

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

MUNICIPIO DE NAGUABO
AUDITORÍA 2007-2008
30 DE JUNIO DE 2008

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, 2008

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, 2008

CONTENTS

	Page
<u>BASIC FINANCIAL STATEMENTS</u>	
Independent Auditors' Report	1-2
Required Supplementary Information (Part 1) Management's Discussion and Analysis	3-12
Government-Wide Financial Statements:	
Statement of Net Assets	13
Statement of Activities	14
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	15
Statement of Revenues, Expenditures and Changes in Fund Balances	16
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	17-18
Notes to Basic Financial Statements	19-45
<u>SUPPLEMENTARY INFORMATION</u>	
Required Supplementary Information (Part II):	
Budgetary Comparison Schedule-General Fund	46
Notes to Budgetary Comparison Schedule-General Fund	47
Schedule of expenditures of federal awards	48-49
Notes to the schedule of expenditures of federal awards	50
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u>	
Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	51-53

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, 2008

CONTENTS

	Page
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)</u>	
Report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133	54-56
<u>FINDINGS AND QUESTIONED COSTS</u>	
Schedule of findings and questioned cost	57-69
Summary schedule of prior year audit findings	70-72



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT 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, 2008, which collectively comprise the **Municipality's** basic financial statements as listed in the table of contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

The accounting records of the **Municipality of Naguabo** related to interfund transactions are not adequate. Accordingly, we were unable to obtain sufficient evidence to support and to satisfy ourselves about the amount recorded in each major fund and the aggregate remaining fund information as due from / due to other funds (stated at \$3,509,275 in the total governmental funds column of the Balance Sheet – governmental funds) and transfer in / transfer out (stated at \$383,870 in the total governmental funds column of the Statement of Revenues, Expenditures and Changes in Fund Balances – governmental funds).

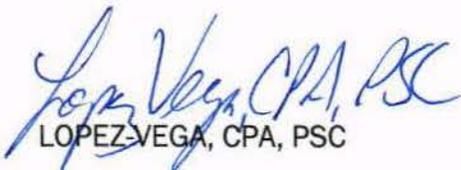
In our opinion, except for the effects of the matters discussed in the third paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Naguabo, Puerto Rico**, as of June 30, 2008, 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 December 22, 2008, on our consideration of the **Municipality's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for 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 **45** are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality 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**. Such information 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.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 22, 2008

Stamp No. 2312191 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2008

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, 2008. 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, 2007. 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 2008 deserve special mention:

1. Total assets of the Municipality amounted to \$44,723,146 which represents an increase of 2% compared to prior fiscal year, as restated;
2. At the end of fiscal year 2008, total liabilities amounted to \$11,485,963. Out of said amount, \$7,875,794 corresponded to long-term liabilities of which \$5,290,800 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 \$33,237,183;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$13,130,534, derived from the following sources: \$288,192 charges for services; \$2,225,583 from operating grants and contributions; \$941,310 from capital grants and contributions obtained from other sources, and \$9,675,449 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

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 \$13,194,241;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to a decrease in the Net Assets figure by \$(63,707);
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund deficit of \$(1,612,605);
8. As the end of the current fiscal year, the Municipality's General Fund deficit amounted to \$(5,343,660), compared to a fund deficit of \$(3,917,087) in the prior fiscal year, as restated;
9. The actual General Fund budgetary activities resulted in an unfavorable balance of \$(1,110,237).

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 2008. 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, 2008

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, 2008, shows total expenses incurred to afford the cost of all functions and programs amounted to \$13,194,241. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$3,455,085 was derived from the following sources: \$288,192 charges for services; \$2,225,583 from operating grants and contributions; and \$941,310 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$9,675,449. When such figure is added to the \$3,455,085 previously mentioned, total revenues available for the financing of activities amounted to \$13,130,534. There was a deficit of revenues over expenses in the amount of \$(63,707) which decrease 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, 2008

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 implemented the capitalization of infrastructure since 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 \$33,237,183 at the end of 2008, compared to \$33,300,890 at the end of the previous year, as restated, and showed in the following condensed Statement of Net Assets of the Primary Government.

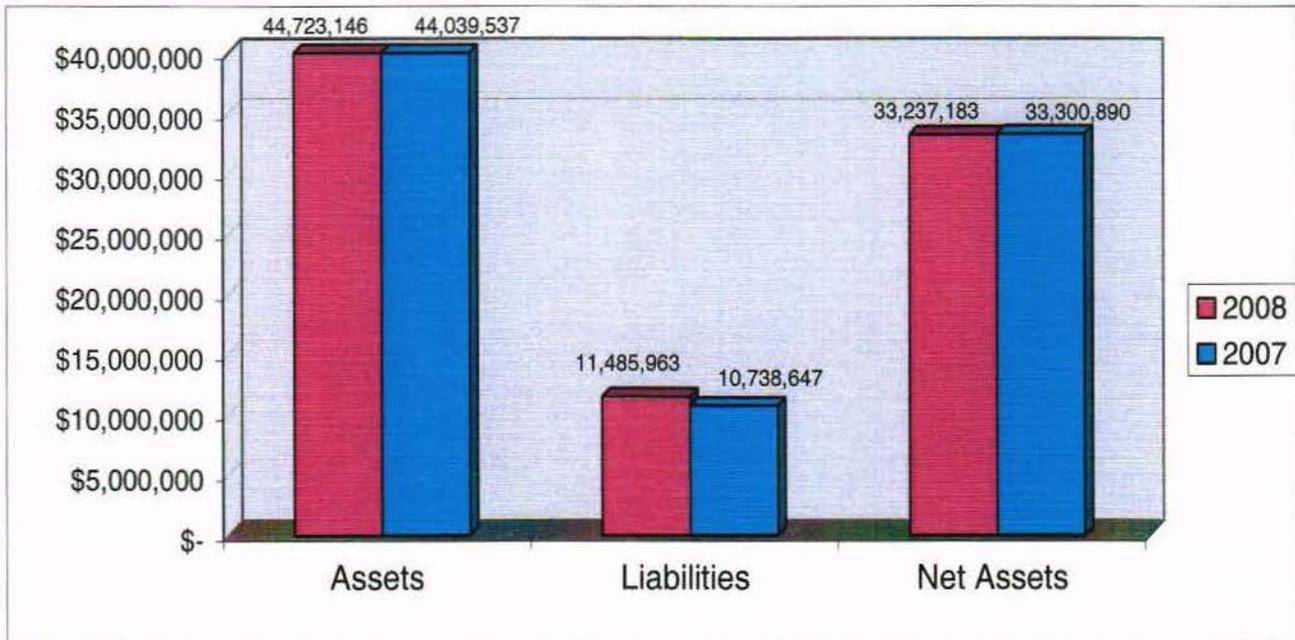
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Condensed Statement of Net Assets	2008	2007	Change	%
Current and other assets	\$ 4,648,122	\$ 5,344,992	\$ (696,870)	(13%)
Capital assets	40,075,024	38,694,545	1,380,479	4%
Total assets	44,723,146	44,039,537	683,609	2%
Current and other liabilities	3,610,169	2,218,104	1,392,065	63%
Long-term liabilities	7,875,794	8,520,543	(644,749)	(8%)
Total liabilities	11,485,963	10,738,647	747,316	7%
Invested in capital assets, net of related debt	38,714,224	37,213,845	1,500,379	4%
Restricted	3,936,834	4,079,028	(142,194)	(3%)
Unrestricted deficit	(9,413,875)	(7,991,983)	(1,421,892)	18%
Total net assets, as restated	\$ 33,237,183	\$ 33,300,890	\$ (63,707)	-



Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2008, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$(63,707) decrease in the Municipality's net assets. Approximately 38 percent of the Municipality's total revenue came from taxes, while 59 percent resulted from grants and contributions, including federal aid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

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 works, public safety, 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.

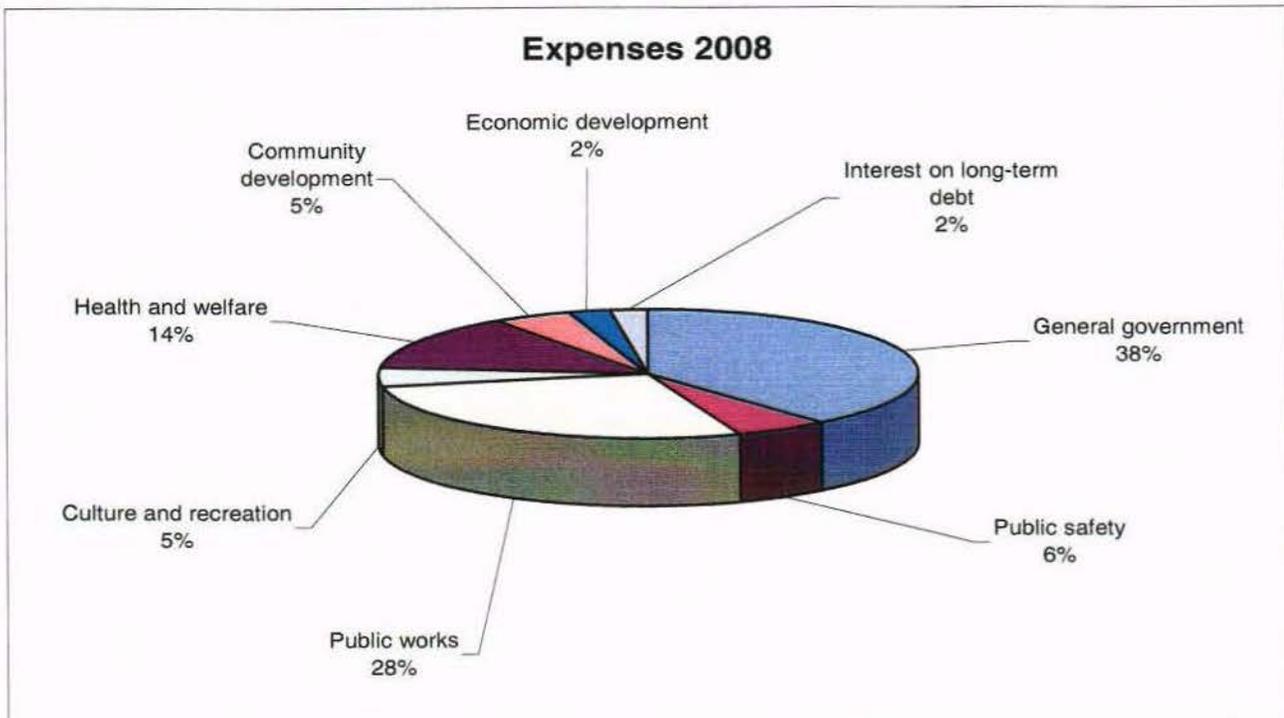
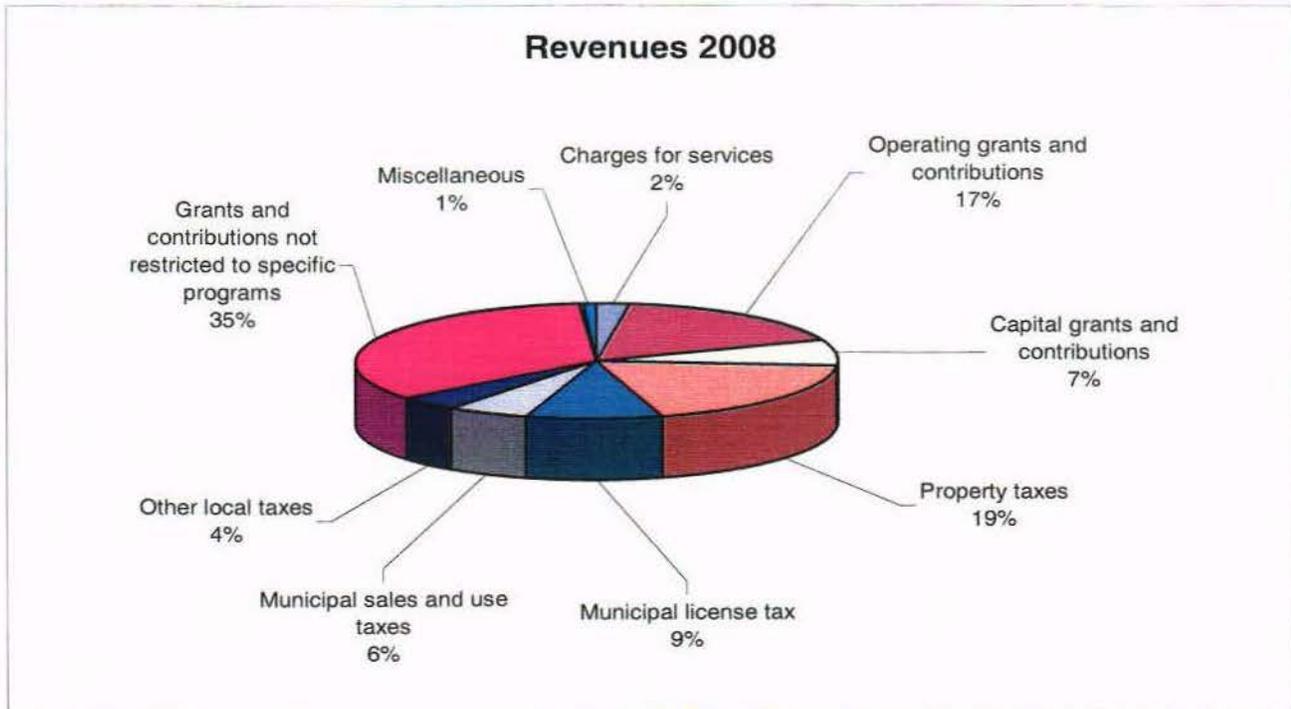
Condensed Statement of Activities	2008	2007	Change	%
Program revenues:				
Charges for services	\$ 288,192	\$ 137,509	\$ 150,683	110%
Operating grants and contributions	2,225,583	1,552,454	673,129	43%
Capital grants and contributions	941,310	3,603,725	(2,662,415)	(74%)
General revenues:				
Property taxes	2,531,397	2,288,850	242,547	11%
Municipal license tax	1,184,996	1,041,736	143,260	14%
Municipal sales and use taxes	727,641		727,641	100%
Other local taxes	548,712	886,707	(337,995)	(38%)
Grants and contributions not restricted to specific programs	4,546,655	4,362,146	184,509	4%
Interest and investment earnings	43,605	64,419	(20,814)	(32%)
Miscellaneous	92,443	624,482	(532,039)	(85%)
Total revenues	13,130,534	14,562,028	(1,431,494)	(10%)
Expenses				
General government	5,147,764	5,016,764	131,000	3%
Public safety	732,084	699,192	32,892	5%
Public works	3,653,105	2,328,313	1,324,792	57%
Culture and recreation	606,725	619,922	(13,197)	(2%)
Health and welfare	1,796,412	1,765,292	31,120	2%
Community development	645,456	204,704	440,752	215%
Economic development	326,125	243,796	82,329	34%
Interest on long-term debt	286,570	332,708	(46,138)	(14%)
Total expenses	13,194,241	11,210,691	1,983,550	18%
Change in net assets	(63,707)	3,351,337	(3,415,044)	(102%)
Net assets, beginning of year-as restated	33,300,890	29,949,553	3,351,337	11%
Net assets, end of year	\$ 33,237,183	\$ 33,300,890	\$ (63,707)	-

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

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, 2008

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 deficit of \$(1,612,605), an increase of \$(53,149) in comparison with the prior year. There are reservations of fund balance amounting to \$4,158,814. This is the fund balance that it is not available for new spending because it has already been committed 1) \$421,980 to liquidate contracts and purchase orders of the prior fiscal year, 2) \$580,572 to pay debt service, 3) \$2,194,251 to pay for capital projects and 4) \$962,011 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, 2008, the general fund ended with a deficit of \$(5,343,660).

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 \$(1,110,237), 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, 2008

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2008, amounts to \$47,108,095, with an accumulated depreciation of \$7,033,071 (including depreciation charges for the year totaled \$959,573), leaving a net book value of \$40,075,024. 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, 2008, the Municipality has \$28,683 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, 2008

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 2008-2009.

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 2008. 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 PO 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, 2008

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 79,378
Cash with fiscal agent	1,160,070
Accounts receivable:	
Municipal license taxes	17,284
Construction excise taxes	36,000
Municipal sales and use taxes	43,155
Intergovernmental	3,303,565
Others	8,670
Capital assets:	
Land, improvements, and construction in progress	21,280,483
Other capital assets, net of depreciation	18,794,541
Total capital assets	<u>40,075,024</u>
Total assets	<u>44,723,146</u>
Liabilities	
Bank overdraft	294,380
Accounts payable and accrued liabilities	2,153,519
Interest payable	57,187
Due to other governmental entities	565,678
Deferred revenues:	
Municipal license tax	539,405
Noncurrent liabilities:	
Due within one year	680,110
Due in more than one year	7,195,684
Total liabilities	<u>11,485,963</u>
Net Assets	
Invested in capital assets, net of related debt	38,714,224
Restricted for:	
Capital projects	2,194,251
Debt service	780,572
Other purposes	962,011
Unrestricted (deficit)	<u>(9,413,875)</u>
Total net assets	<u>\$ 33,237,183</u>

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, 2008**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and
		Charges for	Operating	Capital	Changes in Net Assets
		Services	Grants and	Grants and	Governmental
			Contributions	Contributions	Activities
General government	\$ 5,147,764	\$ 58,734	\$ -	\$ -	\$ (5,089,030)
Public safety	732,084	2,936	44,303		(684,845)
Public works	3,653,105	48,024	240,414	542,482	(2,822,185)
Health and welfare	1,796,412		1,066,866		(729,546)
Culture and recreation	606,725	178,498	9,702		(418,525)
Economic development	326,125		326,125		-
Community development	645,456		538,173	398,828	291,545
Interest on long-term debt	286,570				(286,570)
Total governmental activities	\$ 13,194,241	\$ 288,192	\$ 2,225,583	\$ 941,310	\$ (9,739,156)
General revenues:					
Property taxes					2,531,397
Municipal license tax					1,184,996
Municipal sales and use taxes					727,641
Other local taxes					548,712
Grants and contributions not restricted to specific programs					4,546,655
Interest and investment earnings					43,605
Miscellaneous					92,443
Total general revenues					9,675,449
Change in net assets					(63,707)
Net assets - beginning, as restated					33,300,890
Net assets - ending					\$ 33,237,183

Commonwealth of Puerto Rico
Municipality of Naguabo
Balance Sheet
Governmental Funds
June 30, 2008

	General Fund	Special Revenue Fund - State & Local Grants	Special Revenue Fund Federal Grants	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets							
Cash and cash equivalents	\$ 9,720	\$ -	\$ -	\$ 20,819	\$ -	\$ 48,839	\$ 79,378
Cash with fiscal agent	5,779		53,299	269,759	831,233		1,160,070
Accounts receivable:							
Municipal license taxes	17,284						17,284
Construction excise taxes	36,000						36,000
Municipal sales and use taxes	43,155						43,155
Intergovernmental	592,994	80,888	2,443,157	180,000	6,526		3,303,565
Others	6,901	1,769					8,670
Due from other funds	312,998	780,361	262,125	2,058,791		95,000	3,509,275
Total assets	\$ 1,024,831	\$ 863,018	\$ 2,758,581	\$ 2,529,369	\$ 837,759	\$ 143,839	\$ 8,157,397
Liabilities and Fund Balances							
Liabilities :							
Bank overdraft	\$ 294,380	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 294,380
Accounts payable and accrued liabilities	1,330,937	56,050	101,408	202,156	200,000		1,890,551
Interest payable					57,187		57,187
Due to other governmental entities	565,678						565,678
Due to other funds	3,045,097	188,331	135,623	132,962		7,262	3,509,275
Deferred revenues:							
Municipal license tax	539,405						539,405
Intergovernmental	592,994						592,994
Federal grant revenues			2,320,532				2,320,532
Total liabilities	6,368,491	244,381	2,557,563	335,118	257,187	7,262	9,770,002
Fund balances:							
Reserved for:							
Encumbrances	421,980						421,980
Capital projects				2,194,251			2,194,251
Debt service fund					580,572		580,572
Other purposes	5,779	618,637	201,018				825,434
Reserved reported in nonmajor funds:							
Other purposes						136,577	136,577
Unreserved:							
Undesignated	(5,771,419)						(5,771,419)
Total fund balances	(5,343,660)	618,637	201,018	2,194,251	580,572	136,577	(1,612,605)
Total liabilities and fund balances	\$ 1,024,831	\$ 863,018	\$ 2,758,581	\$ 2,529,369	\$ 837,759	\$ 143,839	

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

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	40,075,024
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds	(7,875,794)
Accrual basis of accounting accounts payable recognized in government-wide financial statements	(262,968)
Liabilities reported in funds and not reported in statement of net assets	2,913,526
Net assets of governmental activities	\$ 33,237,183

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2008

	General Fund	Special Revenue Fund - State & Local Grants	Special Revenue Fund Federal Grants	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues							
Property taxes	\$ 1,612,298	\$ -	\$ -	\$ -	\$ 486,275	\$ -	\$ 2,098,573
Municipal license taxes	1,184,996						1,184,996
Municipal sales and use taxes	470,043				257,598		727,641
Licenses, permits and other local taxes	552,405						552,405
Charges for services	2,875						2,875
Intergovernmental	4,546,655	574,227		542,483			5,663,365
Fines and forfeitures	2,935						2,935
Rent of property	257,603						257,603
Interest	43,605						43,605
Federal grants			2,045,967			640,989	2,686,956
Miscellaneous	79,684	3,308				30,536	113,528
Total revenues	8,753,099	577,535	2,045,967	542,483	743,873	671,525	13,334,482
Expenditures							
Current:							
General government	5,732,793						5,732,793
Public safety	732,787	19,030					751,817
Public works	2,935,983	206,482	105,808	1,073,920			4,322,193
Health and welfare	746,568	83,481	345,474			614,711	1,790,234
Culture and recreation	295,176	8,450					303,626
Economic development		326,125					326,125
Community development			1,485,680				1,485,680
Debt service:							
Principal					399,900		399,900
Interest					286,570		286,570
Total expenditures	10,443,307	643,568	1,936,962	1,073,920	686,470	614,711	15,398,938
Excess (deficiency) of revenues over (under) expenditures	(1,690,208)	(66,033)	109,005	(531,437)	57,403	56,814	(2,064,456)
Other financing sources (uses)							
Transfers in	65,000			76,922	241,243	705	383,870
Transfers out	(306,365)	(66,800)	(10,705)				(383,870)
Long-term debt issued	505,000						505,000
Total other financing sources (uses)	263,635	(66,800)	(10,705)	76,922	241,243	705	505,000
Net change in fund balances	(1,426,573)	(132,833)	98,300	(454,515)	298,646	57,519	(1,559,456)
Fund balance - beginning, as restated	(3,917,087)	751,470	102,718	2,648,766	281,926	79,058	(53,149)
Fund balance, ending	\$ (5,343,660)	\$ 618,637	\$ 201,018	\$ 2,194,251	\$ 580,572	\$ 136,577	\$ (1,612,605)

*CAO
5/11/09*

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, 2008

Net Change in Fund Balances - Total Governmental Funds \$ (1,559,456)

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

Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 2,382,122

Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets, resulting in a loss on disposal of capital assets on the Government-Wide Statement of Activities and Changes in Net Assets. (42,070)

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. (959,573)

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 debt proceeds exceed the debt service principal payments. (70,100)

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. 28,291

Repayment of long term Treasury Department income tax withheld 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. 58,200

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. (14,813)

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. 287,823

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. 22,481

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 (Continued)
For the Year Ended June 30, 2008

Repayment of long term Puerto Rico Aqueduct and Sewer Authority (PRASA) 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 PRASA from prior year.	80,901
Repayment of long term Department of Labor and Human Resources debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represents the change in long-term debt with the Department of Labor and Human Resources from prior year.	15,620
Repayment of long term social security debts with the Internal Revenue Service (IRS) and the Treasury Department are 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 social security debts from prior year.	236,345
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.	(203,949)
Accounts Payable reported in the Government-Wide Statement of Activities and Changes in Net Assets, but not reported in the Governmental Funds because they do not require the use of current financial resources. The following amount represents the change in accounts payable from prior year.	(290,529)
Change in the debt service principal accounts payable reported in the Governmental Fund Financial Statements.	_____ (35,000)
Change in Net Assets of Governmental Activities	_____ \$ (63,707) _____

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2008

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 ("USGAAP") 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 implemented the capitalization of infrastructure since July 1, 2006.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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. Based on the above criteria, the Municipality does not have component units to include within its reporting entity.

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, 2008

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 - State & Local Grants- is the accounting entity in which revenues derived from local funds and state grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or state statutes.

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 - State & Local 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, 2008

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 – State & Local 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 – State & Local 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 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 (“USGAAP”) 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, 2008

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 expenditures 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, other 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, 2008

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 service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law. Also, cash with fiscal agent consist of unused proceeds of bonds and notes issued for the acquisition of equipment and construction of major capital improvements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

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

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the general fund represent property tax due from the Municipal Revenue Collection Center (CRIM).

Intergovernmental receivable in the special revenue fund – state & local grants, in the special revenue fund – federal grants, and in the capital projects fund – state & local grants, 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

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

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

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

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

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

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. All sick leave pay and salary related benefits are accrued when incurred in the governmental-wide financial statements when employee meets such criteria.

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 when the liability is incurred.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

8. **Reservations 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.
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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

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, 2008 amounted to \$281,181. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$144,360 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets.

The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets</u> <u>Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 40,075,024	
Deduct:		
Bonds and notes payable	<u>(1,360,800)</u>	\$ 38,714,224
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		2,194,251
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balance	580,572	
Add:		
Accrual basis accounts payable	<u>200,000</u>	780,572
<u>Net assets restricted for other purposes</u>		
General fund-fund balance restricted for other purposes	5,779	
Special revenue fund-state & local grants-fund balance restricted for other purpose	618,637	
Special revenue fund-federal grants-fund balance restricted for other purpose	201,018	
Other governmental funds-fund balance restricted for other purposes	<u>136,577</u>	962,011

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

<u>Net assets unrestricted (deficit)</u>		
General fund – total fund balance (deficit):	\$ (5,343,660)	
Add:		
Accrual basis accounts receivable	2,913,526	
Deduct:		
General fund–fund balance restricted for other purposes	(5,779)	
Accrual basis accounts payable	(462,968)	
Bonds and notes payable	(3,930,000)	
Property tax debt	(364,026)	
Compensated Absences	(1,446,738)	
Income tax withheld debt	(180,717)	
Claims and judgments	(428,956)	
LIMS Repayment Plan	(89,925)	
Social Security debt	(74,632)	<u>(9,413,875)</u>
Total net assets – governmental activities		<u>\$ 33,237,183</u>

2. DEPOSITS

Under Commonwealth of Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral 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 \$9,720 in the General Fund, and \$20,819 in the capital projects fund –state and local grants were fully collateralized at June 30, 2008. In the other governmental funds there were deposits with commercial banks of \$48,839 that were fully collateralized.

The deposits at GDB of \$5,779 in the general fund, the \$53,299 in the special revenue fund – federal grants, the \$269,759 that is restricted for capital projects in the capital projects fund –state and local grants, and the \$831,233 that is restricted principally for debt service in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. Municipal license taxes

The Municipality imposes 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

3. RECEIVABLES (CONTINUED)

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, 2008, 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 taxes receivable represents filed municipal license tax returns that were uncollected as of June 30, 2008, net of allowance for uncollectible accounts. At June 30, 2008, the municipal license taxes receivable amounted \$17,284.

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

B. Municipal sales and use taxes

On July 29, 2007, an amendment to Act No. 117 of July 4, 2006, known as the "Tax Fairness Act of 2006", was enacted with the purpose of establishing a mandatory sales and use tax of 1.5% at the Municipal Level. The Municipalities of Puerto Rico are responsible to collect 1% of the corresponding tax with the same exemptions and limitations that the portion collected by the Treasury Department. The Act provides an optional surtax on the un-process food. This surtax must be approved by the Municipal Legislature.

The Treasury Department is responsible to create, the Municipal Development Fund (.02%), The Municipal Redemption Fund (.02%) and The Municipal Improvements Fund (.01%) with the remaining 0.5%.

Municipal sales and use taxes receivable represents filed municipal sales and use tax returns that were uncollected as of June 30, 2008, net of allowance for uncollectible accounts. At June 30, 2008, the municipal sales and use taxes receivable amounted \$43,155.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

3. RECEIVABLES (CONTINUED)

C. Intergovernmental

Intergovernmental receivable in the general fund represents the balance owed from the Municipal Revenue Collection Center (CRIM) at June 30, 2008, as described in Note 7. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ 592,994
Total	<u>\$ 592,994</u>

Intergovernmental receivables in special revenue fund – state and local 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 receivables:

<u>Governmental Entity</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Department of Labor and Human Resources- Law 82 Grant	\$ 50,907
Commonwealth of Puerto Rico-Department of Labor and Human Resources- Law 52 Grant	20,279
Others	<u>9,702</u>
Total	<u>\$ 80,888</u>

Intergovernmental receivables in special revenue fund – federal grants represent expenditures incurred not yet reimbursed by the federal government. Following is a detail of the intergovernmental receivables:

<u>Program Description</u>	<u>Amount</u>
Child Care and Development Block Grant	\$ 71,678
Community Development Block Grant-State's Program	2,331,510
Homeland Security Grant Program	<u>39,969</u>
Total	<u>\$ 2,443,157</u>

Intergovernmental receivable in capital projects fund – state and local 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>Governmental Entity</u>	<u>Amount</u>
Commonwealth of Puerto Rico-Rural Development	\$ 180,000
Total	<u>\$ 180,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in the Debt Service Fund represents property tax receivable at June 30, 2008. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM)	\$ 6,526
Total	<u>\$ 6,526</u>

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2008, and interfund transfers during the fiscal year ended at June 30, 2008, 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 - State & Local Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	\$ 166,847
General Fund	Special Revenue Fund - Federal Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	105,927
General Fund	Capital Projects Fund	Reimbursable expenditures	32,962
General Fund	Other Governmental funds	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	7,262
Capital Projects Funds	General Fund	Reimbursable expenditures	820,406
Special Revenue Fund - Federal Grants	General Fund	Reimbursable expenditures	62,968
Special Revenue Fund - Federal Grants	Capital Projects Fund	Reimbursable expenditures	100,000
Special Revenue Fund- State & Local Grants	General Fund	Cash pool in the same bank account	780,361
Capital Projects Funds	General Fund	Cash pool in the same bank account	1,187,205
Capital Projects Funds	Special Revenue Fund - State & Local Grants	Cash pool in the same bank account	21,484
Capital Projects Funds	Special Revenue Fund - Federal Grants	Cash pool in the same bank account	29,696
Special Revenue Fund- Federal Grants	General Fund	Cash pool in the same bank account	99,157
Other Governmental Funds	General Fund	Payroll and related accruals paid and not reimbursed	95,000
Total			<u>\$ 3,509,275</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

4. INTERFUND TRANSACTIONS

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Capital Projects Fund	Transfer of funds for special funds outlays	\$ 65,122
General Fund	Debt Service Fund	Debt Retirement	241,243
Special Revenue Fund- State & Local Grants	General Fund	Transfer of funds for operating outlays	65,000
Special Revenue Fund- State & Local Grants	Capital Projects Fund	Transfer of funds for special funds outlays	1,800
Special Revenue Fund- Federal Grants	Other Governmental Funds	Transfer of funds for special funds outlays	705
Special Revenue Fund- Federal Grants	Capital Projects Fund	Transfer of funds for special funds outlays	<u>10,000</u>
Total			<u>\$ 383,870</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2008, 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, 2007</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2008</u>
Capital asset, not being depreciated:				
Land	\$ 19,200,460	\$ -	\$ -	\$ 19,200,460
Construction in progress	<u>1,021,464</u>	<u>1,374,301</u>	<u>(315,742)</u>	<u>2,080,023</u>
Total capital assets not being depreciated	<u>20,221,924</u>	<u>1,374,301</u>	<u>(315,742)</u>	<u>21,280,483</u>
Capital assets, being depreciated:				
Buildings	13,705,097	170,187		13,875,284
Buildings improvements	4,098,073	235,245		4,333,318
Infrastructure	2,834,005	-		2,834,005
Infrastructure improvements	1,444,611	683,287		2,127,898
Equipment	868,934	144,444	(77,029)	936,349
Work of Art	1,500			1,500
Furnishing	81,902	6,327		88,229
Computers	75,075	21,154		96,229
Vehicles	<u>1,471,881</u>	<u>62,919</u>	<u>-</u>	<u>1,534,800</u>
Total capital assets being depreciated	<u>24,581,078</u>	<u>1,323,563</u>	<u>(77,029)</u>	<u>25,827,612</u>
Less accumulated depreciation for:				
Buildings	(1,811,364)	(345,827)		(2,157,191)
Buildings improvements	(322,269)	(105,904)		(428,173)
Infrastructure	(2,215,960)	(70,850)		(2,286,810)
Infrastructure improvements	(129,837)	(125,249)		(255,086)
Equipment	(429,147)	(129,164)	34,959	(523,352)
Work of Art	(363)	(150)		(513)
Furnishing	(36,783)	(14,232)		(51,015)
Computers	(48,649)	(21,548)		(70,197)
Vehicles	<u>(1,114,085)</u>	<u>(146,649)</u>	<u>-</u>	<u>(1,260,734)</u>
Total accumulated depreciation	<u>(6,108,457)</u>	<u>(959,573)</u>	<u>34,959</u>	<u>(7,033,071)</u>
Total capital assets being depreciated, net	<u>18,472,621</u>	<u>363,990</u>	<u>(42,070)</u>	<u>18,794,541</u>
Governmental activities capital assets, net	<u>\$ 38,694,545</u>	<u>\$ 1,738,291</u>	<u>\$ (357,812)</u>	<u>\$ 40,075,024</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:	<u>Amount</u>
General government	\$ 158,712
Public safety	19,094
Public works	369,024
Culture and recreation	317,226
Community Development	81,906
Economic Development	1
Health and welfare	<u>13,610</u>
Total depreciation expense-governmental activities	<u>\$ 959,573</u>

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2008 are summarized as follows:

Description	General Fund	Special Revenue Fund-State & Local Grants	Special Revenue Fund - Federal Grants	Capital Projects Fund - State & Local Grants	Debt Service Fund	Total
Accounts payable	\$ 1,045,363	\$ 56,050	\$ 101,408	\$ 202,156	\$ 200,000	\$ 1,604,977
Accrued liabilities	<u>285,574</u>	-	-	-	-	<u>285,574</u>
Total	<u>\$ 1,330,937</u>	<u>\$ 56,050</u>	<u>\$ 101,408</u>	<u>\$ 202,156</u>	<u>\$ 200,000</u>	<u>\$ 1,890,551</u>

7. 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

7. PROPERTY TAXES (CONTINUED)

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 final liquidation noting that the collections exceeded advances by \$592,994. 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 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, 2008, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$62,041.

On January 26, 2000, Public Law No. 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 No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No.146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years.

Also, on October 11, 2002, Public Law No. 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 No. 42 enacted on January 26, 2000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

7. PROPERTY TAXES (CONTINUED)

On June 26 1997, Public Law No. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 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 \$208,517 and \$93,468 related to Law No. 42 and Law No. 146 respectively.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

8. 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>
Land Authority	\$ 102,925
Puerto Rico Aqueduct and Sewer Authority	20,530
General Services Administration	490
Puerto Rico Telephone Company	1,101
Department of Labor and Human Resources	4,160
Internal Revenue Service	309,808
Retirement System Administration	<u>126,664</u>
Total	<u>\$ 565,678</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, 2008, the outstanding debt balance was \$89,925. This amount will be presented in the government wide statement of net assets.

9. DEFERRED REVENUES

- A. Municipal License Tax-** The deferred revenues of \$539,405 in the general fund relates to municipal license tax collected in fiscal year 2007-08 that will be earned in fiscal year 2008-09.
- B. Intergovernmental -** The deferred revenues of \$592,994 in the general fund relates to the balance owned from the Municipal Revenue Collection Center (CRIM) at June 30, 2008, as described in Note 7.
- 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-State's Program	\$ 2,248,854
Child Care and Development Block Grant	<u>71,678</u>
Total	<u>\$ 2,320,532</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

10. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2008, was as follows:

<u>Description</u>	<u>Beginning Balance, as restated</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$ 4,841,000	\$ -	\$ (395,000)	\$ 4,446,000	\$ 367,000
Notes Payable	379,700	505,000	(39,900)	844,800	40,900
Property Tax Debts	392,317		(28,291)	364,026	24,630
Social Security Debts	310,976		(236,344)	74,632	35,364
Claims and Judgments	716,779	65,177	(353,000)	428,956	80,177
Compensated Absences	1,431,925	106,001	(91,188)	1,446,738	50,000
Income Tax Withheld Debt	238,917		(58,200)	180,717	58,200
LIMS Repayment Plan	112,407		(22,482)	89,925	23,839
Puerto Rico Aqueduct and Sewer Authority	80,901		(80,901)		
Department of Labor and Human Resources	<u>15,620</u>	<u>-</u>	<u>(15,620)</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 8,520,542</u>	<u>\$ 676,178</u>	<u>\$ (1,320,926)</u>	<u>\$ 7,875,794</u>	<u>\$ 680,110</u>

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

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, 2008 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, 2008</u>
1996-Series	1-1-2020	\$ 514,000	4.50%	\$ 361,000
1998-Series	1-1-2023	576,000	4.50%	427,000
2000-Series	1-1-2025	239,000	4.50%	198,000
2001-Series	7-1-2010	590,000	5.00% to 8.00%	225,000
2002-Series	7-1-2016	370,000	5.00% to 8.00%	270,000
2003-Series	7-1-2027	285,000	4.17% to 5.31%	260,000
2003-Series	7-1-2027	990,000	5.00% to 7.50%	870,000
2004-Series	7-1-2013	865,000	5.00% to 7.50%	500,000
2005-Series	7-1-2014	475,000	3.28% to 7.25%	360,000
2005-Series	7-1-2019	1,140,000	4.37% to 7.25%	<u>975,000</u>
Total general obligation bonds				<u>\$ 4,446,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

10. LONG-TERM LIABILITIES (CONTINUED)

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

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 367,000	\$ 227,308
2010	388,000	220,975
2011	421,000	196,981
2012	349,000	174,855
2013	372,000	155,033
2014-2018	1,289,000	527,682
2019-2023	853,000	233,636
2024-2028	<u>407,000</u>	<u>61,824</u>
Total	<u>\$ 4,446,000</u>	<u>\$ 1,798,294</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. 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, 2008</u>
1997-Series	7-1-16	\$ 400,000	3.27% to 8.00%	\$ 225,000
2005-Series	1-1-13	153,700	4.50%	114,800
2008-Series	1-1-15	505,000	3.93% to 7.50%	<u>505,000</u>
Total notes payable				<u>\$ 844,800</u>

These notes, except the 1997 Series \$400,000 note, are payable from the special ad valorem property tax of 1.50% and the municipal sales and use tax of (.02%), which are 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

10. LONG-TERM LIABILITIES (CONTINUED)

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 40,900	\$ 36,731
2010	101,900	50,288
2011	107,900	46,440
2012	114,000	36,772
2013	125,100	29,380
2014-2018	<u>355,000</u>	<u>40,687</u>
Total	<u>\$ 844,800</u>	<u>\$ 240,298</u>

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, 2008, as described in Note 7.
5. **Social Security Debts-** This amount represents an outstanding balance at June 30, 2008 of payment agreement with the Treasury Department and the Internal Revenue Service, related to social security debt from prior years.
6. **Claims and Judgments-** This amount represent the balance related to legal claims at June 30, 2008, as described in Note 13.
7. **Compensated Absences-** The government-wide statement of net assets includes \$602,019 of accrued sick leave benefits, and approximately \$844,719 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
8. **Income Tax Withheld Debt-** This amount represent an outstanding balance at June 30, 2008 of payment agreement with the Treasury Department, related to income tax withheld during prior years.
9. **LIMS Repayment Plan-** This amount represents the balance owed to the CRIM at June 30, 2008, as described in Note 8.

11. PENSION PLAN

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

11. PENSION PLAN (CONTINUED)

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

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

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions during the year ended June 30, 2008 amounted to \$304,333. This amount represented 100% of the required contribution.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

11. PENSION PLAN (CONTINUED)

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

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2008, a copy of which can be obtained from the Retirement System, Minillas Station, PO Box 42004, San Juan, PR 00940.

12. RISK MANAGEMENT

The Property Division is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the Area of Public Insurance Department at the Treasury Department of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

13. COMMITMENTS AND 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 \$428,956 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

13. COMMITMENTS AND CONTINGENCIES (CONTINUED)

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.

14. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

The GASB has issued the following statements that have effective dates after June 30, 2008:

- a. GASB Statement No.51, Accounting and Financial Reporting for Intangible Assets, which is effective for periods beginning after June 15, 2009.
- b. GASB Statement No.52, Land and Other Real Estate Held as Investments by Endowments, which is effective for periods beginning after June 15, 2008.

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

15. PRIOR PERIOD ADJUSTMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

Description	General Fund	Special Revenue Fund - State & Local Grants	Special Revenue Fund - Federal Grants	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Fund	Total
Fund balance, beginning	\$ (3,900,422)	\$ 664,293	\$ 128,186	\$ 2,686,569	\$ 281,926	\$ 79,058	\$ (60,390)
To correct prior year interfund transaction	(119,186)	119,186					
To correct prior year accounts receivable		7,241					7,241
To correct prior year fund classification	<u>102,521</u>	<u>(39,250)</u>	<u>(25,468)</u>	<u>(37,803)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fund balance, beginning as restated	<u>\$ (3,917,087)</u>	<u>\$ 751,470</u>	<u>\$ 102,718</u>	<u>\$ 2,648,766</u>	<u>\$ 281,926</u>	<u>\$ 79,058</u>	<u>\$ (53,149)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

15. PRIOR PERIOD ADJUSTMENTS (CONTINUED)

B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS

The following restatements have been made in the governmental wide financial statements, which are reported as an adjustment to the beginning net assets:

<u>Description</u>	<u>Total</u>
Net assets, beginning	\$ 33,004,734
To correct prior year accounts receivable	7,241
To correct prior year property tax debt	<u>288,915</u>
Net assets, beginning as restated	<u>\$ 33,300,890</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2008

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Property taxes	\$ 1,676,722	\$ 1,676,722	\$ 1,612,298	\$ (64,424)
Fines and forfeitures	30,000	30,000	8,626	(21,374)
Municipal license taxes	1,325,000	1,325,000	1,146,212	(178,788)
Municipal sales and use taxes	700,000	700,000	426,888	(273,112)
Licenses, permits and other local taxes	803,000	803,000	516,405	(286,595)
Charges for service	5,500	5,500	2,875	(2,625)
Intergovernmental	4,691,760	5,126,807	4,546,655	(580,152)
Interest	20,000	20,000	43,605	23,605
Rent of property	142,700	142,700	246,869	104,169
Miscellaneous	<u>20,000</u>	<u>20,000</u>	<u>79,684</u>	<u>59,684</u>
Total revenues	<u>9,414,682</u>	<u>9,849,729</u>	<u>8,630,117</u>	<u>(1,219,612)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	4,685,381	5,653,536	5,583,387	70,149
Public safety	761,173	749,553	718,521	31,032
Public works	2,600,999	2,144,614	2,167,714	(23,100)
Health and welfare	756,071	756,724	739,236	17,488
Culture and recreation	331,683	304,059	290,253	13,806
Operating transfer to other funds	<u>279,375</u>	<u>241,243</u>	<u>241,243</u>	<u>-</u>
Total expenditures, encumbrances and other financing uses	<u>9,414,682</u>	<u>9,849,729</u>	<u>9,740,354</u>	<u>109,375</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,110,237)</u>	<u>\$ (1,110,237)</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 8,630,117
Differences-budget to USGAAP:				
Non-budgeted transfer in				65,000
Non budgeted revenue				90,482
USGAAP adjustments to revenues				<u>32,500</u>
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 8,818,099</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 9,740,354
Differences-budget to USGAAP:				
Non-budgeted transfer out				65,122
Prior year encumbrances recorded as current year expenditures for USGAAP basis				1,118,838
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(174,642)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,749,672</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

NOTES TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2008

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 USGAAP, 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 USGAAP 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, 2008 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2008.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2008

<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		\$ 3,290
Pass-through the Commonwealth of Puerto Rico-Department of Education: Child and Adult Care Food Program	10.558	Not Available	<u>13,078</u>
Total U.S. Department of Agriculture			<u>16,368</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program: Emergency Shelter Grants Program	14.231		21,062
Direct Program: Section 8 Housing Choice Vouchers	14.871		640,989
Pass-through the Commonwealth of Puerto Rico - Municipal Affairs Commissioner Office: Community Development Block Grants - State's Program	14.228	07-AB-FC-47 06-AB-FC-47 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	1,482,390
Pass-through the Commonwealth of Puerto Rico - Municipality of San Juan: Housing Opportunities for Persons with Aids	14.241	Not Available	<u>36,536</u>
Total U.S. Department of Housing and Urban Development			<u>2,180,977</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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: Child Care and Development Block Grant	93.575	Not Available	<u>274,797</u>
Total U.S. Department of Health and Human Services			<u>274,797</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 1552	5,803
Hazard Mitigation Grant	97.039	Not Available	10,475
Pass-through the Commonwealth of Puerto Rico Governor Office – Public Security Affairs Office: Homeland Security Grant Program	97.067	Not Available	<u>88,622</u>
Total U.S. Department of Homeland Security			<u>104,900</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 2,577,042</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, 2008

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	\$ 1,936,053	\$ 640,989	\$ 2,577,042
Non federal programs expenditures	<u>909</u>	<u>(26,278)</u>	<u>(25,369)</u>
Total expenditures in the general purpose financial Statements	<u>\$ 1,936,962</u>	<u>\$ 614,711</u>	<u>\$ 2,551,673</u>



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

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, 2008, which collectively comprise the **Municipality's** basic financial statements and have issued our report thereon dated December 22, 2008, which was unqualified at the governmental-wide financial statement level, but qualified at the fund financial statements level because we were unable to obtain sufficient evidence to support and to satisfy ourselves about the amount recorded in each major fund and the aggregate remaining fund information as due from/ due to other funds and transfer in / transfer out. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

**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 consider the deficiencies described in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting. (Items **08-01** through **08-03**)

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items **08-01** and **08-03** 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items **08-02** and **08-03**.

We also noted certain other matters that we reported to management of the **Municipality of Naguabo** in a separate letter dated December 22, 2008.

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



**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)**

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
December 22, 2008

Stamp No. 2312202 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

Certified Public Accountants / Management Advisors

Member of:

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

**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, 2008. 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 *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Municipality 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 of 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, 2008. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items **08-04** through **08-07**.

**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 the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **Municipality of Naguabo's** internal control over compliance.

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

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items **08-04** through **08-07** to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items **08-05** and **08-07** to be material weaknesses.

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



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)

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 December 22, 2008.

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
December 22, 2008

Stamp No. 2312203 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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2008

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:	Qualified for fund financial statement and unqualified for governmental-wide financial statements	
Internal control over financial reporting:		
Material weakness identified?	Yes <input checked="" type="checkbox"/>	No
Significant deficiencies identified not considered to be material weaknesses?	Yes <input checked="" type="checkbox"/>	None reported
Noncompliance material to financial statements noted?	Yes <input checked="" type="checkbox"/>	No

Federal awards

Internal Control over major programs:		
Material weakness identified?	Yes <input checked="" type="checkbox"/>	No
Significant deficiencies identified not considered to be material weaknesses?	Yes <input checked="" type="checkbox"/>	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 <input checked="" type="checkbox"/>	No
---	---	----

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
14.228	Community Development Block Grant – State’s Program
14.871	Section 8 Housing Choice Voucher

Dollar threshold used to distinguish between Type A and Type B programs	\$ 300,000	
Auditee qualified as low-risk auditee?	Yes	No <input checked="" type="checkbox"/>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section II – Financial Statements Findings

Finding Reference	08-01
Requirement	Financial Reporting – Interfund Transactions
Statement of Condition	During our examination, we noted that for the fiscal year 2007-2008, the accounting records of the Municipality related to interfund transactions are not adequate.
Criteria	Article 8.010 (C) (2) and (3) of State Act Number 81 of August 30, 1991, stated that Municipality should maintain accurate accounting records and fund controls.
Cause of Condition	The Management's controls and procedures failed to assure that the Municipality maintained accurate accounting records related to interfund transactions.
Effect of Condition	The Municipality did not maintain an adequate control of the accounting records regarding interfund transactions.
Recommendation	We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to interfund transactions.
Questioned Costs	None.
Management Response and Corrective Action	As part of our corrective action plan, we will review the interfund balance as of June 30, 2008, in order to determine the correct balance. Implementation Date: Immediately Responsible Person: Sr. Hector E. Machín Nazario Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section II - Financial Statements Findings

Finding Reference	08-02
Requirement	Payroll and Related Liabilities - Personnel, Employment and Rate Authorizations
Statement of Condition	<p>We performed a payroll test and examined a sample of twenty (20) personnel files, and the related payroll documents of those functionaries and employees. The following will summarize the situations found:</p> <ul style="list-style-type: none">a. Two (2) personnel files did not include evidence of the employees' previous work experience;b. Five (5) personnel files did not include evidence of the employees' academic preparation;c. According to the information found on one (1) personnel file, we noted that the functionary contracted by the Municipality did not comply with the minimum academic preparation requirements for the position;d. According to the information found on three (3) personnel files, we noted that the salaries paid to two (2) functionaries and one (1) employee exceeded the wage rates established by Municipality's Reclassification and Retribution Plan.
Criteria	<p>Article 11.007 (b) of State Act Number 81 of August 30, 1991 states that the minimum requirements to hold each Municipality's positions will be established based on the qualifications established on the job description. The Reclassification and Retribution Plan establish the minimum requirements to hold each Municipality's positions.</p> <p>The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter IV, Section 18-(1) establish that the Municipality will prepare the payroll based on the employee files. Also, Article 11.023 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain updated employee's files.</p>
Cause of Condition	<p>The Municipality's control and procedures failed to assure that all functionaries and employees were contracted in accordance with the minimum requirements established in the Reclassification and Retribution Plan.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section II – Financial Statements Findings

Finding Reference	08-02 (Continued)
Effect of Condition	The Municipality is not in compliance with the Articles 11.007 (b) and 11.023 of State Act Number 81 of August 30, 1991, and with the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter IV, Section 18-(1). Also, the Municipality is not in compliance with the Reclassification and Retribution Plan requirements.
Recommendation	We recommend that the Municipality should implement the necessary internal controls and procedures in the personnel acquisition process, in order to comply with the requirements established in the State Act Number 81 of August 30, 1991, in the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico and in the Reclassification and Retribution Plan.
Questioned Cost	None.
Management Response and Corrective Action	The Auditor's recommendation would be considered as part of corrective action plan development and implementation. Implementation Date: Immediately Responsible Person: Sr. Hector E. Machín Nazario Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section II – Financial Statements Findings

Finding Reference	08-03
Requirement	Inventory Management
Statement of Condition	During our examination, we noted that the Municipal Garage does not have adequate controls for dispatching fuel to the municipal vehicles.
Criteria	The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter VII, Section 24 states that the Municipality will establish procedures and controls to manage materials and inventories in the different Municipality's departments.
Cause of Condition	The Management's controls and procedures failed to assure that the Municipality maintained reliable controls related to the dispatching of fuel to the municipal vehicles.
Effect of Condition	The Municipality is not in compliance with the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter VII, Section 24.
Recommendation	We recommend that the Municipality should strengthen its internal control procedures, in order to maintain accurate records that detail the fuel usage information for all the Municipality's vehicles.
Questioned Costs	None.
Management Response and Corrective Action	The Auditor's recommendation would be considered as part of corrective action plan development and implementation. Implementation Date: Immediately Responsible Person: Sr. Hector E. Machín Nazario Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	08-04
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:</p> <p>a. For the fifteen (15) participants, we noted that the HAP Register maintained during the fiscal year ended on June 30, 2008 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 contract rent payable to the owner, monthly rent payable by the family, 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 the 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, 2008

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 08-04 (Continued)

Management Response
and Corrective Action

As part of our corrective action plan, we will amend the HAP Register, according with the Federal regulations. Also, we gave direct instructions to the Program staff to complete the HAP Register. We will monitor, on a monthly basis, the Program staff to assure that the HAP Register is properly maintained.

Implementation Date: Immediately

Responsible Person: Carmen L. Rodriguez Montañez
Section 8 Program's Supervisor - Interim

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	08-05
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>We performed a housing rehabilitation test of eight (8) participant's files and found the following:</p> <ul style="list-style-type: none">a. In one (1) participant's file, we did not observe evidence of the program's inspector intermediate visit;b. In four (4) participant's files, we did not observe evidence of the program's inspector final visit. Also, these files did not include photos evidencing the completion of the rehabilitation works;c. In five (5) participant's files, the applicant's eligibility or non-eligibility determination was not documented.
Criteria	<p>Code of Federal Regulations 24, Section 570.506 (b) state that at a minimum, the grantee should maintain records demonstrating that each activity undertaken meets one of the three national objectives of the CDBG Program, i.e., benefit low- and moderate-income persons, prevent or eliminate slums or blight, or meet community development needs having a particular urgency. Also, Code of Federal Regulations 24, Section 570.506 (b) (9) states that when CDBG- State Program funds are used for residential rehabilitation activity to aid in the prevention or elimination of slums or blight in a slum or blighted area, the grantee must maintain records to support the local definition of "substandard", must document a pre-rehabilitation inspection report describing the deficiencies in each structure to be rehabilitated, and must document the details and scope of CDBG assisted rehabilitation, by structure.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	08-05 (Continued)
Cause of Condition	The Municipality's controls and procedures failed to assure that inspections to monitor the rehabilitation activities were conducted, and to assure that all participant's files were duly documented as required by regulation.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Section 570.506 (b) and 570.506 (b) (9).
Recommendation	We recommend the Program Management to instruct and monitor program staff to follow procedures established by the Program, regarding housing rehabilitation activities. This should include completion of all eligibility and inspections forms.
Questioned Costs	None.
Management Response and Corrective Action	Regarding situation (a), the intermediate visit form in the file was not completed, but there is a certification signed by the inspector which indicates the inspection was performed. Regarding situation (b), all the files have the final photos and have the breakdown's signed by the inspector, which indicates that they were visited. Regarding situation (c), there was no letter of eligibility in the files, but there was the income limits table which indicates their eligibility.
Auditors Comment	According to our examination of documents filed in the participant files reported in the condition above, we did not observe evidence that supports the management response. Therefore, we believe that the conditions prevail. Implementation Date: This information was not provided Responsible Person: Elizbeth López Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	08-06
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	We performed a housekeeping assistance project test of fifteen (15) participant's files and found the following: a. The Municipality did not appoint a Service Coordinator. This employee would be in charge to evaluate all applications, taking in consideration the minimum requirements established in the operational guide; b. In the fifteen (15) participant's files, we did not find evidence that demonstrate that the program staff visited, at least, three (3) times the participant housing unit during the contract period, to ensure the quality of services.
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 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 in noncompliance with the Code of Federal Regulations 24, Section 570.484 and with the operational guide.
Recommendation	We recommended management to follow the procedures established in the operational guide titled "Guía Operacional para la Prestación del Servicio de Auxiliares en el Hogar del Municipio de Naguabo", as amended on April 25, 2007.
Questioned Costs	None.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 08-06 (Continued)

Management Response
and Corrective Action

Regarding situation (a), the coordinator is the Federal Program Director. Regarding situation (b), the visits to the housing units of each participant were done at the beginning, at the middle and at the end of the contracted service period.

Auditors Comment

According to our examination of documents filed in the participant files reported in the condition above, we did not observe evidence that supports the management response. Therefore, we believe that the conditions prevail.

Implementation Date: This information was not provided

Responsible Person: Elizbeth López
 Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	08-07
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	Davis-Bacon Act
Statement of Condition	<p>During our Davis-Bacon Act test, we verified the construction projects 01-FD-47-003 and 04-FC-47-001, related to streets improvement activities. We found the following exceptions:</p> <ul style="list-style-type: none">a) In one (1) case, the Municipality did not inform to the contractors, in the procurement process, the requirements for Davis Bacon Act;b) In two (2) cases, the Municipality did not require to contractor to submit certification and copies of payrolls with prevailing wage rates;c) In one (1) case, the Municipality did not complete the monitoring of the contractors classification of workers and wage rates paid.
Criteria	Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Cause of Condition	The Municipality's controls and procedures failed to apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wage rates.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Recommendation	We recommend management to follow monitoring system procedures developed, including obtaining contractor's and subcontractor's weekly payrolls to be reviewed on a weekly basis by the responsible municipal employee, and interview contractor's and subcontractor's laborers periodically (up to ten percent (10%) of the workers on long term projects) to establish the degree of compliance and the nature and extend of violations, if any, and then, communicate contractors, promptly, about any failure in the payroll process.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 08-07 (Continued)

Questioned Costs None.

Management Response
and Corrective Action

Regarding situation (a), there was no written information in the file of the procurement process of the requirements for Davis Bacon Act, but the construction company has been contracted before by the Municipality and know which are the documents that are required. Also, these projects were completed, but in future contracts, we will file the pre-construction meetings minutes that indicates the requirement.

Regarding situation (b) in the pre-construction meeting minutes, it does not mention to the contractor to submit certifications and copies of payrolls, but the contractor did comply with the requirement and the documents are included in the files.

Regarding situation (c), the interviews to workers were made at the beginning, interim and before finalizing the project contract. Nevertheless, we will be monitoring this situation in the future.

Implementation Date: Immediately

Responsible Person: Elizbeth López
 Federal Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2008

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
07-01	14.871	<p><u>The auditors examined the Housing Assistance Payment Register (HAP Register) maintained by the PHA for fifteen (15) participants and found the following exception: (a) For the fifteen (15) participants, the auditors noted that the HAP Register maintained during the fiscal year ended on June 30, 2007, 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 08-04.</p>
07-02	14.228	<p><u>During the fiscal year ended June 30, 2007, the Program disclosed in loose sheets, information related to CDBG 2005 and 2006 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.</u></p> <p><u>The auditors performed a housekeeper activities test of ten (10) participant's files and found the following situations: (a) According to project's operational guide (before amendment on April 25, 2007), the Program staff must visit at least twice per month, the participant's housing unit to ensure the quality of services. Nevertheless, in four (4) participants' files (for housekeepers that participated prior to the amendment), the auditors noted the following situations: (1) In three (3) participants' files, the auditors noted that the Federal Programs Director only visited twice the housing unit during the contract period; (2) In one (1) participant's file, the auditors noted that the Federal Programs Director visited only once the housing unit during the contract period; (b) According to project's operational guide (after amendment on April 25, 2007), the Program staff must visit at least three times during the contract period, the participant's housing unit to ensure the quality of services. Nevertheless, in three (3) participants' files (for housekeepers that participated subsequent to the amendment), the auditors noted that the Federal Programs Director visited only once the housing unit during the contract period; (c) In one (1) participant's file, the auditors observed the following situations: (1) The Federal Program Director did not document if the housekeeper complied with the minimum requirements regarding work experience; (2)The auditors did not observe evidence of the visits made to the housing unit during the contract period.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 08-06.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
07-03	14.228	<p><u>The auditors performed a housing rehabilitation activities test of eight (8) participant's files and found the following situations: (a) In four (4) participants' files, the applicant eligibility form was not properly documented; (b) In one (1) participant's file, the auditors did not observe evidence of residence existence; (c) In five (5) participants' files, the final inspection form was not properly documented.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 08-05.</p>
06-01	14.228	<p><u>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.</u></p> <p><u>Also, the auditors performed a housekeeper activities test of ten (10) participant's files and found the following exceptions: (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, the auditors noted that the Federal Programs Director visited only two (2) times the housing unit during the fiscal year ended June 30, 2006. In addition, the auditors could not determine if these visits were made in presence of the housekeeper; (b) In two (2) participant's files, the auditors noted that the Federal Programs Director visited only one (1) time the housing unit during the fiscal year ended June 30, 2006. Also, the auditors could not determine if these visits were made in presence of the housekeeper; (c) In two (2) participant's files, the auditors observed that the Federal Program Director did not document if the participant complied with the minimum requirements regarding work experience.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 08-06.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
06-04	14.871	<p>The auditors examined the Housing Assistance Payment Register (HAP Register) maintained by the PHA for fifteen (15) participants and found the following exception: (a) For fourteen (14) participants, the auditors 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> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 08-04.</p>
05-02	14.228	<p>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.</p> <p>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.</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>
05-08	14.871	<p>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.</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>