,893	361,956	220%
Health and sanitation		1,428,620		(100%)
Health and welfare	1,957,246	1,989,100	(31,854)	(2%)
Community development	879,424	997,084	(117,660)	(12%)
Economic development	279,738		279,738	100%
Capital Outlay		173,359	(173,359)	(100%)
Interest on long-term debt	241,839	211,430	30,409	14%
Total expenses	12,401,314	10,853,823	1,547,491	14%
Change in net assets	2,520,526	7,305,284	(4,784,758)	(65%)
Net assets, beginning of year	15,649,010	8,343,816	7,305,194	88%
Net assets, end of year	\$ 18,169,536	\$ 15,649,100	\$ 2,520,436	16%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

The Municipality's net assets increase by \$2,520,526, a difference of the prior year through (\$4,784,758). Key elements of this increase are as follows: Change in revenues results of municipal license and construction tax related to a dam project begun during the fiscal year. However, change in revenues results of grants and contributions not restricted to specific programs decrease mainly by (\$7,331,534), result of donated capital assets of approximately \$6,600,000 during prior year.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$1,300,387, an increase of \$2,419,042 in comparison with the prior year. There are reservations of fund balance amounting to \$1,224,439. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$120,061), 2) to pay debt service (\$424,066), 3) to pay for capital projects (\$229,574) and 4) for other purposes (\$450,738).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2005, the general fund has a fund balance of \$200,283.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The actual General Fund budgetary activities resulted in a favorable balance of \$1,497,197, caused mainly due to unexpected variances in revenue collections from miscellaneous sources.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has not maintained complete and adequate records related to the Capital Assets acquired and constructed in the past years, but the Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets, and then, comply with such requirement. The Municipal Administration expects to develop a broad and comprehensive identification and assessments project of all fixed assets owned by the local government in order to capitalize them in its Statement of Net Assets, and then, reflects the correct net assets figure of the Municipality as a whole.

The Municipality's investment in capital assets as of June 30, 2005, amounts to \$25,779,601, net of accumulated depreciation of \$1,976,831 (including depreciation charges for the year totaled \$455,112), leaving a net book value of \$23,802,770. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure, work of art, furnishing, computers and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2005, the Municipality has \$46,139 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a Municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a Municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2005-2006.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2005. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 40, Naguabo, Puerto Rico 00718-0040, or call (787) 874-3040.

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Net Assets
June 30, 2005

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 1,634,951
Cash with fiscal agent	1,037,622
Accounts receivable:	
Municipal license tax	4,502
Intergovernmental	356,203
Federal	2,015,755
Interest	14,210
Other	147,482
Capital assets	
Land, improvements, and construction in progress	10,991,283
Other capital assets, net of depreciation	12,811,487
Total capital assets	23,802,770
Total assets	29,013,495
 Liabilities	
Accounts payable and accrued liabilities	461,243
Due to other governmental entities	637,155
Deferred revenues:	
Municipal license tax	481,864
Federal grant revenues	12,720
Interest payable	50,731
Noncurrent liabilities:	
Due within one year	959,220
Due in more than one year	8,241,026
Total liabilities	10,843,959
 Net Assets	
Invested in capital assets, net of related debt	20,284,770
Restricted for:	
Capital projects	229,574
Debt service	829,066
Other purposes	2,308,089
Unrestricted (deficit)	(5,481,963)
Total net assets	\$ 18,169,536

The notes to the financial statements are an integral part of this statement.

**Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Activities
For the Year Ended June 30, 2005**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes In Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 6,622,542	\$ 16,184	\$ 95,664	\$ -	\$ (6,510,694)
Public safety	576,541	12,291			(564,250)
Public works	1,317,135	108,725	95,419	64,431	(1,048,560)
Health and welfare	1,957,246	28,246	1,091,969		(837,031)
Culture and recreation	526,849	86,112	84,400	229,097	(127,240)
Economic development	279,738		279,738		-
Community development	879,424		27,645	1,148,101	296,322
Interest on long-term debt	241,839				(241,839)
Total governmental activities	\$ 12,401,314	\$ 251,558	\$ 1,674,835	\$ 1,441,629	(9,033,292)
General revenues:					
					2,395,455
					1,270,606
					4,000,729
					3,679,732
					32,314
					174,982
					11,553,818
					2,520,526
					15,649,010
					\$ 18,169,536

Commonwealth of Puerto Rico
Municipality of Naguabo
Balance Sheet
Governmental Funds
June 30, 2005

	General Fund	Special Revenue Fund Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Cash and cash equivalents	\$ 1,023,850	\$ 192,186	\$ -	\$ 418,915	\$ 1,634,951
Cash with fiscal agent	4,274	104,258	882,951	46,139	1,037,622
Accounts receivable:					
Municipal license tax	4,502				4,502
Intergovernmental	225,157	2,015,755		131,046	2,371,958
Interest	14,210				14,210
Other	87,143				87,143
Prepaid Expenses	60,339				60,339
Due from other funds	333,902	106,668		226,901	667,471
Total assets	\$ 1,753,377	\$ 2,418,867	\$ 882,951	\$ 823,001	\$ 5,878,196
Liabilities and Fund Balances					
Liabilities :					
Accounts payable and accrued liabilities	\$ 204,206	\$ 166,799	\$ 405,000	\$ 90,238	\$ 866,243
Interest payable			50,731		50,731
Due to other governmental entities	637,155				637,155
Due to other funds	229,869	174,066	3,154	260,382	667,471
Deferred revenues:					
Municipal license tax	481,864				481,864
Federal grant revenues		1,874,345			1,874,345
Total liabilities	1,553,094	2,215,210	458,885	350,620	4,577,809
Fund balances:					
Reserved for:					
Encumbrances	120,061				120,061
Debt service fund			424,066		424,066
Other purposes	4,274	203,657			207,931
Reserved reported in nonmajor funds:					
Capital projects				229,574	229,574
Other purposes				242,807	242,807
Unreserved:					
Undesigned	75,948				75,948
Total fund balances	200,283	203,657	424,066	472,381	1,300,387
Total liabilities and fund balances	\$ 1,753,377	\$ 2,418,867	\$ 882,951	\$ 823,001	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	23,802,770
Long-term liabilities, including interest payable, are not due and payable in the current period, and therefore, are not reported in the funds	(9,200,246)
Liabilities reported in funds and not reported in statement of net assets	2,266,625
Net assets of governmental activities	\$ 18,169,536

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2005

	General Fund	Special Revenue Fund Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues					
Property taxes	\$ 1,822,223	\$ -	\$ 451,605	-	\$ 2,273,828
Municipal license taxes	1,270,606				1,270,606
Licenses, permits and other local taxes	4,002,099				4,002,099
Charges for services	20,898				20,898
Fines and forfeitures	12,291				12,291
Intergovernmental	3,830,448			805,274	4,635,722
Rent of property	185,357				185,357
Interest	32,314				32,314
Federal grants		1,848,165		585,800	2,433,965
Miscellaneous	232,225	350		47,723	280,298
Total revenues	11,408,461	1,848,515	451,605	1,438,797	15,147,378
Expenditures					
Current:					
General government	\$ 5,979,402	\$ 2,968	\$ -	\$ 29,739	\$ 6,012,109
Public safety	573,423			8,984	582,407
Public works	2,345,416	29,892		495,132	2,870,440
Health and welfare	801,153	423,276		727,457	1,951,886
Culture and recreation	203,353			285,923	489,276
Economic development				279,738	279,738
Community development		1,366,641			1,366,641
Debt service:					
Principal			549,000		549,000
Interest			241,839		241,839
Total expenditures	9,902,747	1,822,777	790,839	1,826,973	14,343,336
Excess (deficiency) of revenues over (under) expenditures	1,505,714	25,738	(339,234)	(388,176)	804,042
Other financing sources (uses)					
Transfers in	55,535		200,712	3,700	259,947
Transfers out	(200,712)	(3,700)		(55,535)	(259,947)
Long-term debt issued	1,615,000				1,615,000
Total other financing sources (uses)	1,469,823	(3,700)	200,712	(51,835)	1,615,000
Net change in fund balances	2,975,537	22,038	(138,522)	(440,011)	2,419,042
Fund balance (deficit) beginning	(2,775,254)	181,619	562,588	912,392	(1,118,655)
Fund balance, ending	<u>\$ 200,283</u>	<u>\$ 203,657</u>	<u>\$ 424,066</u>	<u>\$ 472,381</u>	<u>\$ 1,300,387</u>

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico
Municipality of Naguabo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2005

Net Change in Fund Balances - Total Governmental Funds	\$ 2,419,042
 Amounts reported for governmental activities in the Statement of Activities are different because:	
Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.	2,761,599
Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds.	(455,113)
Bonds and notes proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments.	(1,176,000)
Repayment of long term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long -term property tax advance debt in the Government-Wide Statement of Net Assets. This is the amount paid in the current period. The following amount represent the change in long-term property tax advance debt from prior year.	(404,202)
Repayment of long term Treasury Department debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Treasury Department from prior year.	(104,054)
Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represents the change in long-term compensated absences from prior year.	(173,513)
Long-term claims and judgments are reported in the Governmental-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, claims and judgments are not reported as expenditures in Government Funds. The following amount represents the change in long-term claims and judgments from prior year.	(241,000)
Repayment of long term Department of Labor and Human Resources debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Department of Labor and Human Resources from prior year.	61,630
Repayment of long term Puerto Rico Land Authority debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Puerto Rico Land Authority from prior year.	76,085

Commonwealth of Puerto Rico
Municipality of Naguabo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2005

Repayment of long term Puerto Rico Electric Power Authority (PREPA) debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the PREPA from prior year.	(128,410)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenue in the funds. The following amount represents the change in this revenues from prior year.	(225,538)
Some expenses reported in the Governmental Funds do not require the use of current financial resources and, therefore, are not reported as expenses in the Statement of Activities. The following amount represents the change in this expenses from prior year.	<u>110,000</u>
Change in Net Assets of Governmental Activities	<u>\$ 2,520,526</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Naguabo** (the Municipality) was founded on the year 1775. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a fourteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality has elected to delay the capitalization of infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The following is a summary of the significant accounting policies of the Municipality:

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 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.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

Special Revenue Fund – Federal Grants- is the accounting entity in which revenues derived from federal grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal statutes.

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

General Fund - Is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund – Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund – Section 8 - Special Revenue Funds are used to account for revenues derived from section 8 choice voucher program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund – Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Fund – State and Local Grants - Capital Projects Fund are used to account for financial resources used for the acquisition or construction of major capital facilities.

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

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are 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. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No. 20.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Governmental fund 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 purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, Accounting and Financial Reporting for Non Exchange Transactions (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenues 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.

Property taxes, franchise taxes, licenses, rent, 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 the government receives cash.

Private-sector standards of accounting and financial reporting issue prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The preparation of the 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Assets, liabilities and net assets

- 1. Cash, cash equivalents, and cash with fiscal agent-** The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services 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.

- 2. 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."

Advances 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.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

5. **Long-term obligations-** The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

6. **Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

7. **Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.
8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:
 - a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
 - b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
 - c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
 - d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:
 - a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

10. Risk financing- The Municipality carries commercial insurance to cover 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.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2005 amounted to approximately \$233,419. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$199,731 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 23,802,770	
Deduct:		
Bonds and notes payable	<u>(3,518,000)</u>	\$ 20,284,770
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		229,574
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balance		829,066
<u>Net assets restricted for other purposes</u>		
Special revenue fund - local and state grants restricted		2,308,089
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 200,283	
Deduct:		
Bonds Payable	(2,630,000)	
Property Tax Debt	(742,509)	
Compensated Absences	(1,235,488)	
PR Electric Power Authority (PREPA)	(128,410)	
Treasury Department	(655,839)	
Claims and judgments	<u>(290,000)</u>	<u>(5,481,963)</u>
Total net assets - governmental activities		<u>\$ 18,169,536</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

2. DEPOSITS

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of \$1,023,850 in the general fund, and \$192,186 in the special revenue fund – federal grants were fully collateralized at June 30, 2005. In the other governmental funds there were deposits with commercial banks of \$418,915 that were fully collateralized.

The deposits at GDB of \$4,274, that is restricted for other purposes in the general fund, the \$104,258 in the special revenue fund – federal grants, the \$882,951 that is restricted for debt service fund and \$46,139 in the other governmental funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality impose a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to 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 on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2005, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues

2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2005, net of allowance for uncollectible.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

3. RECEIVABLES (CONTINUED)

B. Intergovernmental Receivables- Intergovernmental receivables in the general fund principally consist of the amounts due from the Puerto Rico Electric Power Authority ("PREPA") resulting from payments made by the Municipality, which will be reimbursed at the issuance of the ("PREPA") final liquidation. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Puerto Rico Electric Power Authority ("PREPA")	\$ 225,157
Total	<u>\$ 225,157</u>

Intergovernmental receivable in special revenue fund – federal grants represent grants that met the eligibility and time requirements by the recipient and the funds are not received yet. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$ 1,852,577
Child Care and Development Block Grant	150,458
Non-Urbanized Area Formula Program, Section 5311	<u>12,720</u>
Total	<u>\$ 2,015,755</u>

Intergovernmental receivable in the other governmental funds represent expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Department of Labor and Human Resources- Law 52 Grant	\$ 90,077
Commonwealth of Puerto Rico-Legislature	<u>40,969</u>
Total	<u>\$ 131,046</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2005, and interfund transfers during the fiscal year ended at June 30, 2005, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund - Federal Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	\$ 170,366
General Fund	Debt Service Fund	Interest Revenue	3,154
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	160,382
Special Revenue Fund - Federal Grants	General Fund	Reimbursable expenditures	2,968
Special Revenue Fund - Federal Grants	Special Revenue Fund - Federal Grants	Reimbursable expenditures	3,700
Special Revenue Fund - Federal Grants	Other Governmental Funds	Reimbursable expenditures	100,000
Other Governmental Funds	General Fund	Reimbursable expenditures	<u>226,901</u>
Total			<u>\$ 667,471</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt retirement	\$ 200,712
Special Revenue Fund - Federal Grants	Other Governmental Funds	Transfer of funds to Other Governmental Funds	3,700
Other Governmental Funds	General Fund	Transfer of funds to General Fund	<u>55,535</u>
Total			<u>\$ 259,947</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2005, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2005</u>
Capital asset, not being depreciated:				
Land	\$ 7,125,208	\$ 1,038,244	\$ -	\$ 8,163,452
Construction in progress	<u>2,369,638</u>	<u>458,193</u>	<u>-</u>	<u>2,827,831</u>
Total capital assets not being depreciated	<u>\$ 9,494,846</u>	<u>\$ 1,496,437</u>	<u>\$ -</u>	<u>\$ 10,991,283</u>
Capital assets, being depreciated:				
Buildings	\$ 7,103,360	\$ -	\$ -	\$ 7,103,360
Buildings improvements		476,012		476,012
Infrastructure	4,406,073	163,254		4,569,327
Infrastructure improvements		498,646		498,646
Equipment	694,554	35,366		729,920
Work of Art		1,500		1,500
Furnishing		28,266		28,266
Computers		16,122		16,122
Vehicles	<u>1,319,170</u>	<u>45,995</u>	<u>-</u>	<u>1,365,165</u>
Total capital assets being depreciated	<u>\$ 13,523,157</u>	<u>\$ 1,265,161</u>	<u>\$ -</u>	<u>\$ 14,788,318</u>
Less accumulated depreciation for:				
Buildings	\$ (346,797)	\$ (110,120)		\$ (456,917)
Buildings improvements		(5,508)		(5,508)
Infrastructure	(242,334)	(67,768)		(310,102)
Infrastructure improvements		(14,643)		(14,643)
Equipment	(231,784)	(125,272)		(357,056)
Work of Art		(63)		(63)
Furnishing		(1,525)		(1,525)
Computers		(1,322)		(1,322)
Vehicles	<u>(700,804)</u>	<u>(128,891)</u>	<u>-</u>	<u>(829,695)</u>
Total accumulated depreciation	<u>\$ (1,521,719)</u>	<u>\$ (455,112)</u>	<u>\$ -</u>	<u>\$ (1,976,831)</u>
Total capital assets being depreciated, net	<u>\$ 12,001,438</u>	<u>\$ 810,049</u>	<u>\$ -</u>	<u>\$ 12,811,487</u>
Governmental activities capital assets, net	<u>\$ 21,496,284</u>	<u>\$ 2,306,486</u>	<u>\$ -</u>	<u>\$ 23,802,770</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 212,338
Public safety	6,563
Public works	66,295
Culture and recreation	38,616
Community Development	122,264
Health and welfare	<u>9,036</u>
Total depreciation expense-governmental activities	<u>\$ 455,112</u>

6. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the Municipal Revenue Collection Center (CRIM), a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. 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 CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. At the date of the release of these financial statements, the CRIM issued the preliminary liquidation noting that the advances exceeded collections by \$213,904. This excess will not be funded with available expendable financial resources at June 30, 2005. Based on this, such amount was presented in the government-wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

6. PROPERTY TAXES (CONTINUED)

The Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2005, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$124,081.

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years.

Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26 1997, Public Law Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law. As of June 30 2005, the related unpaid property tax advances presented in the Statement of Net Assets amounted to approximately \$227,770.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

6. PROPERTY TAXES (CONTINUED)

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$ 15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$ 50,000 of the assessed value to retailers having annual net sales of less than \$ 150,000.

The annual tax rate is 8.33% for real property and 6.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in 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. From such fund, a distribution is made to all municipalities; (b) 1.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the general fund include the following:

<u>Governmental Entity</u>	<u>Amount</u>
Puerto Rico Aqueduct and Sewer Authority	\$ 92,684
General Services Administration	250
Land Authority	70,085
Department of Treasury	402,425
Department of Labor and Human Resources	27,663
Retirement System Administration	<u>44,048</u>
Total	<u>\$ 637,155</u>

8. DEFERRED REVENUES

A. Municipal License Tax- The deferred revenues of approximately \$481,864 in the general fund relates to municipal license tax collected in fiscal year 2004-05 that will be earned in fiscal year 2005-06.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

8. DEFERRED REVENUES (CONTINUED)

Federal Government- The deferred revenues presented in the special revenue fund – federal grants represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$ 1,745,547
Child Care and Development Block Grant	116,078
Non-Urbanized Area Formula Program, Section 5311	<u>12,720</u>
Total	<u>\$ 1,874,345</u>

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2005, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$4,297,000	\$1,615,000	\$ 274,000	\$5,638,000	\$380,000
Note Payable	675,000		165,000	510,000	185,000
Property Tax Advances	193,546	213,904	16,792	390,658	16,792
Property Tax - Treasury	144,761		20,680	124,081	20,680
Income Tax Withheld		664,106	482,053	182,053	182,053
Income Tax Withheld	413,517		58,200	355,317	58,200
Unemployment	38,072		38,072		
Unemployment-Federal	23,558		23,558		
Social Security	138,268		19,800	118,468	19,800
Claims and Assessments	49,000	290,000	49,000	290,000	
P.R. Land Authority	76,085		76,085		
Compensated Absences	1,061,975	377,929	204,416	1,235,488	50,000
CRIM – Law 146		227,770		227,770	
Puerto Rico Electric Power Authority	<u> </u>	<u>160,084</u>	<u>31,674</u>	<u>128,410</u>	<u>46,695</u>
Total	<u>\$7,110,782</u>	<u>\$3,548,793</u>	<u>\$1,459,330</u>	<u>\$9,200,245</u>	<u>\$959,220</u>

1. Legal debt margin- The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

9. LONG-TERM LIABILITIES (CONTINUED)

2. Bonds payable- The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. During the current year, the Municipality issued bonds for approximately \$1,615,000. Bonds payable outstanding at June 30, 2005 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2005</u>
1992-Series	7-1-2006	\$ 415,000	4.37% to 6.36%	\$ 90,000
1996-Series	1-1-2020	514,000	4.50%	424,000
1998-Series	7-1-2007	320,000	4.86% to 6.71%	125,000
1998-Series	1-1-2023	576,000	4.50%	484,000
2000-Series	1-1-2025	239,000	4.50%	220,000
2001-Series	7-1-2010	590,000	5.00% to 8.00%	405,000
2002-Series	7-1-2016	370,000	5.00% to 8.00%	325,000
2003-Series	7-1-2027	285,000	5.00% to 6.50%	275,000
2003-Series	7-1-2027	990,000	5.00% to 6.50%	935,000
2004-Series	7-1-2013	865,000	5.00% to 6.00%	740,000
2005-Series	7-1-2014	475,000	3.27% to 5.00%	475,000
2005-Series	7-1-2019	1,140,000	4.37% to 5.00%	<u>1,140,000</u>
Total general obligation bonds				<u>\$ 5,638,000</u>

These bonds, except the 2003 Series \$990,000 bond and the 2004 Series \$865,000 bond, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. The 2003 Series \$990,000 bond and the 2004 Series \$865,000 bond are payable with General Fund resources.

Annual debt service requirements to maturity for bonds payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 380,000	\$ 277,803
2007	417,000	291,396
2008	395,000	267,110
2009	367,000	244,270
2010	388,000	221,455
2011-2015	1,704,000	783,550
2016-2020	1,217,000	401,208
2021-2025	560,000	152,958
2026-2030	<u>210,000</u>	<u>16,250</u>
Total	<u>\$ 5,638,000</u>	<u>\$ 2,656,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

9. LONG-TERM LIABILITIES (CONTINUED)

- 3. Notes Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2005</u>
1997-Series	7-1-16	\$ 400,000	5.00% to 8.00%	\$ 285,000
1999-Series	7-1-05	620,000	2.70% to 7.81%	110,000
2000-Series	7-1-06	200,000	3.21% to 7.81%	70,000
2002-Series	7-1-06	100,000	3.21% to 5.00%	<u>45,000</u>
Total notes payable				<u>\$ 510,000</u>

This notes, except the 1997 Series \$400,000 note, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 185,000	\$ 18,060
2007	80,000	13,713
2008	20,000	11,750
2009	20,000	10,750
2010	25,000	9,625
2011-2015	140,000	30,950
2016-2020	<u>40,000</u>	<u>1,000</u>
Total	<u>\$ 510,000</u>	<u>\$ 95,848</u>

- 4. Compensated absences-** The government-wide statement of net assets includes approximately \$501,414 of accrued sick leave benefits, and approximately \$734,074 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

10. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

10. PENSION PLAN (CONTINUED)

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, 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.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions during the year ended June 30, 2005 amounted to approximately \$219,075.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

10. PENSION PLAN (CONTINUED)

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 ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2005, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

11. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

12. CAPITAL ASSETS REPORTED VALUE

The Municipality has not maintained complete records related to the Capital Assets reported in governmental activities of the government-wide financial statements and, therefore, such condition would affect the amounts of assets, net assets, and expenses of the governmental activities. The Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

13. CONTINGENCIES

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$290,000 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)**

YEAR ENDED JUNE 30, 2005

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Property taxes	\$ 1,636,944	\$ 1,822,223	\$ 1,822,223	\$ -
Fines and forfeiture	2,500	12,341	12,291	(50)
Municipal license tax	739,820	883,046	1,266,104	383,058
Licenses, permits and other local taxes	793,504	3,919,083	3,923,406	4,323
Charges for service	42,000	29,333	20,898	(8,435)
Intergovernmental	4,569,964	4,114,404	4,299,840	185,436
Interest	2,000	74,478	16,086	(58,392)
Rent of property	106,000	75,543	176,907	101,364
Miscellaneous	<u>12,000</u>	<u>200,285</u>	<u>232,225</u>	<u>31,940</u>
Total revenues	<u>\$ 7,904,732</u>	<u>\$ 11,130,736</u>	<u>\$ 11,769,980</u>	<u>\$ 639,244</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	4,248,483	6,418,722	5,588,832	829,890
Public safety	706,688	574,995	574,191	804
Public works	1,642,128	2,927,088	2,901,936	25,152
Health and welfare	808,499	805,250	803,745	1,505
Culture and recreation	264,559	204,206	203,367	839
Operating transfer to other funds	<u>234,375</u>	<u>200,475</u>	<u>200,712</u>	<u>(237)</u>
Total expenditures, encumbrances and other financing uses	<u>7,904,732</u>	<u>11,130,736</u>	<u>10,272,783</u>	<u>857,953</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,497,197</u>	<u>\$ 1,497,197</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 11,769,980
Differences-budget to GAAP:				
Proceed from bond issuance				1,615,000
GAAP adjustments to revenues				(361,519)
No budgeted transfer in				<u>55,535</u>
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 13,078,996</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 10,272,783
Differences-budget to GAAP:				
Non-budgeted expenditures				(49,263)
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(120,061)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,103,459</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND

YEAR ENDED JUNE 30, 2005

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2005 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2005.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Direct Program: Water and Water Disposal Loans and Grants	10.770		\$ 75,500
Pass-through the Commonwealth of Puerto Rico-Department of Education: Child and Adult Care Food Program	10.558	Not Available	<u>13,628</u>
Total U.S. Department of Agriculture			<u>89,128</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program: Section 8 Housing Choice Vouchers	14.871		597,657
Pass-through the Commonwealth of Puerto Rico - Municipal Affairs Commissioner Office: Community Development Block Grants - State's Program	14.228	04-AB,FC,FE-47 03-AB,FC-47 02-AB,FC-47 01-FD,FC-47 98-FD-47 97-FD-47	1,291,141
Pass-through the Commonwealth of Puerto Rico - Municipality of San Juan: Housing Opportunities for Persons with Aids	14.241	Not Available	<u>30,640</u>
Total U.S. Department of Housing and Urban Development			<u>1,919,438</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2005

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico - Family Department (ACUDEN):			
Child Care and Development Block Grant	93.575	Not Available	<u>409,646</u>
Total U.S. Department of Health and Human Services			<u>409,646</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Public Assistance Grants	97.036	Not Available	<u>29,892</u>
Total U.S. Department of Homeland Security			<u>29,892</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 2,448,104</u>

The accompanying notes are an integral part of this schedule

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Naguabo** and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the fund financial statements. 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*.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund Federal Grants and in the Other Governmental Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Description	Special Revenue Fund Federal Grants	Other Governmental Funds	Total
Per Schedule of Expenditures of Federal Awards	\$ 1,819,807	\$ 628,297	\$ 2,448,104
Non federal programs expenditures	2,970	1,198,676	1,201,646
Total expenditures in the general purpose financial Statements	<u>\$ 1,822,777</u>	<u>\$ 1,826,973</u>	<u>\$ 3,649,750</u>



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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- Puerto Rico Society of Certified Public Accountants

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

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

We have audited the basic financial statements of the **Municipality of Naguabo** as of and for the year ended June 30, 2005, and have issued our report thereon dated November 21, 2005, which was unqualified at the fund financial statements level, but adverse at the government-wide financial statements level because, we were unable to obtain competent evidential matter related to the Capital Assets reported in the governmental activities. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Naguabo's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Naguabo's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. The reportable condition is described in the accompanying schedule of findings and questioned costs as item **05-01**.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose reportable conditions that are also considered to be material weaknesses. However, we believe items **05-01** of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs is material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the **Municipality of Naguabo** in a separate letter dated November 21, 2005.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
November 21, 2005

Stamp No. 2106089 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.





López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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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 the Municipal Legislature
Municipality of Naguabo
Naguabo, Puerto Rico**

Compliance

We have audited the compliance of the **Municipality of Naguabo** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. The **Municipality of Naguabo's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Naguabo's** management. Our responsibility is to express an opinion on the **Municipality of Naguabo's** compliance based on our audit.

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

In our opinion, the **Municipality of Naguabo** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that 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 items, **05-02** through **05-08**.

**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
(CONTINUED)**

Internal Control Over Compliance

The management of the **Municipality of Naguabo** is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the **Municipality of Naguabo's** internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality of Naguabo's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items **05-02** through **05-08**.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees on the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness. However, of the reportable conditions described above, we consider items **05-06** through **05-08**, to be material weaknesses. We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Naguabo** in a separate letter dated February 2, 2006.



**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
(CONTINUED)**

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

Lopez Vega, CPA, PSC
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
February 2, 2006

Stamp No. 2106090 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2005

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:	Unqualified, except for adverse for government-wide financial statements	
Internal control over financial reporting:		
Material weakness identified?	Yes <input checked="" type="checkbox"/>	No
Reportable conditions identified not considered to be material weaknesses?	Yes	None reported <input checked="" type="checkbox"/>
Noncompliance material to financial statements noted?	Yes	No <input checked="" type="checkbox"/>

Federal awards

Internal Control over major programs:		
Material weakness identified?	Yes <input checked="" type="checkbox"/>	No
Reportable conditions identified not considered to be material weaknesses?	Yes <input checked="" type="checkbox"/>	None reported
<u>Type of auditor’s report issued on compliance for major programs:</u>	Unqualified	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes <input checked="" type="checkbox"/>	No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
14.228	Community Development Block Grant – State’s Program
14.871	Section 8 Housing Choice Voucher
Dollar threshold used to distinguish between Type A and Type B programs	\$ 300,000
Auditee qualified as low-risk auditee?	Yes No <input checked="" type="checkbox"/>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

Finding Reference	05-01
Requirement	Fixed\Capital Assets and Expenditures – Subsidiary Ledger
Statement of Condition	The Municipality's accounting system and records for capital assets did not reconcile at the beginning of the fiscal year in the governmental activities and also, has not recorded depreciation expense on those assets. Accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.
Criteria	Chapter IX, Article 9.002 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain updated property accounting records. Also, the GASB Statement No. 34 requires that all capital assets, including infrastructure, must be presented in the Statement of Net Assets and that these assets must be depreciated during its useful life.
Cause of Condition	Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.
Effect of Condition	The Municipality's Government Wide Financial Statements do not present fairly, the financial position of the governmental activities, and the change in financial position of the Municipality.
Recommendation	We recommended to Management to compile all the information related to the capital assets presented in the financial statements of the fiscal year ended June 30, 2004, in order to conciliate that amount with the Municipality's accounting system and records for capital assets.
Questioned Costs	None
Management Response and Corrective Action	As part of the Municipality consultants' works for fiscal year 2005-2006, we'll request our consultants to compile the information related to capital assets beginning balance at July, 1, 2004. Implementation Date: December 31, 2006 Responsible Person: Héctor E. Machín Nazario Finance Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-02
Program	Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Allowable Activities
Statement of Condition	<p>During the fiscal year ended June 30, 2005, we noted that the program did not disclose in bulletin boards, in loose sheets or in a newspaper of general circulation, the following information related to the project: (1) the project purpose; (2) dates, places and hours to apply; (3) the eligibility requirements and; (4) the limit date to apply. Also, the program did not nominate a service coordinator. This employee would be in charge to evaluate all applications, taking in consideration the minimum requirements established in the operational guide.</p> <p>We performed a housekeeper activities test of ten (10) participant files and found the following exceptions:</p> <ul style="list-style-type: none">a. In the ten (10) participant’s files, we did not find evidence that demonstrate if the Federal Program Director visited at least two times per month the participant housing unit to ensure the quality of services;b. In the ten (10) participant’s files, we did not find evidence that demonstrate if the Federal Program Director notified to the applicant the approval of application.
Criteria	<p>Code of Federal Regulations 24, Section 570.484 states that the Municipality must assure that the program funds benefit very low, low- and moderate income persons and retain documentation justifying its certification. Also, the Municipality has an operational guide that includes all procedures and program’s requirements for housekeeper activities.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-02 (continued)
Cause of Condition	The Municipality's controls and procedures failed to assure that the program administration complied with all requirements established in the operational guide.
Effect of Condition	The Municipality is not in compliance with 24 CFR, Section 570.484 and with the operational guide.
Recommendation	We recommended management to follow the procedures established in the operational guide title "Guía Operacional para la Prestación del Servicio de Auxiliares en el Hogar del Municipio de Naguabo".
Questioned Costs	None

**Management Response
and Corrective Action**

Immediately, the necessary measures will be taken to disclose the information required by the operational guide, related to this project. Visits were not made personally, but phone calls were made to the participants to ensure the quality of service; this action will be made personally by Federal Program Office. In addition, written approval weren't made (they were made by phone); action to this matter will be taken to new program participants.

Implementation Date: March, 2006

Responsible Person: Elizbeth López De Victoria
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-03
Program	Community Development Block Grants – State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Suspension and Debarment
Statement of Condition	During our test, we noted that the Municipality did not perform procedures to assure that the individuals and entities that received contracts, are not suspended or debarred from participation in federal programs.
Criteria	OMB Common Rules, Subpart C, Section 85.35 state that grantees and sub grantees must not make any award or permit any award (sub grant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension."
Cause of Condition	The Municipality did not maintain adequate monitoring procedures to assure that all contracts formalized with individuals and entities, that were paid with federal funds, were not suspended or debarred from participation in federal programs.
Effect of Condition	The Municipality is not in compliance with OMB Common Rules, Subpart C, Section 85.35.
Recommendation	We recommend management to implement monitoring procedures to assure that the individuals and entities that receive contracts are not suspended or debarred from participation in federal programs.
Questioned Costs	None
Management Response and Corrective Action	The Municipality will include in subsequent contracts for federal funded projects, the provision of Debarment and Suspension, as of Executive Order 12549. Implementation Date: March, 2006 Responsible Person: Elizbeth López De Victoria Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-04**

Program **Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)**

Requirement **Procurement**

Statement of Condition During our contract provision test, we verified five (5) contracts for the Community Development Block Grants – State’s Program and found the following exceptions:

- a. One (1) contract did not include a provision for termination by grantee for default;
- b. One (1) contract did not include a provision for compliance with Executive Order 11246 “Equal Employment Opportunity”;
- c. One (1) contract did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours & Safety Standards Act;
- d. Five (5) contracts did not include a provision for granting access, to GAO or other federally agency, to books and other documentation;
- e. Five (5) contracts did not include a provision for compliance with Energy Policy and Conservation Act;
- f. One (1) contract did not include a provision for compliance with the Copeland “Anti-Kickback”;
- g. One (1) contract did not include provisions for retention of all required records for three years;

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-04 (continued)
	h. One (1) contract did not include provisions for compliance with EO-1991-55 (Certification of income tax);
	i. Five (5) contracts did not include provisions for compliance with suspension and debarment.
Criteria	Code of Federal Regulations 24, Subpart I, Section 570.489 (g) requires that all purchase orders and contracts include all clauses required by Federal Statutes, executive orders and implementing regulations.
Cause of Condition	The Municipality's internal control and procedures failed to detect the exclusion of certain contract clauses in the procurement process.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Section 570.489 (g).
Recommendation	We recommend that the Municipality should strengthen its procedures in order to assure that the contracts contain all provisions requested by federal agencies.
Questioned Costs	None
Management Response and Corrective Action	<p>During the fiscal period, a contract in English was used by the Municipality, which contained most of the provisions required by the federal regulation. Nevertheless, during the year, the format was translated to Spanish. The Spanish contract does not contain all the provisions required by the federal regulation. As part of our corrective action plan, we will return to implant the contract in English and revise it in order to identify possible exclusions of required provisions.</p> <p>Implementation Date: March, 2006</p> <p>Responsible Person: Elizbeth López De Victoria Federal Program Director</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-05
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Eligibility of Individuals
Statement of Condition	<p>We performed an eligibility test of fifteen (15) participant files and found the following exceptions:</p> <ul style="list-style-type: none">a. In two (2) participant's files, there was no evidence of the "Privacy Act Notice" signed by the head of household during the fiscal year ended June 30, 2005;b. In two (2) participant's files, we noted that the PHA did not consider a dependent allowance for the sons of the head of household, as part of the Housing Assistance Payment calculation. As result, in one of those cases, the PHA paid an incorrect utility reimbursement to the family for a period of seven (7) months during fiscal year;c. In one (1) participant's file, we noted that the PHA used a Minimum Rent of \$0 instead of \$25, as stated by the program. As result, the PHA paid an incorrect utility reimbursement to the family by a period of two (2) months during fiscal year;
Criteria	<p>Code of Federal Regulations 24, Sections 5.230, 5.212 and 982.516 states that as a condition of admission or continued occupancy, the PHA must require the tenant and other family members to provide necessary information, documentation and releases for the PHA to verify income eligibility. As part of this regulation, the participant and other members of the family who are at least 18 years old must sign an application form, one or more releases forms, a federally prescribed general release form for employment information and a Privacy Act Notice. Also, the Code of Federal Regulations 24, Section 982.505 and the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6) establishes the procedures to be followed to calculate the Housing Assistance Payment.</p>
Cause of Condition	<p>The Municipality controls and procedures failed to assure that all HAP's payments are duly computed by the program staff, and that the participant's files contained all documents required.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-05 (continued)

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Sections 5.230, 5.212, 982.516, 982.505 and with the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6).

Recommendation The Municipality must give instructions to the program staff to assure that the participant files include all documentation required by Federal regulations. Also, we recommend the PHA to strengthen its monitoring procedures to assure the HAP's are duly computed as required by the Federal Regulations.

Questioned Costs None

**Management Response
and Corrective Action**

As part of our correction action plan, we will give instructions to the program staff to assure that all the active participants in the program complete the Privacy Act Notice annually. Also, a monitoring system will be implanted in order to identify possible errors in calculations of the Housing Assistant Payments.

Implementation Date: March, 2006

Responsible Person: Carmen M. de Jesús
Section 8 Program Supervisor

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-06**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Special Test – Selection from the Section 8 Waiting List**

Statement of Condition During the fiscal year ended June 30, 2005, the program maintained two (2) Waiting Lists. In the first one, the PHA includes all the interested families in the program. In the second one, the PHA includes only the families that comply with the minimum requirements to be accepted in the program. In our test, we found the following exceptions:

- a. We selected a sample of ten (10) interested families included in the first Waiting List and noted that the PHA did not include six (6) of these families in the second Waiting List. No documental evidence was found that indicate the reasons to exclude those families;
- b. In the first Waiting List, we noted that the PHA did not include all information required by the Federal Regulation and by the Administrative Plan;
- c. In the second Waiting List, we noted that for the first sixty two (62) applicants, the PHA did not include all information required by the Federal Regulation and by the Administrative Plan.

Criteria Code of Federal Regulations 24, Subpart E, Section 982.201 through 982.207 states the waiting list procedures. The PHA must have written policies in its Housing Choice Voucher Program administrative plan for selecting applicants from the waiting list and PHA documentation must show that the PHA follows these policies when selecting applicants for admission from the waiting list. Except for special admission applicants, all families admitted to the program must be selected from the waiting list. Selection from the waiting list generally occurs when the PHA notifies a family whose name reaches the top of the waiting list to come in to verify eligibility for admission.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-06 (continued)**

Code of Federal Regulations 24, Subpart E, Section 982.204 states that the PHA must maintain information that permits the PHA to select participants from the waiting list in accordance with the PHA admission policies. The waiting list must contain the following information for each applicant listed: (1) Applicant name; (2) Family unit size (number of bedrooms for which family qualifies under PHA occupancy standards); (3) Date and time of application; (4) Qualification for any local preference and; (5) Racial or ethnic designation of the head of household.

Cause of Condition The program's controls and procedures failed to assure that the PHA maintained documental evidence of the reasons used by the program to exclude families from the waiting list and also failed to assure that the waiting lists included all information required by the Federal Regulation and by the Administrative Plan.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Subpart E, Section 982.201 through 982.207

Recommendation We recommend to the PHA, to maintain documental evidence of the reasons used by the program to exclude families from the waiting list. Also, we recommend the PHA to strengthen its monitoring procedures to maintain a waiting list with all information required by the Federal Regulation (applicant name, family unit size, date and time of application, qualification for any local preference and ethnic designation of the head of household). This control must permit proper tracing of participants selected in the waiting list in order to assure the selection from the top of the waiting list.

Questioned Costs None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-06 (continued)

**Management Response
and Corrective Action**

As part of our corrective action plan, we will close the effective Waiting Lists and will open a single Waiting List to avoid that similar situations in the future. If interested families are not selected to participate in the program, we will maintain documental evidence of the reasons taken for the rejection. Also, we put in the new Waiting List, all the information required by the federal regulation.

Implementation Date: March, 2006

Responsible Person: Carmen M. de Jesús
Section 8 Program Supervisor

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-07
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test - Reasonable Rent
Statement of Condition	The determination of reasonable rent (reasonable rent certification) was not duly documented. We examined a sample of fifteen (15) participant's files and found that ten (10) of these files (related to new participants selected during fiscal year ended June 30, 2005), did not include the certification of reasonable rent, including the comparable rent with other similar units.
Criteria	Code of Federal Regulations 24, Subpart K, Sections 982.507 (a), 982.507 (b) and 982.158 (f) (7) states that the PHA may not approve a lease until the PHA determines that the initial rent to owner is a reasonable rent. The PHA must determine whether the rent to owner is a reasonable rent in comparison to rent for other comparable unassisted units. Also, the PHA must maintain records to document the basis for the determination that the rent paid to the owner is reasonable.
Cause of Condition	The PHA controls and procedures failed to assure that a reasonable rent determination was performed as required by the federal regulations.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Subpart K, Sections 982.507 (a), 982.507 (b) and 982.158 (f) (7).
Recommendation	We recommend management to strengthen controls procedures to assure that the rent paid to the owners is reasonable and that appropriate documentation regarding the determination of reasonable rent has been maintained in the applicable participant's files.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-07 (continued)

Questioned Costs None.

**Management Response
and Corrective Action**

As part of our correction action plan, we will implant procedures in order to determine if the rent paid to the owners is reasonable. These procedures will be implanted to the participants admitted to the program after March 2006.

Implementation Date: March, 2006

Responsible Person: Carmen M. de Jesús
Section 8 Program Supervisor

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-08
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Housing Assistance Payment (HAP)
Statement of Condition	The Housing Assistance Payment Register maintained by the PHA during fiscal year ended June 30, 2005, did not include all the information required by the federal agency.
Criteria	Code of Federal Regulations 24, Section 982.158 states that the PHA's are required to maintain a HAP contract register or similar record in which to record the PHA's obligation for monthly HAP's. This record must provide information as to: the name and address of the family, the name and address of the owner, dwelling unit size, the beginning date of the lease term, the monthly rent payable to the owner, monthly rent payable by the family to the owner, and the monthly HAP. The record shall also provide data as to the date the family vacates and the number of days the unit is vacant, if any.
Cause of Condition	The PHA controls and procedures failed to assure that the HAP Register maintained by the PHA includes all the information required by federal agency.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Section 982.158.
Recommendation	We recommend to the Municipality management to strengthen controls procedures to include in the HAP Register all the information required by federal agency.
Questioned Costs	None.
Management Response and Corrective Action	According to the Federal Law that is ruled, the form was created and will be effective on March 2006. Implementation Date: March, 2006 Responsible Person: Carmen M. de Jesús Section 8 Program Supervisor

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-01	14.219	<p><u>The Municipality does not have procedures in place to verify the status of an entity as to suspensions and debarments when contracting services or procuring goods with federal funds.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-03.</p>
04-02	14.219	<p><u>Contracts are not prepared for each of the pavement or repavement works requested. Instead, at the beginning of the fiscal year, an annual general contract for all pavement or repavement works is granted to the contractor to which the auction was adjudged. Such contracts lack of most of the federal required provisions and did not establish Municipality and contractor's responsibilities nor work description. Also, nine (9) out of eighteen (18) auctions bidders were not included on the Municipality's bidders register (Registro de Licitadores) as required by the Municipalities law.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-04.</p>
04-03	14.871	<p><u>Section 8 Housing Choice Vouchers Program does not have adequate controls over the timing of disbursements once the federal funds are received. Also, during fiscal year 2003-2004, monthly bank account balance maintained by the Program was between \$36,000 and \$164,000, before next monthly receipt.</u></p> <p>Full corrective action has been taken.</p>
04-04	14.871	<p><u>In three (3) out of twenty (20) cases, payment standard amounts (PSA) considered as part of HAP determination (HUD Form 50058) were incorrect and not in accordance with what it was established in the Program's administrative plan. In one (1) out twenty (20) cases, family dependents were not considered for purpose of determining TTP and final HAP amount. In one (1) out of 20 cases, a member of a family which was over 18 year old was considered as a dependent for purposes of determining HAP amount. In two (2) out of twenty (20) cases, income evidence was not considered for purpose of determining HAP amount.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-05.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

04-05 14.871 Rent amounts paid to owners of Section 8 Housing Choice Voucher Program's dwelling units, were not in accordance with Public Housing Authority administrative plan. According to the PHA administrative plan, the amount of rent to be paid to owners should be 90% of the fair market rent based on HUD effective tables. In seventeen (17) out of twenty (20) cases, the amounts of rent paid to the owners of the dwelling units were below HUD 90% fair market rent amount.

Full corrective action has been taken.

04-06 14.871 Five (5) participant's files do not contain at least one of the following documents: (A) Negative certification from the PR Unemployment Department; (B) Affidavit regarding family composition and income and; (C) Negative certification from "ASUME".

Full corrective action has been taken.

03-04 14.871 Eligibility Test - Lack of documentation

No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 05-05.

03-05 14.871 Eligibility Test - Evidence of income

Full corrective action has been taken.

03-07 11.307 Procurement and Suspension

No longer valid. During the fiscal year 2004-2005 no expenditure was presented in the Schedule of Expenditures of Federal Awards, related to Economic Adjustment Assistance Program.

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF NAGUABO

**BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION**

YEAR ENDED JUNE 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2005

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

**To the Honorable Mayor and
the Municipal Legislature
Municipality of Naguabo
Naguabo, 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 Naguabo, Puerto Rico (Municipality)**, as of and for the year ended June 30, 2005, which collectively comprise the **Municipality's** basic financial statements as listed in the table of contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 12 to the financial statements, the **Municipality** has not maintained evidence of ownership in certain capital assets. Also, the **Municipality's** accounting system and records of capital assets did not reconcile at the beginning of the fiscal year in the governmental activities and, accordingly, has not recorded depreciation expense on those assets. Accounting principles generally accepted in the United States of America require that capital assets be capitalized and depreciated, which would increase the assets and expenses of the governmental activities. The amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonably determinable.

In our opinion, because of the effects of the matter discussed in the third paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the **Municipality of Naguabo, Puerto Rico**, as of June 30, 2005, and the changes in financial position, thereof for the year then ended.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of each major fund, and the aggregate remaining fund information of the **Municipality of Naguabo, Puerto Rico**, as of June 30, 2005, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule-General Fund on page 41 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
November 21, 2005

Stamp No. 2019486 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2005

This discussion and analysis of the Municipality of Naguabo (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2005. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2004. This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. asses management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2005 deserve special mention:

1. Total assets of the Municipality amounted to \$29,013,495 which represents an increase of 12% compared to prior fiscal year;
2. At the end of fiscal year 2005, total liabilities amounted to \$10,843,959. Out of said amount, \$9,200,246 corresponded to long-term liabilities of which \$6,148,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
3. Total net assets of the Municipality amounted to \$18,169,536 which represents an increase of 16% compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$14,921,840, derived from the following sources: \$251,558 charges for services; \$1,674,835 from operating grants and contributions; \$1,441,629 from capital grants and contributions obtained from other sources, and \$11,553,818 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$12,401,314;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$2,520,526;
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$1,300,387;
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$200,283, compared to a fund deficit of (\$2,775,254) in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in a favorable balance of \$1,497,197 which is indicative of full compliance with the balanced budget principle applicable to all municipalities of the Commonwealth Government of Puerto Rico as required by the Municipal Autonomous Act enacted in August 1991.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2005. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds. This in turn will benefit the welfare of Naguabo constituents.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2005, shows total expenses incurred to afford the cost of all functions and programs amounted to \$12,401,314. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$3,368,022 was derived from the following sources: \$251,558 charges for services; \$1,674,835 from operating grants and contributions; and \$1,441,629 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$11,553,818. When such figure is added to the \$3,368,022 previously mentioned, total revenues available for the financing of activities amounted to \$14,921,840. There was an excess of revenues over expenses in the amount of \$2,520,526 which contributed with an increase to the figure of net assets attained at the end of the fiscal year.

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Naguabo, total assets exceeded government liabilities by \$18,169,536 at the end of 2005, compared to \$15,649,010 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

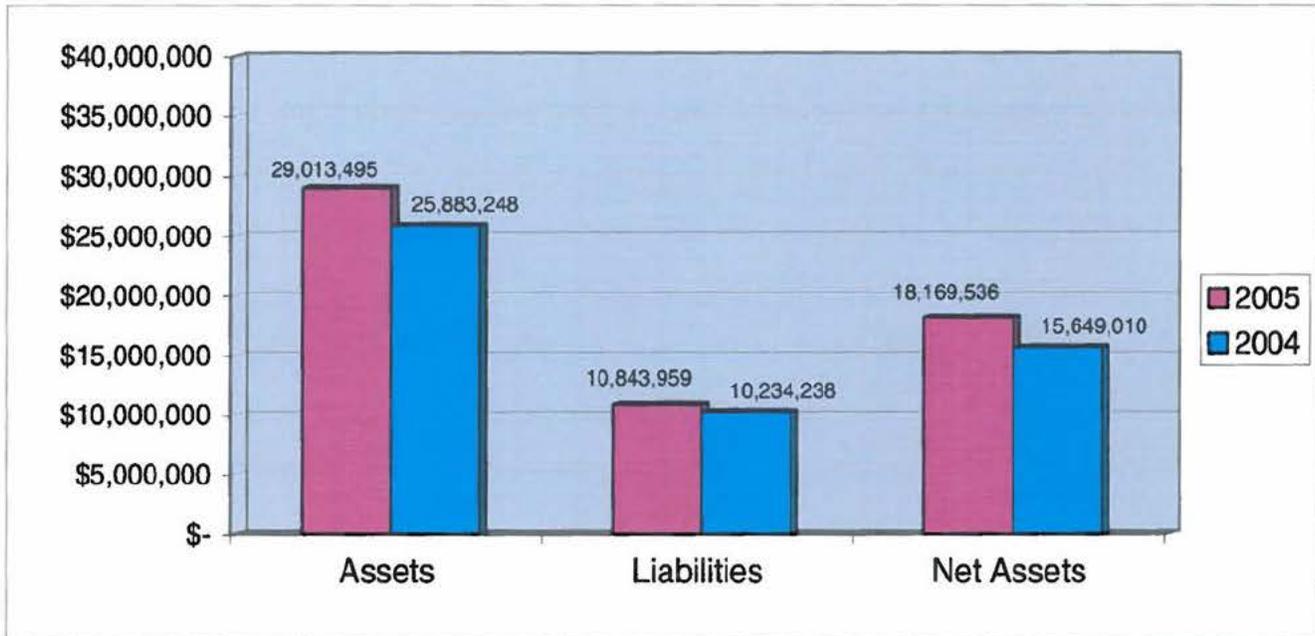
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Condensed Statement of Net Assets	2005	2004	Change	%
Current and other assets	\$ 5,210,725	\$ 4,386,964	\$ 823,761	19%
Capital assets	23,802,770	21,496,284	2,306,486	11%
Total assets	29,013,495	25,883,248	3,130,247	12%
Current and other liabilities	1,643,713	3,123,456	(1,479,743)	(47%)
Long-term liabilities	9,200,246	7,110,782	2,089,464	29%
Total liabilities	10,843,959	10,234,238	609,721	6%
Invested in capital assets, net of related debt	20,284,770	19,064,284	1,220,486	6%
Restricted	3,366,729	4,260,856	(894,127)	(21%)
Unrestricted deficit	(5,481,963)	(7,676,130)	2,194,167	(29%)
Total net assets	\$ 18,169,536	\$ 15,649,010	\$ 2,520,526	16%



Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2005, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$2,520,526 increase in the Municipality's net assets. Approximately 51 percent of the Municipality's total revenue came from taxes, while 46 percent resulted from grants and contributions, including federal aid. Charges for Services provided 2 percent of the total revenues.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

The Municipality's expenses cover a range of services. The largest expenses were for general government, public safety, public works, culture and recreation, health and welfare services, and community development. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

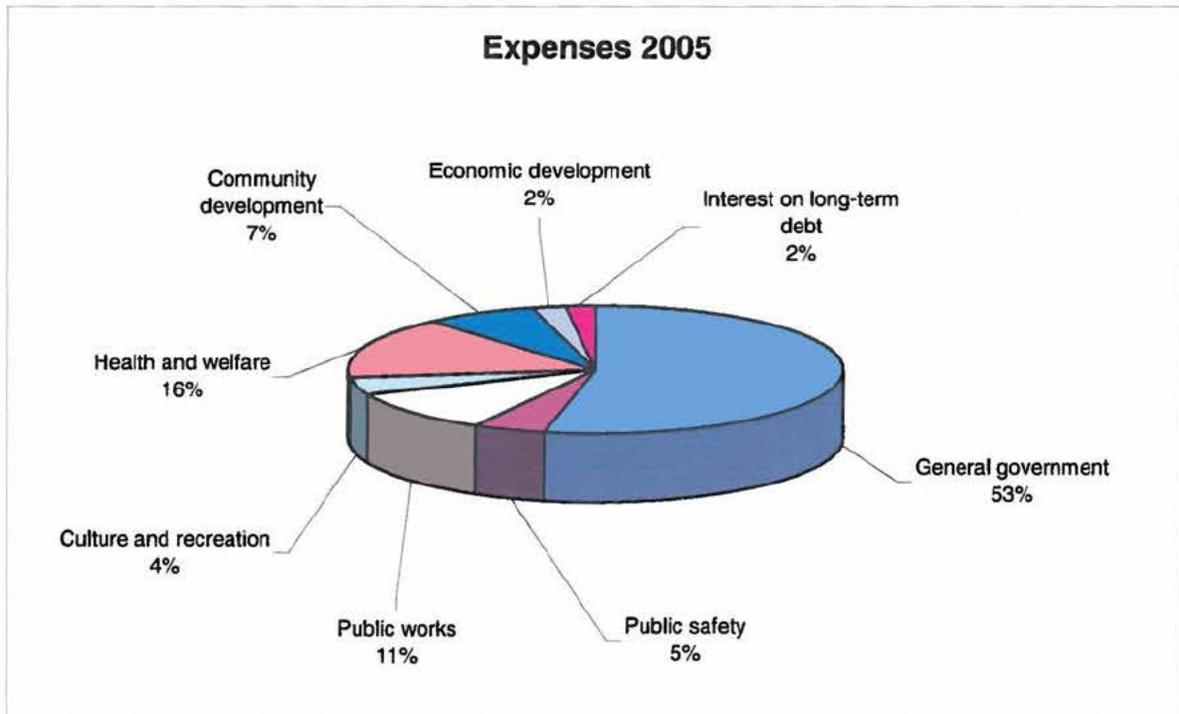
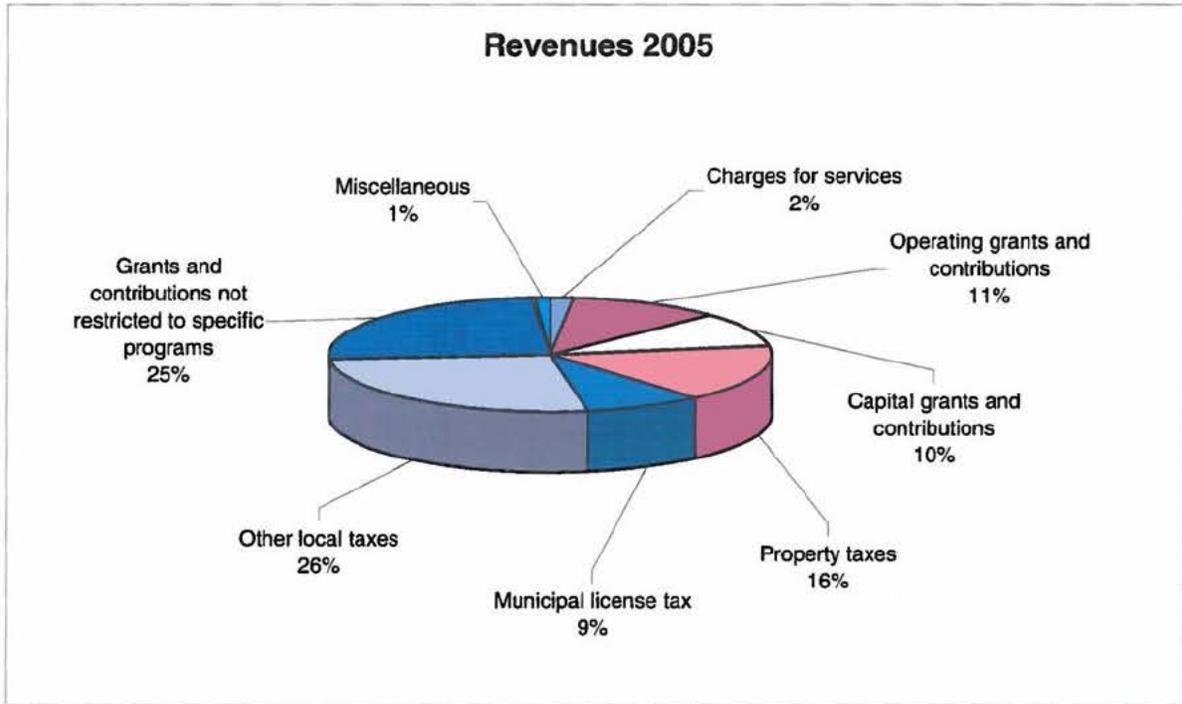
Condensed Statement of Activities	2005	2004	Change	%
Program revenues:				
Charges for services	\$ 251,558	\$ -	\$ 251,558	100%
Operating grants and contributions	1,674,835	2,675,854	(1,001,019)	(37%)
Capital grants and contributions	1,441,629	747,689	693,940	93%
General revenues:				
Property taxes	2,395,455	2,235,583	159,872	7%
Municipal license tax	1,270,606	718,902	551,704	77%
Other local taxes	4,000,729	411,000	3,589,729	873%
Grants and contributions not restricted to specific programs	3,679,732	11,011,266	(7,331,534)	(67%)
Rent		99,102	(99,102)	(100%)
Interest and investment earnings	32,314		32,314	100%
Miscellaneous	174,982	259,711	(84,729)	(33%)
Total revenues	14,921,840	18,159,107	(3,237,267)	(18%)
Expenses				
General government	6,622,542	4,458,200	2,164,342	49%
Public safety	576,541	449,393	127,148	28%
Public works	1,317,135	981,744	335,391	34%
Culture and recreation	526,849	164,893	361,956	220%
Health and sanitation		1,428,620		(100%)
Health and welfare	1,957,246	1,989,100	(31,854)	(2%)
Community development	879,424	997,084	(117,660)	(12%)
Economic development	279,738		279,738	100%
Capital Outlay		173,359	(173,359)	(100%)
Interest on long-term debt	241,839	211,430	30,409	14%
Total expenses	12,401,314	10,853,823	1,547,491	14%
Change in net assets	2,520,526	7,305,284	(4,784,758)	(65%)
Net assets, beginning of year	15,649,010	8,343,816	7,305,194	88%
Net assets, end of year	\$ 18,169,536	\$ 15,649,100	\$ 2,520,436	16%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

The Municipality's net assets increase by \$2,520,526, a difference of the prior year through (\$4,784,758). Key elements of this increase are as follows: Change in revenues results of municipal license and construction tax related to a dam project begun during the fiscal year. However, change in revenues results of grants and contributions not restricted to specific programs decrease mainly by (\$7,331,534), result of donated capital assets of approximately \$6,600,000 during prior year.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$1,300,387, an increase of \$2,419,042 in comparison with the prior year. There are reservations of fund balance amounting to \$1,224,439. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$120,061), 2) to pay debt service (\$424,066), 3) to pay for capital projects (\$229,574) and 4) for other purposes (\$450,738).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2005, the general fund has a fund balance of \$200,283.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The actual General Fund budgetary activities resulted in a favorable balance of \$1,497,197, caused mainly due to unexpected variances in revenue collections from miscellaneous sources.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has not maintained complete and adequate records related to the Capital Assets acquired and constructed in the past years, but the Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets, and then, comply with such requirement. The Municipal Administration expects to develop a broad and comprehensive identification and assessments project of all fixed assets owned by the local government in order to capitalize them in its Statement of Net Assets, and then, reflects the correct net assets figure of the Municipality as a whole.

The Municipality's investment in capital assets as of June 30, 2005, amounts to \$25,779,601, net of accumulated depreciation of \$1,976,831 (including depreciation charges for the year totaled \$455,112), leaving a net book value of \$23,802,770. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure, work of art, furnishing, computers and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2005, the Municipality has \$46,139 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a Municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a Municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2005-2006.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2005. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 40, Naguabo, Puerto Rico 00718-0040, or call (787) 874-3040.

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Net Assets
June 30, 2005

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 1,634,951
Cash with fiscal agent	1,037,622
Accounts receivable:	
Municipal license tax	4,502
Intergovernmental	356,203
Federal	2,015,755
Interest	14,210
Other	147,482
Capital assets	
Land, improvements, and construction in progress	10,991,283
Other capital assets, net of depreciation	12,811,487
Total capital assets	23,802,770
Total assets	29,013,495
Liabilities	
Accounts payable and accrued liabilities	461,243
Due to other governmental entities	637,155
Deferred revenues:	
Municipal license tax	481,864
Federal grant revenues	12,720
Interest payable	50,731
Noncurrent liabilities:	
Due within one year	959,220
Due in more than one year	8,241,026
Total liabilities	10,843,959
Net Assets	
Invested in capital assets, net of related debt	20,284,770
Restricted for:	
Capital projects	229,574
Debt service	829,066
Other purposes	2,308,089
Unrestricted (deficit)	(5,481,963)
Total net assets	\$ 18,169,536

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Activities
For the Year Ended June 30, 2005

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 6,622,542	\$ 16,184	\$ 95,664	\$ -	\$ (6,510,694)
Public safety	576,541	12,291			(564,250)
Public works	1,317,135	108,725	95,419	64,431	(1,048,560)
Health and welfare	1,957,246	28,246	1,091,969		(837,031)
Culture and recreation	526,849	86,112	84,400	229,097	(127,240)
Economic development	279,738		279,738		-
Community development	879,424		27,645	1,148,101	296,322
Interest on long-term debt	241,839				(241,839)
Total governmental activities	\$ 12,401,314	\$ 251,558	\$ 1,674,835	\$ 1,441,629	(9,033,292)
General revenues:					
					2,395,455
					1,270,606
					4,000,729
					3,679,732
					32,314
					174,982
					11,553,818
					2,520,526
					15,649,010
					\$ 18,169,536

Commonwealth of Puerto Rico
Municipality of Naguabo
Balance Sheet
Governmental Funds
June 30, 2005

	General Fund	Special Revenue Fund Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Cash and cash equivalents	\$ 1,023,850	\$ 192,186	\$ -	\$ 418,915	\$ 1,634,951
Cash with fiscal agent	4,274	104,258	882,951	46,139	1,037,622
Accounts receivable:					
Municipal license tax	4,502				4,502
Intergovernmental	225,157	2,015,755		131,046	2,371,958
Interest	14,210				14,210
Other	87,143				87,143
Prepaid Expenses	60,339				60,339
Due from other funds	333,902	106,668		226,901	667,471
Total assets	\$ 1,753,377	\$ 2,418,867	\$ 882,951	\$ 823,001	\$ 5,878,196
Liabilities and Fund Balances					
Liabilities :					
Accounts payable and accrued liabilities	\$ 204,206	\$ 166,799	\$ 405,000	\$ 90,238	\$ 866,243
Interest payable			50,731		50,731
Due to other governmental entities	637,155				637,155
Due to other funds	229,869	174,066	3,154	260,382	667,471
Deferred revenues:					
Municipal license tax	481,864				481,864
Federal grant revenues		1,874,345			1,874,345
Total liabilities	1,553,094	2,215,210	458,885	350,620	4,577,809
Fund balances:					
Reserved for:					
Encumbrances	120,061				120,061
Debt service fund			424,066		424,066
Other purposes	4,274	203,657			207,931
Reserved reported in nonmajor funds:					
Capital projects				229,574	229,574
Other purposes				242,807	242,807
Unreserved:					
Undesigned	75,948				75,948
Total fund balances	200,283	203,657	424,066	472,381	1,300,387
Total liabilities and fund balances	\$ 1,753,377	\$ 2,418,867	\$ 882,951	\$ 823,001	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	23,802,770
Long-term liabilities, including interest payable, are not due and payable in the current period, and therefore, are not reported in the funds	(9,200,246)
Liabilities reported in funds and not reported in statement of net assets	2,266,625
Net assets of governmental activities	\$ 18,169,536

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2005

	General Fund	Special Revenue Fund Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues					
Property taxes	\$ 1,822,223	\$ -	\$ 451,605	-	\$ 2,273,828
Municipal license taxes	1,270,606				1,270,606
Licenses, permits and other local taxes	4,002,099				4,002,099
Charges for services	20,898				20,898
Fines and forfeitures	12,291				12,291
Intergovernmental	3,830,448			805,274	4,635,722
Rent of property	185,357				185,357
Interest	32,314				32,314
Federal grants		1,848,165		585,800	2,433,965
Miscellaneous	232,225	350		47,723	280,298
Total revenues	11,408,461	1,848,515	451,605	1,438,797	15,147,378
Expenditures					
Current:					
General government	\$ 5,979,402	\$ 2,968	\$ -	\$ 29,739	\$ 6,012,109
Public safety	573,423			8,984	582,407
Public works	2,345,416	29,892		495,132	2,870,440
Health and welfare	801,153	423,276		727,457	1,951,886
Culture and recreation	203,353			285,923	489,276
Economic development				279,738	279,738
Community development		1,366,641			1,366,641
Debt service:					
Principal			549,000		549,000
Interest			241,839		241,839
Total expenditures	9,902,747	1,822,777	790,839	1,826,973	14,343,336
Excess (deficiency) of revenues over (under) expenditures	1,505,714	25,738	(339,234)	(388,176)	804,042
Other financing sources (uses)					
Transfers in	55,535		200,712	3,700	259,947
Transfers out	(200,712)	(3,700)		(55,535)	(259,947)
Long-term debt issued	1,615,000				1,615,000
Total other financing sources (uses)	1,469,823	(3,700)	200,712	(51,835)	1,615,000
Net change in fund balances	2,975,537	22,038	(138,522)	(440,011)	2,419,042
Fund balance (deficit) beginning	(2,775,254)	181,619	562,588	912,392	(1,118,655)
Fund balance, ending	200,283	203,657	424,066	472,381	1,300,387

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Commonwealth of Puerto Rico
Municipality of Naguabo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2005

Net Change in Fund Balances - Total Governmental Funds **\$ 2,419,042**

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

Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 2,761,599

Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. (455,113)

Bonds and notes proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments. (1,176,000)

Repayment of long term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long-term property tax advance debt in the Government-Wide Statement of Net Assets. This is the amount paid in the current period. The following amount represent the change in long-term property tax advance debt from prior year. (404,202)

Repayment of long term Treasury Department debt is an expenditure in Governmental Funds, but the repayment reduces long-term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Treasury Department from prior year. (104,054)

Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represents the change in long-term compensated absences from prior year. (173,513)

Long-term claims and judgments are reported in the Governmental-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, claims and judgments are not reported as expenditures in Government Funds. The following amount represents the change in long-term claims and judgments from prior year. (241,000)

Repayment of long term Department of Labor and Human Resources debt is an expenditure in Governmental Funds, but the repayment reduces long-term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Department of Labor and Human Resources from prior year. 61,630

Repayment of long term Puerto Rico Land Authority debt is an expenditure in Governmental Funds, but the repayment reduces long-term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Puerto Rico Land Authority from prior year. 76,085

Commonwealth of Puerto Rico
Municipality of Naguabo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2005

Repayment of long term Puerto Rico Electric Power Authority (PREPA) debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the PREPA from prior year.	(128,410)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenue in the funds. The following amount represents the change in this revenues from prior year.	(225,538)
Some expenses reported in the Governmental Funds do not require the use of current financial resources and, therefore, are not reported as expenses in the Statement of Activities. The following amount represents the change in this expenses from prior year.	<u>110,000</u>
Change in Net Assets of Governmental Activities	<u><u>\$ 2,520,526</u></u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Naguabo** (the Municipality) was founded on the year 1775. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a fourteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality has elected to delay the capitalization of infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The following is a summary of the significant accounting policies of the Municipality:

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 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.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

Special Revenue Fund – Federal Grants- is the accounting entity in which revenues derived from federal grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal statutes.

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each if which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

General Fund - Is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund – Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund – Section 8 - Special Revenue Funds are used to account for revenues derived from section 8 choice voucher program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund – Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Fund – State and Local Grants - Capital Projects Fund are used to account for financial resources used for the acquisition or construction of major capital facilities.

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

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America (“GAAP”) as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are 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. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No. 20.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Governmental fund 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 purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, Accounting and Financial Reporting for Non Exchange Transactions (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenues 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.

Property taxes, franchise taxes, licenses, rent, 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 the government receives cash.

Private-sector standards of accounting and financial reporting issue prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The preparation of the 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Assets, liabilities and net assets

- 1. Cash, cash equivalents, and cash with fiscal agent-** The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services 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.

- 2. 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."

Advances 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.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

5. **Long-term obligations-** The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

6. **Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

7. Claims and judgments- The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.

8. Reservation of fund balance- Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.

b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.

d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.

9. Interfund and intra-entity transactions- The Municipality has the following types of transactions among funds:

a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

10. Risk financing- The Municipality carries commercial insurance to cover 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.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2005 amounted to approximately \$233,419. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$199,731 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 23,802,770	
Deduct:		
Bonds and notes payable	<u>(3,518,000)</u>	\$ 20,284,770
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		229,574
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balance		829,066
<u>Net assets restricted for other purposes</u>		
Special revenue fund - local and state grants restricted		2,308,089
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 200,283	
Deduct:		
Bonds Payable	(2,630,000)	
Property Tax Debt	(742,509)	
Compensated Absences	(1,235,488)	
PR Electric Power Authority (PREPA)	(128,410)	
Treasury Department	(655,839)	
Claims and judgments	<u>(290,000)</u>	<u>(5,481,963)</u>
Total net assets - governmental activities		<u>\$ 18,169,536</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

2. DEPOSITS

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of \$1,023,850 in the general fund, and \$192,186 in the special revenue fund - federal grants were fully collateralized at June 30, 2005. In the other governmental funds there were deposits with commercial banks of \$418,915 that were fully collateralized.

The deposits at GDB of \$4,274, that is restricted for other purposes in the general fund, the \$104,258 in the special revenue fund - federal grants, the \$882,951 that is restricted for debt service fund and \$46,139 in the other governmental funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality impose a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to 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 on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2005, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues

2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2005, net of allowance for uncollectible.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

3. RECEIVABLES (CONTINUED)

B. Intergovernmental Receivables- Intergovernmental receivables in the general fund principally consist of the amounts due from the Puerto Rico Electric Power Authority ("PREPA") resulting from payments made by the Municipality, which will be reimbursed at the issuance of the ("PREPA") final liquidation. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Puerto Rico Electric Power Authority ("PREPA")	\$ 225,157
Total	\$ 225,157

Intergovernmental receivable in special revenue fund – federal grants represent grants that met the eligibility and time requirements by the recipient and the funds are not received yet. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$ 1,852,577
Child Care and Development Block Grant	150,458
Non-Urbanized Area Formula Program, Section 5311	<u>12,720</u>
Total	\$ 2,015,755

Intergovernmental receivable in the other governmental funds represent expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Department of Labor and Human Resources- Law 52 Grant	\$ 90,077
Commonwealth of Puerto Rico-Legislature	<u>40,969</u>
Total	\$ 131,046

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2005, and interfund transfers during the fiscal year ended at June 30, 2005, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund - Federal Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	\$ 170,366
General Fund	Debt Service Fund	Interest Revenue	3,154
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	160,382
Special Revenue Fund - Federal Grants	General Fund	Reimbursable expenditures	2,968
Special Revenue Fund - Federal Grants	Special Revenue Fund - Federal Grants	Reimbursable expenditures	3,700
Special Revenue Fund - Federal Grants	Other Governmental Funds	Reimbursable expenditures	100,000
Other Governmental Funds	General Fund	Reimbursable expenditures	<u>226,901</u>
Total			<u>\$ 667,471</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt retirement	\$ 200,712
Special Revenue Fund - Federal Grants	Other Governmental Funds	Transfer of funds to Other Governmental Funds	3,700
Other Governmental Funds	General Fund	Transfer of funds to General Fund	<u>55,535</u>
Total			<u>\$ 259,947</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2005, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2005</u>
Capital asset, not being depreciated:				
Land	\$ 7,125,208	\$ 1,038,244	\$ -	\$ 8,163,452
Construction in progress	<u>2,369,638</u>	<u>458,193</u>	<u>-</u>	<u>2,827,831</u>
Total capital assets not being depreciated	<u>\$ 9,494,846</u>	<u>\$ 1,496,437</u>	<u>\$ -</u>	<u>\$ 10,991,283</u>
Capital assets, being depreciated:				
Buildings	\$ 7,103,360	\$ -	\$ -	\$ 7,103,360
Buildings improvements		476,012		476,012
Infrastructure	4,406,073	163,254		4,569,327
Infrastructure improvements		498,646		498,646
Equipment	694,554	35,366		729,920
Work of Art		1,500		1,500
Furnishing		28,266		28,266
Computers		16,122		16,122
Vehicles	<u>1,319,170</u>	<u>45,995</u>	<u>-</u>	<u>1,365,165</u>
Total capital assets being depreciated	<u>\$ 13,523,157</u>	<u>\$ 1,265,161</u>	<u>\$ -</u>	<u>\$ 14,788,318</u>
Less accumulated depreciation for:				
Buildings	\$ (346,797)	\$ (110,120)		\$ (456,917)
Buildings improvements		(5,508)		(5,508)
Infrastructure	(242,334)	(67,768)		(310,102)
Infrastructure improvements		(14,643)		(14,643)
Equipment	(231,784)	(125,272)		(357,056)
Work of Art		(63)		(63)
Furnishing		(1,525)		(1,525)
Computers		(1,322)		(1,322)
Vehicles	<u>(700,804)</u>	<u>(128,891)</u>	<u>-</u>	<u>(829,695)</u>
Total accumulated depreciation	<u>\$ (1,521,719)</u>	<u>\$ (455,112)</u>	<u>\$ -</u>	<u>\$ (1,976,831)</u>
Total capital assets being depreciated, net	<u>\$ 12,001,438</u>	<u>\$ 810,049</u>	<u>\$ -</u>	<u>\$ 12,811,487</u>
Governmental activities capital assets, net	<u>\$ 21,496,284</u>	<u>\$ 2,306,486</u>	<u>\$ -</u>	<u>\$ 23,802,770</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 212,338
Public safety	6,563
Public works	66,295
Culture and recreation	38,616
Community Development	122,264
Health and welfare	<u>9,036</u>
Total depreciation expense-governmental activities	<u>\$ 455,112</u>

6. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the Municipal Revenue Collection Center (CRIM), a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. 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 CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. At the date of the release of these financial statements, the CRIM issued the preliminary liquidation noting that the advances exceeded collections by \$213,904. This excess will not be funded with available expendable financial resources at June 30, 2005. Based on this, such amount was presented in the government-wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

6. PROPERTY TAXES (CONTINUED)

The Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2005, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$124,081.

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years.

Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26 1997, Public Law Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law. As of June 30 2005, the related unpaid property tax advances presented in the Statement of Net Assets amounted to approximately \$227,770.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

6. PROPERTY TAXES (CONTINUED)

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$ 15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$ 50,000 of the assessed value to retailers having annual net sales of less than \$ 150,000.

The annual tax rate is 8.33% for real property and 6.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in 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. From such fund, a distribution is made to all municipalities; (b) 1.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the general fund include the following:

<u>Governmental Entity</u>	<u>Amount</u>
Puerto Rico Aqueduct and Sewer Authority	\$ 92,684
General Services Administration	250
Land Authority	70,085
Department of Treasury	402,425
Department of Labor and Human Resources	27,663
Retirement System Administration	<u>44,048</u>
Total	<u>\$ 637,155</u>

8. DEFERRED REVENUES

A. **Municipal License Tax**- The deferred revenues of approximately \$481,864 in the general fund relates to municipal license tax collected in fiscal year 2004-05 that will be earned in fiscal year 2005-06.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

8. DEFERRED REVENUES (CONTINUED)

Federal Government- The deferred revenues presented in the special revenue fund – federal grants represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$ 1,745,547
Child Care and Development Block Grant	116,078
Non-Urbanized Area Formula Program, Section 5311	<u>12,720</u>
Total	<u>\$ 1,874,345</u>

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2005, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$4,297,000	\$1,615,000	\$ 274,000	\$5,638,000	\$380,000
Note Payable	675,000		165,000	510,000	185,000
Property Tax Advances	193,546	213,904	16,792	390,658	16,792
Property Tax - Treasury	144,761		20,680	124,081	20,680
Income Tax Withheld		664,106	482,053	182,053	182,053
Income Tax Withheld	413,517		58,200	355,317	58,200
Unemployment	38,072		38,072		
Unemployment-Federal	23,558		23,558		
Social Security	138,268		19,800	118,468	19,800
Claims and Assessments	49,000	290,000	49,000	290,000	
P.R. Land Authority	76,085		76,085		
Compensated Absences	1,061,975	377,929	204,416	1,235,488	50,000
CRIM – Law 146		227,770		227,770	
Puerto Rico Electric Power Authority		<u>160,084</u>	<u>31,674</u>	<u>128,410</u>	<u>46,695</u>
Total	<u>\$7,110,782</u>	<u>\$3,548,793</u>	<u>\$1,459,330</u>	<u>\$9,200,245</u>	<u>\$959,220</u>

- 1. Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

9. LONG-TERM LIABILITIES (CONTINUED)

2. Bonds payable- The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. During the current year, the Municipality issued bonds for approximately \$1,615,000. Bonds payable outstanding at June 30, 2005 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2005</u>
1992-Series	7-1-2006	\$ 415,000	4.37% to 6.36%	\$ 90,000
1996-Series	1-1-2020	514,000	4.50%	424,000
1998-Series	7-1-2007	320,000	4.86% to 6.71%	125,000
1998-Series	1-1-2023	576,000	4.50%	484,000
2000-Series	1-1-2025	239,000	4.50%	220,000
2001-Series	7-1-2010	590,000	5.00% to 8.00%	405,000
2002-Series	7-1-2016	370,000	5.00% to 8.00%	325,000
2003-Series	7-1-2027	285,000	5.00% to 6.50%	275,000
2003-Series	7-1-2027	990,000	5.00% to 6.50%	935,000
2004-Series	7-1-2013	865,000	5.00% to 6.00%	740,000
2005-Series	7-1-2014	475,000	3.27% to 5.00%	475,000
2005-Series	7-1-2019	1,140,000	4.37% to 5.00%	<u>1,140,000</u>
Total general obligation bonds				<u>\$ 5,638,000</u>

These bonds, except the 2003 Series \$990,000 bond and the 2004 Series \$865,000 bond, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. The 2003 Series \$990,000 bond and the 2004 Series \$865,000 bond are payable with General Fund resources.

Annual debt service requirements to maturity for bonds payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 380,000	\$ 277,803
2007	417,000	291,396
2008	395,000	267,110
2009	367,000	244,270
2010	388,000	221,455
2011-2015	1,704,000	783,550
2016-2020	1,217,000	401,208
2021-2025	560,000	152,958
2026-2030	<u>210,000</u>	<u>16,250</u>
Total	<u>\$ 5,638,000</u>	<u>\$ 2,656,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

9. LONG-TERM LIABILITIES (CONTINUED)

3. Notes Payable- The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2005</u>
1997-Series	7-1-16	\$ 400,000	5.00% to 8.00%	\$ 285,000
1999-Series	7-1-05	620,000	2.70% to 7.81%	110,000
2000-Series	7-1-06	200,000	3.21% to 7.81%	70,000
2002-Series	7-1-06	100,000	3.21% to 5.00%	<u>45,000</u>
Total notes payable				<u>\$ 510,000</u>

This notes, except the 1997 Series \$400,000 note, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 185,000	\$ 18,060
2007	80,000	13,713
2008	20,000	11,750
2009	20,000	10,750
2010	25,000	9,625
2011-2015	140,000	30,950
2016-2020	<u>40,000</u>	<u>1,000</u>
Total	<u>\$ 510,000</u>	<u>\$ 95,848</u>

4. Compensated absences- The government-wide statement of net assets includes approximately \$501,414 of accrued sick leave benefits, and approximately \$734,074 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

10. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

10. PENSION PLAN (CONTINUED)

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, 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.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions during the year ended June 30, 2005 amounted to approximately \$219,075.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

10. PENSION PLAN (CONTINUED)

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 ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2005, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

11. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

12. CAPITAL ASSETS REPORTED VALUE

The Municipality has not maintained complete records related to the Capital Assets reported in governmental activities of the government-wide financial statements and, therefore, such condition would affect the amounts of assets, net assets, and expenses of the governmental activities. The Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

13. CONTINGENCIES

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$290,000 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2005

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis) (See Note 1)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 1,636,944	\$ 1,822,223	\$ 1,822,223	\$ -
Fines and forfeiture	2,500	12,341	12,291	(50)
Municipal license tax	739,820	883,046	1,266,104	383,058
Licenses, permits and other local taxes	793,504	3,919,083	3,923,406	4,323
Charges for service	42,000	29,333	20,898	(8,435)
Intergovernmental	4,569,964	4,114,404	4,299,840	185,436
Interest	2,000	74,478	16,086	(58,392)
Rent of property	106,000	75,543	176,907	101,364
Miscellaneous	12,000	200,285	232,225	31,940
Total revenues	\$ 7,904,732	\$ 11,130,736	\$ 11,769,980	\$ 639,244
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	4,248,483	6,418,722	5,588,832	829,890
Public safety	706,688	574,995	574,191	804
Public works	1,642,128	2,927,088	2,901,936	25,152
Health and welfare	808,499	805,250	803,745	1,505
Culture and recreation	264,559	204,206	203,367	839
Operating transfer to other funds	234,375	200,475	200,712	(237)
Total expenditures, encumbrances and other financing uses	7,904,732	11,130,736	10,272,783	857,953
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	\$ -	\$ -	\$ 1,497,197	\$ 1,497,197
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 11,769,980
Differences-budget to GAAP:				
Proceed from bond issuance				1,615,000
GAAP adjustments to revenues				(361,519)
No budgeted transfer in				55,535
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 13,078,996</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 10,272,783
Differences-budget to GAAP:				
Non-budgeted expenditures				(49,263)
Current year encumbrances recorded as expenditures for budgetary purposes				(120,061)
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,103,459</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2005

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2005 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2005.



Hon. Wilfredo Astacio Santiago
Alcalde

Estado Libre Asociado de Puerto Rico
Gobierno Municipal de Naguabo
Oficina del Alcalde

OFIC. DEL COMISIONADO
05 DEC -8 AM 10:41
UNIDAD DE CORREO

Carthago 1. 800 5-

05 DEC -8 PM 2:33
DIVISION DE COMISIONADO
E INTERVENCION

7 de diciembre de 2005

Lcdo. Ángel M. Castillo Rodríguez
Comisionado
Oficina del Comisionado
de Asuntos Municipales
P O Box 70167
San Juan, P R 00936-8167

Estimado señor Comisionado:

Reciba mis saludos cordiales y los que laboramos en el Municipio de Naguabo.

Conforme al Artículo 7.011 Inciso (d) de la Ley Núm. 81, mejor conocida como Ley de Municipios Autónomos de Puerto Rico, le sometemos para la consideración y evaluación de su Oficina, los Estados Financieros Finales Auditados del Año Fiscal 2004-2005. Dichos estados fueron entregados en la Oficina del Contralor de Puerto Rico el 6 de diciembre de 2005, evidencia de su entrega se incluye.

Estos estados reflejan que el Municipio terminó con un exceso de ingresos sobre sus egresos de \$1,505,714 y el cambio neto en el balance de fondo (fund balance) fue de \$2,975,537. Este resultado es muy favorable, ya que el año anterior fue que los egresos excedían los ingresos por \$272,210.

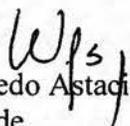
Con el balance de fondo indicado se pudo eliminar en su totalidad el déficit acumulado de \$2,775,254 al 30 de junio de 2004. Por ello, el balance de fondo neto terminó en \$200,283 al 30 de junio de 2005.

i Hacia una Ciudad de Futuro!

Esto significa que nuestra Administración pudo eliminar el déficit antes mencionado heredado al 31 de diciembre de 2004 en solamente seis meses de operación. Cabe señalar que el Municipio lleva más de dieciséis años operando con un déficit acumulado (desde antes del 1988). Esto último representa una administración efectiva de los recursos económicos.

Esperamos que este informe le sirva a sus propósitos.

Cordialmente,


Wilfredo Astacio Santiago
Alcalde

Anejos

cf: Héctor E. Machín Nazario
Director de Finanzas

Grisel Cruz Dipini
Auditora Interna

López-Vega, CPA, PSC
Certified Public Accountants/Management Advisors

14/26/08

Hoja de trámite

Se están entregando cuatro copias de los Estados Financieros Básicos al Municipio

- Una para el Alcalde
- Una para el Director de Finanzas
- Una para la Auditora Interna
- Una para la OCPR

NOMBRE FUNCIONARIO (letra de molde): _____

FIRMA DEL FUNCIONARIO: _____

PUESTO: _____

FECHA: _____

HORA: _____



OCPR
RECIBIDO
05 DEC - 6 AM 10:48

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