

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

MUNICIPIO DE NAGUABO
AUDITORIA 2005-2006
30 DE JUNIO DE 2006

OFICINA DEL COMISIONADO
DE ASUNTOS MUNICIPALES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2006

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

YEAR ENDED JUNE 30, 2006

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
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YEAR ENDED JUNE 30, 2006

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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

INDEPENDENT AUDITORS' 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, 2006, which collectively comprise the **Municipality's** basic financial statements as listed in the table of contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Naguabo, Puerto Rico**, as of June 30, 2006, 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.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2006, on our consideration of the **Municipality's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule-General Fund on page 43 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.

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

José Vega, CPA, PSC.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
October 16, 2006

Stamp No. 2195975 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, 2006

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, 2006. 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, 2005. 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 2006 deserve special mention:

1. Total assets of the Municipality amounted to \$28,488,868 which represents a decrease of (2%) compared to prior fiscal year;
2. At the end of fiscal year 2006, total liabilities amounted to \$11,589,872. Out of said amount, \$9,757,826 corresponded to long-term liabilities of which \$5,736,700 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 \$16,898,996 which represents a decrease of (4%) compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$12,090,916, derived from the following sources: \$159,565 charges for services; \$1,311,157 from operating grants and contributions; \$2,377,707 from capital grants and contributions obtained from other sources, and \$8,242,487 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

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 \$12,884,043;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to a decrease in the Net Assets figure by \$(793,127);
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$186,192;
8. As the end of the current fiscal year, the Municipality's General Fund deficit amounted to \$1,049,803, compared to a fund balances of \$200,283 in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in an unfavorable balance of \$(860,878) 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 2006. 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, 2006

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, 2006, shows total expenses incurred to afford the cost of all functions and programs amounted to \$12,884,043. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$3,848,429 was derived from the following sources: \$159,565 charges for services; \$1,311,157 from operating grants and contributions; and \$2,377,707 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$8,242,487. When such figure is added to the \$3,848,429 previously mentioned, total revenues available for the financing of activities amounted to \$12,090,916. There was an excess of expenses over revenues in the amount of \$(793,127) 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, 2006

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 \$16,898,996 at the end of 2006, compared to \$17,692,123 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

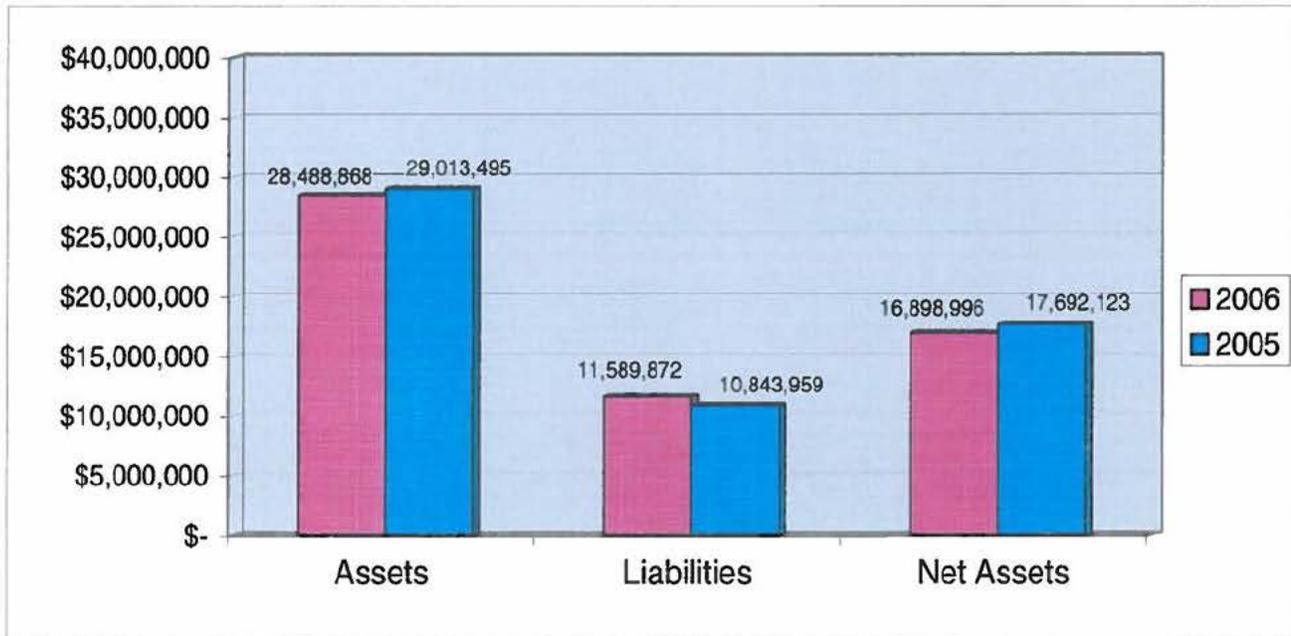
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Condensed Statement of Net Assets	2006	2005	Change	%
Current and other assets	\$ 4,551,275	\$ 5,210,725	\$ (659,450)	(13%)
Capital assets	23,937,593	23,802,770	134,823	1%
Total assets	28,488,868	29,013,495	(524,627)	(2%)
Current and other liabilities	1,832,046	1,643,713	188,333	11%
Long-term liabilities	9,757,826	9,200,246	557,580	6%
Total liabilities	11,589,872	10,843,959	745,913	7%
Invested in capital assets, net of related debt	22,235,893	20,284,770	1,951,123	10%
Restricted	1,569,991	3,366,729	(1,796,738)	(53%)
Unrestricted deficit	(6,906,888)	(5,959,376)	(947,512)	16%
Total net assets	\$ 16,898,996	\$ 17,692,123	\$ (793,127)	(4%)



Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2006, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$(793,127) decrease in the Municipality's net assets. Approximately 32 percent of the Municipality's total revenue came from taxes, while 66 percent resulted from grants and contributions, including federal aid. Charges for Services provided 1 percent of the total revenues.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

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.

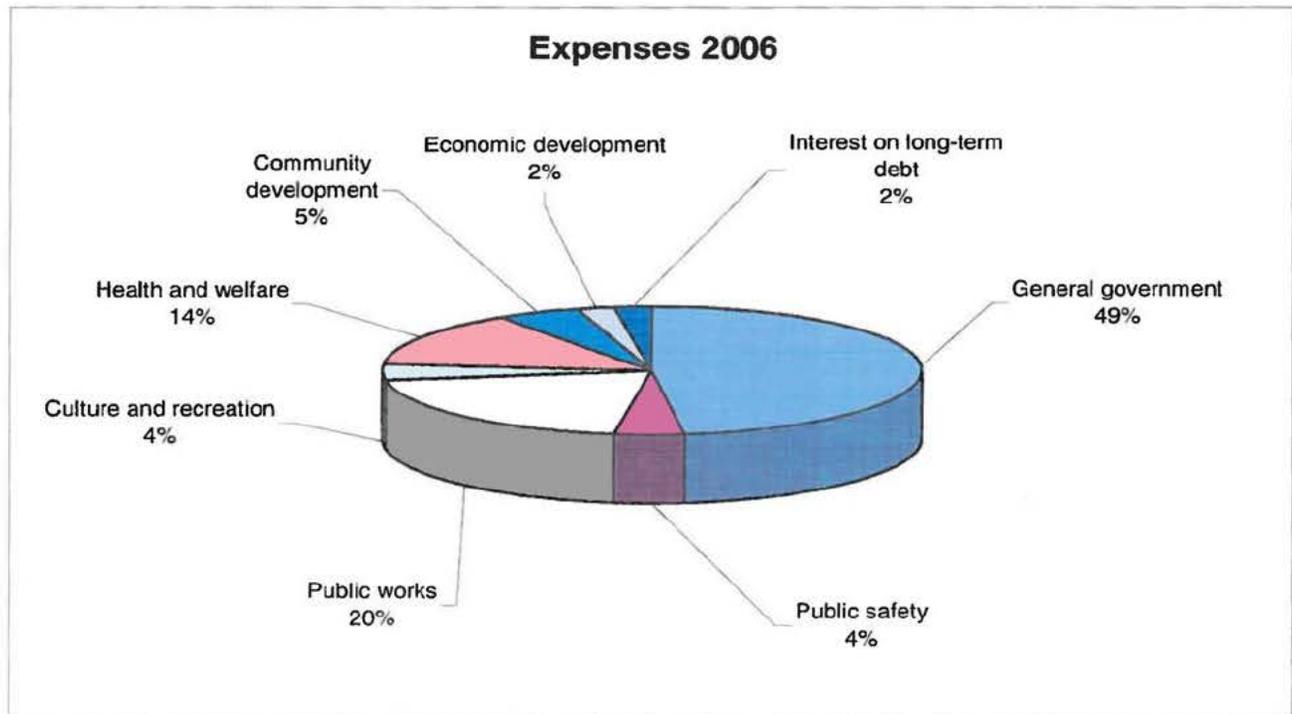
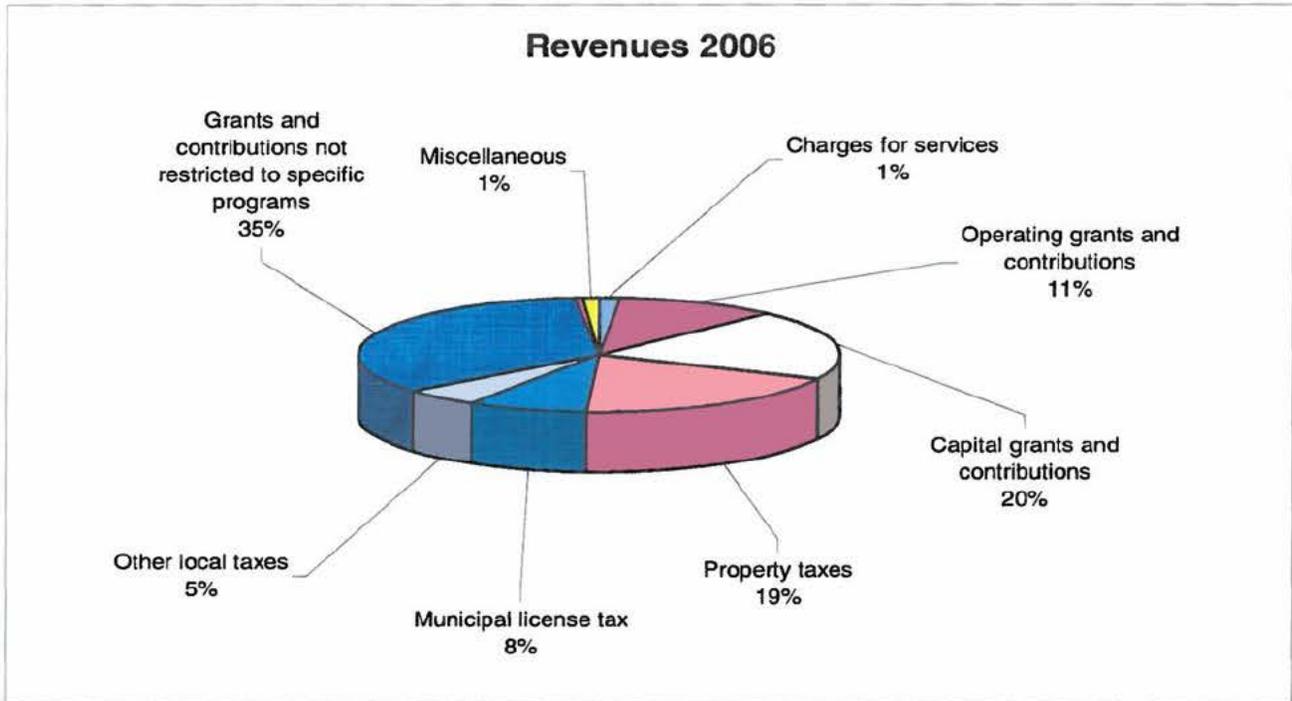
Condensed Statement of Activities	2006	2005	Change	%
Program revenues:				
Charges for services	\$ 159,565	\$ 251,558	\$ (91,993)	(37%)
Operating grants and contributions	1,311,157	1,674,835	(363,678)	(22%)
Capital grants and contributions	2,377,707	1,441,629	936,078	65%
General revenues:				
Property taxes	2,281,235	2,395,455	(114,220)	(5%)
Municipal license tax	1,005,130	1,270,606	(265,476)	(21%)
Other local taxes	638,665	4,000,729	(3,362,064)	(84%)
Grants and contributions not restricted to specific programs	4,122,154	3,679,732	442,422	12%
Interest and investment earnings	55,332	32,314	23,018	71%
Miscellaneous	139,971	174,982	(35,011)	(20%)
Total revenues	12,090,916	14,921,840	(2,830,924)	(19%)
Expenses				
General government	6,174,247	6,622,542	(448,295)	(7%)
Public safety	571,515	576,541	(5,026)	(1%)
Public works	2,607,598	1,317,135	1,290,463	98%
Culture and recreation	511,035	526,849	(15,814)	(3%)
Health and sanitation				-
Health and welfare	1,793,294	1,957,246	(163,952)	(8%)
Community development	661,657	879,424	(217,767)	(25%)
Economic development	260,899	279,738	(18,839)	(7%)
Interest on long-term debt	303,798	241,839	61,959	26%
Total expenses	12,884,043	12,401,314	482,729	4%
Change in net assets	(793,127)	2,520,526	(3,313,653)	(131%)
Net assets, beginning of year	17,692,123	15,171,597	2,520,526	17%
Net assets, end of year	\$ 16,898,996	\$ 17,692,123	\$ (793,127)	(4%)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

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, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Total Municipality's other local taxes revenues, collected during fiscal year 2005-2006, amounted to \$638,665, which represents a decrease of (84%) compared to prior fiscal year collections. The principal reason for this change is prior year construction tax revenue received related to a dam project begun during fiscal year 2004-2005.

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 \$186,192, a decrease of \$(1,114,195) in comparison with the prior year. There are reservations of fund balance amounting to \$1,409,092. This is the fund balance that it is not available for new spending because it has already been committed 1) \$169,101 to liquidate contracts and purchase orders of the prior fiscal year, 2) \$281,562 to pay debt service, 3) \$634,410 to pay for capital projects and 4) \$324,019 for other purposes.

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2006, the general fund ended with a deficit of \$1,049,803.

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 an unfavorable balance of \$(860,878), 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, 2006

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2006, amounts to \$27,029,104, net of accumulated depreciation of \$3,091,511 (including depreciation charges for the year totaled \$710,189), leaving a net book value of \$23,937,593. 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, 2006, the Municipality has \$42,514 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, 2006

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 2006-2007.

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 2006. 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, 2006

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 468,154
Cash with fiscal agent	1,116,021
Accounts receivable:	
Municipal license tax	9,179
Intergovernmental	2,937,090
Other	20,831
Capital assets	
Land, improvements, and construction in progress	7,061,338
Other capital assets, net of depreciation	16,876,255
Total capital assets	23,937,593
Total assets	28,488,868
 Liabilities	
Accounts payable and accrued liabilities	1,049,754
Interest payable	76,546
Due to other governmental entities	160,637
Deferred revenues:	
Municipal license tax	545,109
Noncurrent liabilities:	
Due within one year	1,703,283
Due in more than one year	8,054,543
Total liabilities	11,589,872
 Net Assets	
Invested in capital assets, net of related debt	22,235,893
Restricted for:	
Capital projects	634,410
Debt service	611,562
Other purposes	324,019
Unrestricted (deficit)	(6,906,888)
Total net assets	\$ 16,898,996

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, 2006**

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	\$ 6,174,247	\$ 81,240	\$ 9,733	\$ -	\$ (6,083,274)
Public safety	571,515	13,629	58,408		(499,478)
Public works	2,607,598	17,093	86,295	992,650	(1,511,560)
Health and welfare	1,793,294	32,558	880,560		(880,176)
Culture and recreation	511,035	15,045	15,263		(480,727)
Economic development	260,899		260,898		(1)
Community development	661,657			1,385,057	723,400
Interest on long-term debt	303,798				(303,798)
Total governmental activities	\$ 12,884,043	\$ 159,565	\$ 1,311,157	\$ 2,377,707	(9,035,614)
General revenues:					
Property taxes					2,281,235
Municipal license tax					1,005,130
Other local taxes					638,665
Grants and contributions not restricted to specific programs					4,122,154
Interest and investment earnings					55,332
Miscellaneous					139,971
Total general revenues					8,242,487
Change in net assets					(793,127)
Net assets - beginning, as restated					17,692,123
Net assets - ending					\$ 16,898,996

Commonwealth of Puerto Rico
Municipality of Naguabo
Balance Sheet
Governmental Funds
June 30, 2006

	General Fund	Special Revenue Fund Federal Grants	Capital Projects Fund - Local, State & Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets						
Cash and cash equivalents	\$ 172,347	\$ -	\$ 265,255	\$ -	\$ 30,552	\$ 468,154
Cash with fiscal agent	3,996	35,458	397,919	678,648		1,116,021
Accounts receivable:						
Municipal license tax	9,179					9,179
Intergovernmental	255,950	2,461,989	165,110	13,627	40,414	2,937,090
Other	18,616			2,215		20,831
Due from other funds	245,838	102,968			322,280	671,086
Total assets	\$ 705,926	\$ 2,600,415	\$ 828,284	\$ 694,490	\$ 393,246	\$ 5,222,361
Liabilities and Fund Balances						
Liabilities:						
Accounts payable and accrued liabilities	\$ 715,688	\$ 154,243	\$ 60,912	\$ 330,000	\$ -	\$ 1,260,843
Interest payable				76,546		76,546
Due to other governmental entities	160,637					160,637
Due to other funds	325,248	133,271	132,962	6,382	73,223	671,086
Deferred revenues:						
Municipal license tax	545,109					545,109
Intergovernmental	9,047					9,047
Federal grant revenues		2,312,901				2,312,901
Total liabilities	1,755,729	2,600,415	193,874	412,928	73,223	5,036,169
Fund balances:						
Reserved for:						
Encumbrances	169,101					169,101
Capital projects			634,410			634,410
Debt service fund				281,562		281,562
Other purposes	3,996					3,996
Reserved reported in nonmajor funds:						
Other purposes					320,023	320,023
Unreserved:						
Undesigned	(1,222,900)					(1,222,900)
Total fund balances (deficit)	(1,049,803)		634,410	281,562	320,023	186,192
Total liabilities and fund balances	\$ 705,926	\$ 2,600,415	\$ 828,284	\$ 694,490	\$ 393,246	
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						23,937,593
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds						(9,757,826)
Accrual basis of accounting accounts payable recognized in government-wide financial statements						(118,911)
Liabilities reported in funds and not reported in statement of net assets						2,651,948
Net assets of governmental activities						\$ 16,898,996

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2006

	General Fund	Special Revenue Fund Federal Grants	Capital Projects Fund - Local, State & Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 1,845,353	\$ -	\$ -	\$ 426,835	\$ -	\$ 2,272,188
Municipal license taxes	1,005,130					1,005,130
Licenses, permits and other local taxes	641,409					641,409
Charges for services	35,885					35,885
Fines and forfeitures	13,630					13,630
Intergovernmental	4,122,154	87,851	833,685		350,107	5,393,797
Rent of property	90,215					90,215
Interest	55,332					55,332
Federal grants		1,293,160			613,853	1,907,013
Miscellaneous	146,710	289			58,643	205,642
Total revenues	7,955,818	1,381,300	833,685	426,835	1,022,603	11,620,241
Expenditures						
Current:						
General government	5,175,065	13			7,664	5,182,742
Public safety	564,953				6,107	571,060
Public works	2,189,708	421,972	349,035		395	2,961,110
Health and welfare	827,762	304,923			646,185	1,778,870
Culture and recreation	223,957				24,137	248,094
Economic development					260,899	260,899
Community development		1,011,749	79,814			1,091,563
Debt service:						
Principal				490,000		490,000
Interest				303,798		303,798
Total expenditures	8,981,445	1,738,657	428,849	793,798	945,387	12,888,136
Excess (deficiency) of revenues over (under) expenditures	(1,025,627)	(357,357)	404,836	(366,963)	77,216	(1,267,895)
Other financing sources (uses)						
Transfers in				224,459		224,459
Transfers out	(224,459)					(224,459)
Long-term debt issued		153,700				153,700
Total other financing sources (uses)	(224,459)	153,700		224,459		153,700
Net change in fund balances	(1,250,086)	(203,657)	404,836	(142,504)	77,216	(1,114,195)
Fund balances (deficit), beginning	200,283	203,657	229,574	424,066	242,807	1,300,387
Fund balances (deficit), ending	<u>\$ (1,049,803)</u>	<u>\$ -</u>	<u>\$ 634,410</u>	<u>\$ 281,562</u>	<u>\$ 320,023</u>	<u>\$ 186,192</u>

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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, 2006

Net Change in Fund Balances - Total Governmental Funds \$ (1,114,195)

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.	1,322,425
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.	(710,189)
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 service principal payments exceed debt proceeds.	411,300
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. The following amount represent the change in long-term property tax advance debt from prior year.	(176,805)
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.	(539,947)
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.	(166,931)
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.	(80,000)
Repayment of long term Land Information Management System (LIMS) is an expenditure in Governmental Funds, but the repayment reduces long term LIMS in the Government-Wide Statement of Net Assets. The following amount represent the change in long term LIMS debt from prior year.	(133,608)

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, 2006

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.	460,323
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>(193,910)</u>
Change in Net Assets of Governmental Activities	<u>\$ (793,127)</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2006

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 assets acquired before June 30, 2002.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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 the GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units an amendment of GASB Statement 14". 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, 2006

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.

Capital Projects Fund –Local, State & Federal Grants - is the accounting entity in which revenues derived from local funds, state and federal grants or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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:

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 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 – Local, State and Federal Grants - Capital Projects Fund are used to account for financial resources used for the acquisition or construction of major capital facilities. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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.

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."

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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 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. Intergovernmental receivables in the debt service fund represent property tax due from the Municipal Revenue Collection Center (CRIM).

Intergovernmental receivable in the special revenue, capital project and in other governmental 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.
- 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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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.

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. **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.
- b. **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.
- c. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
- d. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

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.

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, 2006 amounted to approximately \$238,946. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$201,908 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:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

		<u>Total Net Assets</u> <u>Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 23,937,593	
Deduct:		
Bonds and notes payable	<u>(1,701,700)</u>	\$ 22,235,893
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		634,410
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balance	281,562	
Add:		
Accrual basis accounts payable	<u>330,000</u>	611,562
<u>Net assets restricted for other purposes</u>		
General fund—fund balance restricted for other purposes	3,996	
Other governmental funds—fund balance restricted for other purposes	<u>320,023</u>	324,019
<u>Net assets unrestricted (deficit)</u>		
General fund – total deficit:	\$ (1,049,803)	
Add:		
Accrual basis accounts receivable	2,321,948	
Deduct:		
General fund—fund balance restricted for other purposes	(3,996)	
Accrual basis accounts payable	(118,911)	
Bonds Payable	(4,035,000)	
Property Tax Debt	(919,314)	
Compensated Absences	(1,402,419)	
Treasury Department	(1,195,785)	
Claims and judgments	(370,000)	
LIMS Repayment Plan	<u>(133,608)</u>	<u>(6,906,888)</u>
Total net assets – governmental activities		<u>\$ 16,898,996</u>

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 \$172,347 in the general fund and \$265,255 in the capital projects fund – local, state and federal grants, were fully collateralized at June 30, 2006. In the other governmental funds there were deposits with commercial banks of \$30,552 that were fully collateralized.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

2. DEPOSITS (CONTINUED)

The deposits at GDB of \$3,996, that is restricted for other purposes in the general fund, the \$35,458 in the special revenue fund – federal grants, the \$397,919 that is restricted principally for capital projects in the capital projects fund – local, state and federal grants, and the \$678,648 that is restricted for debt service fund 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, 2006, 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, 2006, 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.

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")	\$ 246,903
Municipal Revenue Collection Center ("CRIM")	<u>9,047</u>
Total	<u>\$ 255,950</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

3. RECEIVABLES (CONTINUED)

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	\$ 2,229,855
Child Care and Development Block Grant	147,709
Hazard Mitigation Grant	45,000
Others	<u>39,425</u>
Total	<u>\$ 2,461,989</u>

Intergovernmental receivable in the capital projects fund – local, state and federal grants represent expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Legislature	<u>\$ 165,110</u>
Total	<u>\$ 165,110</u>

Intergovernmental receivable in the debt service fund represent property tax receivable at June 30, 2006. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	<u>\$ 13,627</u>
Total	<u>\$ 13,627</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>Governmental Entity</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Department of Labor and Human Resources- Law 52 Grant	\$ 13,965
Commonwealth of Puerto Rico-Department of Labor and Human Resources- Law 82 Grant	<u>26,449</u>
Total	<u>\$ 40,414</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2006, and interfund transfers during the fiscal year ended at June 30, 2006, 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	\$ 133,271
General Fund	Capital Projects Fund	Reimbursable expenditures	32,962
General Fund	Debt Service Fund	Interest Revenue	6,382
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	73,223
Special Revenue Fund - Federal Grants	General Fund	Reimbursable expenditures	2,968
Special Revenue Fund - Federal Grants	Capital Projects Fund	Reimbursable expenditures	100,000
Other Governmental Funds	General Fund	Reimbursable expenditures	<u>322,280</u>
Total			<u>\$ 671,086</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	<u>\$ 224,459</u>
Total			<u>\$ 224,459</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

5. CAPITAL ASSETS

Capital assets; those with an estimated useful live 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 2006, 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 July 1, 2005 as restated</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2006</u>
Capital asset, not being depreciated:				
Land	\$ 5,859,026	\$ -	\$ -	\$ 5,859,026
Construction in progress	<u>458,194</u>	<u>907,270</u>	<u>(163,152)</u>	<u>1,202,312</u>
Total capital assets not being depreciated	<u>6,317,220</u>	<u>907,270</u>	<u>(163,152)</u>	<u>7,061,338</u>
Capital assets, being depreciated:				
Buildings	13,299,697			13,299,697
Buildings improvements	3,313,498	261,596		3,575,094
Infrastructure	163,254	24,156		187,410
Infrastructure improvements	498,646	32,272		530,918
Equipment	583,356	199,039		782,395
Work of Art	1,500			1,500
Furnishing	46,357	23,760		70,117
Computers	37,059	21,958		59,017
Vehicles	<u>1,446,093</u>	<u>15,525</u>	<u>-</u>	<u>1,461,618</u>
Total capital assets being depreciated	<u>19,389,460</u>	<u>578,306</u>	<u>-</u>	<u>19,967,766</u>
Less accumulated depreciation for:				
Buildings	(1,137,229)	(332,493)		(1,469,722)
Buildings improvements	(133,795)	(89,158)		(222,953)
Infrastructure	(1,677)	(4,584)		(6,261)
Infrastructure improvements	(14,643)	(34,598)		(49,241)
Equipment	(234,671)	(85,143)		(319,814)
Work of Art	(63)	(150)		(213)
Furnishing	(11,453)	(11,021)		(22,474)
Computers	(17,444)	(12,802)		(30,246)
Vehicles	<u>(830,347)</u>	<u>(140,240)</u>	<u>-</u>	<u>(970,587)</u>
Total accumulated depreciation	<u>(2,381,322)</u>	<u>(710,189)</u>	<u>-</u>	<u>(3,091,511)</u>
Total capital assets being depreciated, net	<u>17,008,138</u>	<u>(131,883)</u>	<u>-</u>	<u>16,876,255</u>
Governmental activities capital assets, net	<u>\$ 23,325,358</u>	<u>\$ 775,387</u>	<u>\$ (163,152)</u>	<u>\$ 23,937,593</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 132,690
Public safety	5,041
Public works	176,398
Culture and recreation	303,842
Community Development	73,813
Health and welfare	<u>18,405</u>

Total depreciation expense-governmental activities **\$ 710,189**

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. The CRIM issued the preliminary liquidation noting that the collections exceeded advances by \$9,047. In the governmental funds, the entire receivable has been offset by deferred revenue since the excess was not available to pay liabilities of the current period. In the government-wide financial statements, the entire receivable is recognized as revenue.

The governmental wide statement of net assets includes an outstanding debt balance of \$213,904 corresponding to the 2005 CRIM final liquidation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

The Municipality entered into an agreement with the Commonwealth of Puerto Rico – Treasury Department, for the repayment of excess property tax advances. As of June 30, 2006, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$103,401.

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 o 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.

The governmental wide statement of net assets includes an outstanding debt balance of \$215,731 and \$386,278 related to Law 42 and Law 146 respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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	\$ 26,324
General Services Administration	725
Land Authority	70,085
Department of Labor and Human Resources	8,363
Retirement System Administration	<u>55,140</u>
Total	<u>\$ 160,637</u>

The Municipality reached agreements with other governmental entities for the payment of debts on a long-term basis. These liabilities are presented in the Statement of Net Assets as non-current liabilities.

During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System - LIMS, contracted by the CRIM. A total of \$215,030 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2006, the outstanding debt balance was \$133,608. This amount will be presented in the government wide statement of net assets.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

8. DEFERRED REVENUES

- A. Municipal License Tax-** The deferred revenues of approximately \$545,109 in the general fund relates to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.
- B. Intergovernmental -** The deferred revenues of approximately \$9,047 in the general fund relates to the balance owned from the Municipal Revenue Collection Center (CRIM) at June 30, 2006, as described in Note 6.
- C. Federal grants-** 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	\$ 2,194,286
Child Care and Development Block Grant	73,615
Hazard Mitigation Grant	<u>45,000</u>
Total	<u>\$ 2,312,901</u>

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2006, 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	\$5,638,000	\$ -	\$ (380,000)	\$5,258,000	\$ 417,000
Notes Payable	510,000	153,700	(185,000)	478,700	99,000
Property Tax Advances	618,428	200,775	(3,290)	815,913	217,402
Property Tax – Treasury	124,081		(20,680)	103,401	20,680
Income Tax Withheld	182,053	640,055	(22,108)	800,000	800,000
Income Tax Withheld	355,317		(58,200)	297,117	58,200
Social Security	118,468		(19,800)	98,668	19,800
Claims and Judgments	290,000	220,000	(140,000)	370,000	
Compensated Absences	1,235,488	228,424	(61,493)	1,402,419	50,000
LIMS Repayment Plan		153,601	(19,993)	133,608	21,201
Puerto Rico Electric Power Authority	<u>128,410</u>	<u>-</u>	<u>(128,410)</u>	<u>-</u>	<u>-</u>
Total	<u>\$9,200,245</u>	<u>\$1,596,555</u>	<u>\$(1,038,974)</u>	<u>\$9,757,826</u>	<u>\$1,703,283</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES (CONTINUED)

- 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.

- 2. Bonds Payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. Bonds payable outstanding at June 30, 2006 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, 2006</u>
1992-Series	7-1-2006	\$ 415,000	3.26% to 6.36%	\$ 50,000
1996-Series	1-1-2020	514,000	4.50%	404,000
1998-Series	7-1-2007	320,000	4.86% to 6.71%	85,000
1998-Series	1-1-2023	576,000	4.50%	466,000
2000-Series	1-1-2025	239,000	4.50%	213,000
2001-Series	7-1-2010	590,000	5.00% to 8.00%	350,000
2002-Series	7-1-2016	370,000	5.00% to 8.00%	310,000
2003-Series	7-1-2027	285,000	4.17% to 5.31%	270,000
2003-Series	7-1-2027	990,000	5.00% to 7.50%	915,000
2004-Series	7-1-2013	865,000	5.00% to 7.50%	665,000
2005-Series	7-1-2014	475,000	3.28% to 7.25%	440,000
2005-Series	7-1-2019	1,140,000	4.37% to 7.25%	<u>1,090,000</u>
Total general obligation bonds				<u>\$ 5,258,000</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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES (CONTINUED)

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 417,000	\$ 316,515
2008	395,000	266,106
2009	367,000	243,531
2010	388,000	220,976
2011	421,000	196,981
2012-2016	1,524,000	688,131
2017-2021	1,090,000	334,183
2022-2026	536,000	123,455
2027-2031	<u>120,000</u>	<u>7,260</u>
Total	<u>\$ 5,258,000</u>	<u>\$ 2,397,138</u>

- 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. During the current year, the Municipality issued notes for approximately \$153,700. 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, 2006</u>
1997-Series	7-1-16	\$ 400,000	3.27% to 8.00%	\$ 265,000
2000-Series	7-1-06	200,000	2.70% to 7.81%	35,000
2002-Series	7-1-06	100,000	2.70% to 5.00%	25,000
2005-Series	1-1-13	153,700	4.50%	<u>153,700</u>
Total notes payable				<u>\$ 478,700</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. The 1997 Series \$400,000 note is payable with General Fund resources.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 99,000	\$ 25,644
2008	39,900	18,311
2009	40,900	16,416
2010	46,900	14,476
2011	47,900	14,940
2012-2016	<u>204,100</u>	<u>28,089</u>
Total	<u>\$ 478,700</u>	<u>\$ 117,876</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES (CONTINUED)

4. **Property Tax Debts-** These amounts represent the balance owed to the CRIM and to the Commonwealth of Puerto Rico - Treasury Department at June 30, 2006, as described in Note 6.
5. **Income Tax Withheld-** These amounts represent an outstanding balance at June 30, 2006 of payment agreements with the Treasury Department, related to income tax withheld during prior years.
6. **Social Security-** This amount represents an outstanding balance at June 30, 2006 of payment agreement with the Treasury Department, related to social security debt of prior years.
7. **Claims and Judgments-** This amount represent the balance related to legal claims at June 30, 2006, as described in Note 12.
8. **Compensated Absences-** The government-wide statement of net assets includes approximately \$540,553 of accrued sick leave benefits, and approximately \$861,866 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
9. **LIMS Repayment Plan-** This amount represents the balance owed to the CRIM at June 30, 2006, as described in Note 7.

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.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

10. PENSION PLAN (CONTINUED)

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, 2006 amounted to approximately \$317,217.

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.

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, 2006, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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. 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 \$370,000 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

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

13. BEGINNING GOVERNMENTAL ACTIVITIES NET ASSETS RESTATEMENT:

The beginning Governmental Activities Net Assets has been restated by approximately \$(477,413) to properly present the previously reported net assets at June 30, 2005. The restatement is mainly due to change in capital assets valuation and change in the accumulated depreciation presented in the Governmental Activities Net Assets for the year ended June 30, 2005.

14. SUBSEQUENT EVENTS

On October 30, 2006, the Municipal Legislature by Ordinance Number 12-2006-2007 authorized the Mayor to accept and apply the funds derived from the donation provided to the Municipality by the Commonwealth of Puerto Rico of the 2006, Series A, Public Improvement Bond Issuance of \$675,000,000. During the fiscal year 2006-2007, the Municipality of Naguabo will receive approximately \$1,715,000 from the issuance. Those funds will be used for improvements of Municipality's properties.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2006

	<u>Budgeted Amounts</u>		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis) (See Note 1)	Final Budget Positive (Negative)
REVENUES:				
Property taxes	\$ 1,747,297	\$ 1,747,297	\$ 1,845,353	\$ 98,056
Fines and forfeiture	5,000	5,000	4,929	(71)
Municipal license tax	883,000	883,000	1,000,453	117,453
Licenses, permits and other local taxes	1,508,499	1,508,499	713,549	(794,950)
Charges for service	55,000	55,000	35,885	(19,115)
Intergovernmental	4,269,922	4,490,548	4,122,154	(368,394)
Interest	135,000	135,000	65,452	(69,548)
Rent of property	132,000	132,000	96,165	(35,835)
Miscellaneous	<u>30,000</u>	<u>103,542</u>	<u>146,710</u>	<u>43,168</u>
Total revenues	8,765,718	9,059,886	8,030,650	(1,029,236)
Budget carryover (1)	<u>-</u>	<u>75,948</u>	<u>75,948</u>	<u>-</u>
Total revenues after carryover	<u>8,765,718</u>	<u>9,135,834</u>	<u>8,106,598</u>	<u>(1,029,236)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	4,787,299	5,106,905	5,005,735	101,170
Public safety	701,641	565,763	564,292	1,471
Public works	1,901,898	2,125,024	2,117,331	7,693
Health and welfare	875,355	865,643	831,701	33,942
Culture and recreation	256,550	229,524	223,957	5,567
Operating transfer to other funds	<u>242,975</u>	<u>242,975</u>	<u>224,460</u>	<u>18,515</u>
Total expenditures, encumbrances and other financing uses	<u>8,765,718</u>	<u>9,135,834</u>	<u>8,967,476</u>	<u>168,358</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)				
	\$ -	\$ -	\$ (860,878)	\$ (860,878)
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 8,106,598
Differences-budget to GAAP:				
Budget Carryover				(75,948)
GAAP adjustments to revenues				<u>(74,832)</u>
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,955,818</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 8,967,476
Differences-budget to GAAP:				
GAAP adjustment to expenditures				223,484
Prior year encumbrances recorded as current year expenditures for GAAP basis				150,212
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(135,268)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 9,205,904</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2006

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, 2006 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2006.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2006

<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: Community Facilities Loans and Grants	10.766		\$ 153,478
Direct Program: Water and Water Disposal Loans and Grants	10.770		20,544
Pass-through the Commonwealth of Puerto Rico-Department of Education: Child and Adult Care Food Program	10.558	Not Available	<u>16,582</u>
Total U.S. Department of Agriculture			<u>190,604</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program: Section 8 Housing Choice Vouchers	14.871		581,782
Pass-through the Commonwealth of Puerto Rico - Municipal Affairs Commissioner Office: Community Development Block Grants - State's Program	14.228	05-AB-FC-47 04-AB,FC,FE-47 03-AB,FC-47 02-AB,FC-47 01-FD,FC-47 98-FD-47 97-FD-47	837,727
Pass-through the Commonwealth of Puerto Rico - Municipality of San Juan: Housing Opportunities for Persons with Aids	14.241	Not Available	<u>33,241</u>
Total U.S. Department of Housing and Urban Development			<u>1,452,750</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
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>288,342</u>
Total U.S. Department of Health and Human Services			<u>288,342</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Disaster Grants - Public Assistance	97.036	DR-PR 1247 DR-PR 1501 DR-PR 1552	<u>281,538</u>
Total U.S. Department of Homeland Security			<u>281,538</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 2,213,234</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, 2006

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	\$ 1,598,211	\$ 615,023	\$ 2,213,234
Non federal programs expenditures	<u>140,446</u>	<u>330,364</u>	<u>470,810</u>
Total expenditures in the general purpose financial Statements	<u>\$ 1,738,657</u>	<u>\$ 945,387</u>	<u>\$ 2,684,044</u>



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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Naguabo, Puerto Rico**, as of and for the year ended June 30, 2006, which collectively comprise the **Municipality's** basic financial statements and have issued our report thereon dated October 16, 2006, which was unqualified. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Naguabo's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

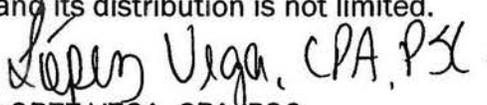
Compliance and Other Matters

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

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

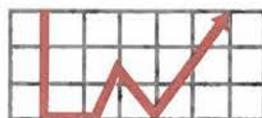
We noted certain other matters that we reported to management of the **Municipality of Naguabo** in a separate letter dated October 16, 2006.

This report is intended solely for the information and use of 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
October 16, 2006

Stamp No. 2195976 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



López-Vega, CPA, PSC

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**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, 2006. 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, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items **06-01** through **06-04**.

**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 the 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 the 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 the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items **06-01** through **06-04**.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weakness. However, of the reportable conditions described above, we consider item **06-04** to be a material weakness.

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 March 2, 2007.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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.

López-Vega, CPA, PSC.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 2, 2007

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López-Vega, CPA, PSC

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2006

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness identified?	Yes	No X
Reportable conditions identified not considered to be material weaknesses?	Yes	None reported X
Noncompliance material to financial statements noted?	Yes	No X

Federal awards

Internal Control over major programs:		
Material weakness identified?	Yes X	No
Reportable conditions identified not considered to be material weaknesses?	Yes X	None reported

Type of auditor’s report issued on compliance for major programs:

	Unqualified	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes X	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 X

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

①

Finding Reference	06-01
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, 2006, the program disclosed in loose sheets, information related to CDBG 2005 grant’s housekeeper activities. Nevertheless, these loose sheets did not include the following information related to the project: (1) dates and hours to apply; (2) the eligibility requirements and; (3) the due 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’s files and found the following exceptions:</p> <ul style="list-style-type: none">a. According to project’s operational guide, the Program must visit at least twice per month, the participant’s housing unit to ensure the quality of services. Nevertheless, in eight (8) participant’s files, we noted that the Federal Programs Director visited only two (2) times the housing unit during the fiscal year ended June 30, 2006. In addition, we could not determine if these visits were made in presence of the housekeeper;b. In two (2) participant’s files, we noted that the Federal Programs Director visited only one (1) time the housing unit during the fiscal year ended June 30, 2006. Also, we could not determine if these visits were made in presence of the housekeeper;c. In two (2) participant’s files, we observed that the Federal Program Director did not document if the participant complied with the minimum requirements regarding work experience.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2006

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	06-01 (Continued)
Criteria	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.
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	<p>The amended proposal will be submitted to OCAM to inform that the visits to the housing units of each participant will be done at the beginning, at the middle and at the end of the contracted service. Also, in future visits of the participant's housing units, it will be documented that the inspection was made in presence of the housekeeper. Actually, the interviews are always done without the presence of the housekeeper.</p> <p>Regarding exception number (c), one of these participants performed the work perfectly. There was great demand to contract housekeepers, which were not available. The other participant was a housekeeper in our Program on December 18, 2003. Nevertheless, for future job applications, we will observe the experiences of each participant more carefully. Also, the application form will be modified to include a section in which the participant can detail previous job experiences.</p> <p>Implementation Date: April, 2007</p> <p>Responsible Person: Elizabeth 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, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-02
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 six (6) participant's files, we noted that the "Privacy Act Notice" was not actualized;b. In one (1) participant's file, the "Privacy Act Notice" was actualized after the expiration date;c. In one (1) file, the participant signed the "Privacy Act Notice" several months after the admission's date;d. In one (1) participant's file, the "Privacy Act Notice" did not include the issued date;e. In one (1) participant's file, we did not found the "Privacy Act Notice" signed by the head of household;f. In one (1) participant's file, we did not found the "Privacy Act Notice" signed by a family member that had more than 18 years old;g. In one (1) participant's file, we noted that several documents obtained by the Program from third parties were not updated and the PHA used them to calculate HAP. These documents were the following; (1) employment verification; (2) credit reports; (3) debt certification from the Treasury Department; (4) certification from the Department of Work and Human Resources; (5) certification from the Municipal Revenue Collection Center (CRIM) and; (6) school certifications;

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2006

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-02 (Continued)
Criteria	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.
Cause of Condition	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.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Sections 5.230, 5.212 and 982.516.
Recommendation	The Municipality must give instructions to the program staff to assure that the participant files include all documentation required by Federal regulations.
Questioned Costs	None
Management Response and Corrective Action	As part of our corrective action plan, the "Privacy Act Notice" will be included in the reexamination documents. Also, we regularly monitor the income levels of the waiting list applicants and new admissions in order to assure that it will meet its income targeting requirements by the end of the fiscal year. Implementation Date: April, 2007 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, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-03
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>During our test, we noted that the PHA did not use an updated Fair Market Rent Schedule to calculate HAP. As result, in several cases, the Program paid an incorrect HAP to the owner and it caused differences in the amount of Tenants Rent to the owner. Also, we performed an eligibility test of fifteen (15) participant files and found the following exceptions:</p> <ul style="list-style-type: none">a. In one (1) participant's file, the PHA did not consider to calculate HAP, an annual income received by a family member. This income was reported in the Nutritional Assistance Program, according to a certification obtained by the Family Department. Also, the PHA did not consider as annual income, a child support received by this family member. This situation was corrected in an Interim Reexamination realized, approximately, eight (8) month after. As result of the situations previously mentioned, the PHA paid an incorrect HAP to owner;b. In one (1) participant's file, the PHA did not consider to calculate HAP, an annual income received by a family member. This income was reported in the Economic Assistance Program, according to a certification obtained by the Family Department. As result of this situation, the Program paid an incorrect HAP to the owner and reimbursed an incorrect utilities to the participant;c. In one (1) participant's file, we found a difference between the family annual income reported in the Annual Reexamination and the family annual income reported in the Nutritional Assistance Program, according to a certification obtained by the Family Department. We did not find explanation regarding this situation;
Criteria	<p>Code of Federal Regulations 24, Subpart K, Section 982.505 establish the procedures to be followed to calculate the Housing Assistance Payment. Also, the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6) and the PHA Administrative Plan establish procedures to be used as part of the HAP calculation.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-03 (Continued)
Cause of Condition	The PHA controls and procedures failed to assure that all HAP's payments are duly computed by the program staff.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Subpart K, Section 982.505 and with the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6).
Recommendation	We recommend the PHA to strengthen its monitoring procedures to assure the HAP's are duly computed as required by the Federal Regulations. Also, we recommend that the PHA must verify the tenant files to determine which families required adjustments in their rents or utility reimbursements, and adjust the same retroactively to the date of the last reexamination, if need.
Questioned Costs	None
Management Response and Corrective Action	<p>The Fair Market Rent Schedule was updated on June 2006. In addition, we designed verification procedures that are essential to obtaining full and accurate information for the best use of the program funds and fair equitable treatment of all participants.</p> <p>Implementation Date: April, 2007</p> <p>Responsible Person: Carmen M. de Jesús Section 8 Program Supervisor</p>

COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-04
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	<p>We examined the Housing Assistance Payment Register (HAP Register) maintained by the PHA for fifteen (15) participants and we found the following exception:</p> <p>a. For fourteen (14) participants, we noted that the HAP Register maintained during the fiscal year ended on June 30, 2006 did not include all the information required by the federal agency.</p>
Criteria	<p>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.</p>
Cause of Condition	<p>The PHA controls and procedures failed to assure that the HAP Register maintained by the PHA includes all the information required by federal agency.</p>
Effect of Condition	<p>The PHA is not in compliance with Code of Federal Regulations 24, Section 982.158.</p>
Recommendation	<p>We recommend to the Municipality's management to strengthen controls procedures to include in the HAP Register all the information required by federal agency.</p>
Questioned Costs	<p>None.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2006

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-04 (Continued)

**Management Response
and Corrective Action**

The program will develop policies, monitoring and staff meetings to prevent and reduce the errors and omissions. Also, the HAP Register was amended in accordance with the Federal Regulations.

Implementation Date: April, 2007

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, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-02	14.228	<p><u>During the fiscal year ended June 30, 2005, 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.</u></p> <p><u>Also, the auditors performed a housekeeper activities test of ten (10) participant files and found the following exceptions: (a) In the ten (10) participant's files, the auditors 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, the auditors did not find evidence that demonstrate if the Federal Program Director notified to the applicant the approval of application.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 06-01.</p>
05-03	14.228	<p><u>During the test, the auditors 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.</u></p> <p>Full corrective action has been taken.</p>

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-04	14.228	<p><u>During the contract provision test, the auditors 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; (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.</u></p> <p>Partially corrective action was taken.</p>
05-05	14.871	<p><u>The auditors performed an eligibility test of fifteen (15) participant files and found the following exceptions: (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, the auditors 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, the auditors 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 06-02.</p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-06	14.871	<p><u>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 the test, the auditors found the following exceptions: (a) the auditors 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, the auditors 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, the auditors 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.</u></p> <p>Full corrective action has been taken.</p>
05-07	14.871	<p><u>The determination of reasonable rent (reasonable rent certification) was not duly documented. The auditors 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.</u></p> <p>Full corrective action has been taken.</p>
05-08	14.871	<p><u>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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 06-04.</p>

COMMONWEALTH OF PUERTO RICO
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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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	14.228	<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>Full corrective action has been taken.</p>
04-02	14.228	<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>Partially corrective action was 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 06-03.</p>
03-04	14.871	<p><u>Eligibility Test - Lack of documentation</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>

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