

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

**MUNICIPIO DE NARANJITO**  
**AUDITORIA 2005-2006**  
**30 DE JUNIO DE 2006**



**Guzman Torres & Co., PSC**  
Certified Public Accountants & Business Advisors

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 2006 TOGETHER WITH INDEPENDENT AUDITORS' REPORT, SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS, REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS AND REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133.**

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF NARANJITO

YEAR ENDED JUNE 30, 2006

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**Guzman Torres & Co., PSC**  
Certified Public Accountants & Business Advisors

## INDEPENDENT AUDITOR'S REPORT

To the City Council  
Municipality of Naranjito  
Naranjito, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Municipality of Naranjito, Puerto Rico, as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Municipality of Naranjito, Puerto Rico, management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Municipality of Naranjito, Puerto Rico as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and other required supplementary information on pages 1 through 8 and 31 through 32 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 Naranjito, Puerto Rico, basic financial statements. The introductory section, combining and individual non major fund financial statements, and statistical tables listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual non major fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Guzmán Torres & Co.'s P.S.C.*

**GUZMAN TORRES & CO., PSC.**

December 30, 2006  
San Juan, Puerto Rico  
License No. 168

Stamp No. 2186690 was affixed to the original of this report.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**MANAGEMENT AND DISCUSSION ANALYSIS**

**YEAR ENDED JUNE 30, 2006**

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**Management's Discussion and Analysis**

Management of the Municipality of Naranjito (the "Municipality") implemented Statement No. 34 ("Statement") of the Governmental Accounting Standards Board ("GASB"), Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments for the fiscal year ended on June 30, 2006. This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of such Statement, and it has been designed accordingly with the following goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget,) and;
- e) Identify individual fund issues or concerns.

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

**FINANCIAL HIGHLIGHTS**

- The Municipality net assets increased by \$ 3,882,860.
- In the fund financial statements, the governmental activities revenue decrease \$772,192 (or 6%) while governmental activities expenditures decrease \$1,704,068 (or 13%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, an increase of \$ 578,921.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$ 170,861.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**MANAGEMENT'S AND DISCUSSION ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**Using This Annual Report**

This annual report consists of a series of new financial statements with a change in the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

**Government-Wide Financial Statements**

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

The Statement of Net Asset presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

**Fund Financial Statements**

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements, focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**MANAGEMENT'S AND DISCUSSION ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**Fund Financial Statements (Continued)**

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

**Infrastructure Assets**

Historically, a government's largest group of assets (infrastructure-roads, bridges, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the Governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrated its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

The Municipality commenced the reporting of infrastructure assets during the current year. Also, the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's combined net assets (excess of assets over liabilities) totaled \$35,421,104 at the end of 2006, compared to \$31,434,390 at the end of the previous year.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

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Net Assets (Continued)

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Condensed Statement of Net Assets  
June 30, 2006

Current assets	\$ 12,787,010
Capital assets	<u>29,784,814</u>
Total assets	<u>42,571,824</u>
Current liabilities	3,537,266
Noncurrent liabilities	<u>3,613,454</u>
Total liabilities	<u>7,150,720</u>
Invested in capital assets, net of related debt	28,425,814
Restricted	8,642,087
Unrestricted (deficit)	<u>(1,646,797)</u>
Total net assets	<u>\$ 35,421,104</u>

Changes in Net Assets

The Municipality's net assets increased by \$ 3,882,860. Approximately 15 percent of the Municipality's total revenue came from taxes, while 78 percent resulted from grants and contributions, including federal aid. Charges for Services provided 1 percent of the total revenues. Interest and investment earnings and miscellaneous provided 6 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works, community development, health and welfare services and public safety. In future years, when prior-year information is available, a comparative analysis of government-wide data will be presented.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

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Changes in Net Assets (Continued)

Condensed Statement of Activities  
June 30, 2006

Program revenues:	
Charges for services	\$ 89,250
Operating grants and contributions	4,451,766
Capital grants and contributions	467,249
General revenues:	
Property taxes	1,954,931
Municipal license tax	956,632
Grants and contributions not restricted to specific programs	10,526,605
Interest and investment earnings	428,546
Miscellaneous	<u>417,749</u>
Total revenues	<u>14,284,463</u>
Expense:	
General government	4,221,672
Public safety	343,595
Public works	3,278,569
Culture and recreation	158,069
Health and welfare	1,454,881
Community development	887,699
Interest on long-term debt	<u>57,118</u>
Total expenses	<u>10,401,603</u>
Change in net assets	3,882,860
Net assets, beginning of year as restated	<u>31,538,244</u>
Net assets, end of year	<u>\$35,421,104</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS**

As noted earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance related legal requirements.

**Governmental Funds**

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$9,249,744, an increase of \$383,399 in comparison with the prior year. There are reservations of fund balance amounting to \$8,656,287. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$14,200), 2) to pay debt service (\$765,853), 3) to pay for capital projects (\$6,317,410) and 4) for other purposes (\$1,558,824).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2006, the general fund has a fund balance of \$607,657.

**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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The Municipality's investment in capital assets as of June 30, 2006, amounts to \$ 35,791,321, net of accumulated depreciation of \$(6,006,507), leaving a net book value of \$ 29,784,814. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. 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 total increase in the Municipality's investment in capital assets for the current fiscal year was \$5,557,391 in terms of net book value. Depreciation charges for the year totaled \$ 786,483.

The Municipality finances a significant portion of its construction activities through bond issuances. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2006 the Municipality has \$6,317,410 of unexpended proceeds from bond 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. See "Limitations on Ability of Municipalities to Issue General Obligation Debt-The Municipal Bonds" for a general description of such limitations.

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 NARANJITO**

**MANAGEMENT'S AND DISCUSSION ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**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 grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal 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 2006-2007 fiscal years.

**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.

**Commonwealth of Puerto Rico**  
**Municipality of Naranjito**  
**Statement of Net Assets**  
**June 30, 2006**

	<b>Governmental Activities</b>
<b>Assets</b>	
Cash and cash equivalents	\$ 11,209,696
Cash with fiscal agent	815,479
Accounts receivable:	
Municipal license tax	7,656
Intergovernmental	754,179
Capital assets	
Land, improvements, and construction in progress	20,169,032
Other capital assets, net of depreciation	9,615,782
Total capital assets	<u>29,784,814</u>
Total assets	<u>42,571,824</u>
 <b>Liabilities</b>	
Accounts payable and accrued liabilities	2,604,632
Due to other governmental entities	65,657
Deferred revenues:	
Municipal license tax	633,023
Federal grant revenues	233,954
Noncurrent liabilities:	
Due within one year	385,976
Due in more than one year	<u>3,227,478</u>
Total liabilities	<u>7,150,720</u>
 <b>Net Assets</b>	
Invested in capital assets, net of related debt	28,425,814
Restricted for:	
Capital projects	6,317,410
Debt service	765,853
Federal and state grant funds	1,558,824
Unrestricted (deficit)	<u>(1,646,797)</u>
Total net assets	<u><u>\$ 35,421,104</u></u>

Commonwealth of Puerto Rico  
Municipality of Naranjito  
Statement of Activities  
For the Year Ended June 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 4,221,672	\$ 76,715	\$ 780,605		\$ (3,364,352)
Public safety	343,595	9,010	239,253		(95,332)
Public works	3,278,569	3,525	1,216,787	320,524	(1,737,733)
Health and welfare	1,454,881		1,039,288		(415,593)
Culture and recreation	158,069		1,095		(156,974)
Community development	887,699		874,738	146,725	133,764
Interest on long-term debt	57,118				(57,118)
<b>Total governmental activities</b>	<b>\$ 10,401,603</b>	<b>\$ 89,250</b>	<b>\$ 4,151,766</b>	<b>\$ 467,249</b>	<b>\$ (5,693,338)</b>
General revenues:					
Property taxes					1,954,931
Municipal license tax					956,632
Grants and contributions not restricted to specific programs					5,907,590
Interest and investment earnings					428,546
Miscellaneous					328,499
<b>Total general revenues</b>					<b>9,576,198</b>
Change in net assets					3,882,860
Net assets - beginning as restated					31,538,244
Net assets - ending					<b>\$ 35,421,104</b>

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

	<u>General Fund</u>	<u>Special Revenue State and Federal Grants</u>	<u>Capital Projects Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>Assets</b>					
Cash and cash equivalents	\$ 1,415,739	\$ 2,206,357	\$ 7,587,600	\$ -	\$ 11,209,696
Cash with fiscal agent		49,626		765,853	815,479
Accounts receivable:					
Municipal license tax	7,656				7,656
Intergovernmental	292,914	461,265			754,179
Due from other funds	444,979				444,979
<b>Total assets</b>	<u>\$ 2,161,288</u>	<u>\$ 2,717,248</u>	<u>\$ 7,587,600</u>	<u>\$ 765,853</u>	<u>\$ 13,231,989</u>
<b>Liabilities and Fund Balances</b>					
<b>Liabilities :</b>					
Accounts payable and accrued liabilities	\$ 854,951	\$ 479,491	\$ 1,270,190	\$ -	\$ 2,604,632
Due to other governmental entities	65,657				65,657
Due to other funds		444,979			444,979
Deferred revenues:					
Municipal license tax	633,023				633,023
Federal grant revenues		233,954			233,954
<b>Total liabilities</b>	<u>1,553,631</u>	<u>1,158,424</u>	<u>1,270,190</u>	<u>-</u>	<u>3,982,245</u>
<b>Fund balances:</b>					
<b>Reserved for:</b>					
Encumbrances	14,200				14,200
Capital projects			6,317,410		6,317,410
Other purposes		1,558,824			1,558,824
<b>Reserved reported in nonmajor funds:</b>					
Debt service fund				765,853	765,853
<b>Unreserved:</b>					
Undesigned	593,457				593,457
<b>Total fund balances</b>	<u>607,657</u>	<u>1,558,824</u>	<u>6,317,410</u>	<u>765,853</u>	<u>9,249,744</u>
<b>Total liabilities and fund balances</b>	<u>\$ 2,161,288</u>	<u>\$ 2,717,248</u>	<u>\$ 7,587,600</u>	<u>\$ 765,853</u>	

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	29,784,814
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds	(3,613,454)
<b>Net assets of governmental activities</b>	<u>\$ 35,421,104</u>

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

	General Fund	Special Revenue State and Federal Grants	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
<b>Revenues</b>					
Property taxes	\$ 1,619,812			\$ 335,119	\$ 1,954,931
Municipal license taxes	956,632				956,632
Licenses, permits and other local taxes	331,210				331,210
Intergovernmental	5,907,590	1,647,694	86,883		7,642,167
Rent of property	76,715				76,715
Finas and forfeitures	9,010				9,010
Interest	428,546				428,546
Charge for services	3,525				3,525
Federal grants		2,232,706			2,232,706
Miscellaneous	295,924	32,555	20		328,499
<b>Total revenues</b>	<b>\$ 9,628,964</b>	<b>\$ 3,912,955</b>	<b>\$ 86,903</b>	<b>\$ 335,119</b>	<b>\$ 13,963,941</b>
<b>Expenditures</b>					
<b>Current:</b>					
General government	5,257,727	780,458			6,038,185
Public safety	347,181	248,470			595,651
Public works	1,541,463	629,167	181,920		2,352,550
Health and welfare	1,619,342	1,095,817			2,715,159
Culture and recreation	284,330	24,972			309,302
Community development		1,205,622	34,955		1,240,577
<b>Debt service:</b>					
Principal				272,000	272,000
Interest				57,118	57,118
<b>Total expenditures</b>	<b>9,050,043</b>	<b>3,984,506</b>	<b>216,875</b>	<b>329,118</b>	<b>13,580,542</b>
Excess (deficiency) of revenues over (under) expenditures	578,921	(71,551)	(129,972)	6,001	383,399
<b>Other financing sources (uses)</b>					
Transfers in			135,470	35,782	171,252
Transfers out	(171,252)				(171,252)
<b>Total other financing sources (uses)</b>	<b>(171,252)</b>	<b>-</b>	<b>135,470</b>	<b>35,782</b>	<b>-</b>
<b>Net changes in fund balances</b>	<b>407,669</b>	<b>(71,551)</b>	<b>5,498</b>	<b>41,783</b>	<b>383,399</b>
Fund balance, beginning as restated	199,988	1,630,375	6,311,912	724,070	8,866,345
<b>Fund balance, ending</b>	<b>\$ 607,657</b>	<b>\$ 1,558,824</b>	<b>\$ 6,317,410</b>	<b>\$ 765,853</b>	<b>\$ 9,249,744</b>

503,802  
199,988  
96,133  
103,855

OK p. 15/08/2007

See auditors' report and notes to the financial statements.

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

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Net Change in Fund Balances - Total Governmental Funds \$ 121,050

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. 6,023,350

Capital assets received as a donation are not recorded in the Governmental Funds, because current financial resources are not involved; however, the transaction must be reflected in the Government-Wide Financial Statements based on the fair value of the donated property. This is the amount of donated capital assets recorded in the current period. 320,524

Depreciation expense on capital assets is 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, depreciation expense is not reported as expenditures in Governmental Funds (786,483)

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 Change in Net Assets. (1,943,328)

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in Governmental Funds. (124,253)

The issuance of long-term debt provides current financial resources to Governmental Funds, while the repayment of principal of long-term debt consumes current financial resources. This is the amount by which debt proceeds exceed debt service principal payments. 272,000

Change in Net Assets of Governmental Activities \$ 3,882,860

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2006

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The **Municipality of Naranjito** (the Municipality) was founded on the year 1824. 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 public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. With this financial report, the Municipality has changed its financial reporting to comply with the provisions of GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. As part of the implementation of GASB Statement No. 34, the Municipality adopted a prospective reporting of its general infrastructure assets. This result in the recognition of the costs incurred during the fiscal year ended June 30, 2006 for the acquisition of infrastructure assets (e.g., roads, bridges, sidewalks). The Municipality expects to report the retroactive historical costs of all of its infrastructure assets during the fiscal year beginning on July 1, 2006.

In conjunction with the implementation of GASB Statement No. 34, the Municipality has also implemented paragraphs six to eleven of GASB Statement No. 38, Certain Financial Statements Note Disclosures, which rescinds some and modifies other financial statement disclosure requirements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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

**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. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

**B. Government-wide and fund financial statements**

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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

**Capital Projects Fund** - 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.

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 NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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**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-** 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 - 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.

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

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

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

**D. Measurement focus, basis of accounting and financial presentation**

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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

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

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, franchise taxes, licenses, rent, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the government receives cash.

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

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

---

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

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

**E. Assets, liabilities and net assets**

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

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

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

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the general fund represent mostly contributions from the Puerto Rico Electric Power Authority, which contribute a specific percentage of their revenues as payment in lieu of taxes. Intergovernmental receivable in the special revenue fund represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

---

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

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

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

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

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

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

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

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

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

---

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

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

- 7. Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.
- 8. Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

  - a. Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
  - b. Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
  - c. Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
  - d. Debt Service Fund-** Represents net assets available to finance future debt service payments.
- 9. Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:

  - a. Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
  - b. Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- 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 NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

---

**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 CRIM for the year ended June 30, 2006 amounted to approximately \$232,000. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$274,000 for workers compensation insurance covering all municipal employees.

**11. Reconciliation of Government-Wide and Fund Financial Statements-** Explanation of certain differences between the Governmental Fund Balance-Total Governmental Funds and Net Assets-Governmental Activities as reported in the Government-Wide Statement of Net Assets. One element of that reconciliation explains that "long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds." The details of this \$2,254,455 are as follows:

Accrued compensated absences	\$ 1,470,073
Due to other governmental entities	723,445
LIMS-Repayment Plan	55,881
Property tax debt - Treasury Department	<u>5,056</u>
Net adjustment to reduce fund balance total governmental funds to arrive at net assets-governmental activities	<u>\$ 2,254,455</u>

**2. DEPOSITS**

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

The Municipality's bank balances in commercial banks of approximately \$1,400,000, \$2,200,000 and \$7,600,000 in the general fund, special revenue fund - federal and state grants, and capital projects fund, respectively, were fully collateralized at June 30, 2006.

The deposits at GDB of \$49,626 that is restricted for specific purposes in the special revenue fund, the \$765,853 in the other governmental fund that is restricted for debt service are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

**3. RECEIVABLES**

**A. *Municipal License Tax***- 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 Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2006, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2006, net of allowance for uncollectibles.

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

***Intergovernmental Receivables***- Intergovernmental receivable in the special revenue fund – state and federal grants represents expenditures incurred not yet reimbursed by the Federal and state governments. Following is a detail of the intergovernmental receivables:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant –State Program	\$ 67,137
Child Care and Development Block Grant	105,476
Law 52	251,012
Law 82	35,944
Other	<u>1,696</u>
<b>Total</b>	<b><u>\$ 461,265</u></b>

**4. INTERFUND TRANSACTIONS**

Interfund receivables and payables at June 30, 2006, and interfund transfers during the fiscal year ended at June 30, 2006, are summarized as follows:

**a. Due from/to other fund:**

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund – State Federal Grants	Payroll Transfer and Reimbursable Expenditures	<b><u>\$ 444,979</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

**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 2006, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<b>Governmental Activities:</b>	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2006</u>
<b>Capital asset, not being depreciated:</b>				
Land	\$ 14,543,103	\$ 317,724	\$ -	\$ 14,860,827
Construction in progress	<u>4,966,682</u>	<u>2,284,851</u>	<u>(1,943,328)</u>	<u>5,308,205</u>
<b>Total capital assets not being depreciated</b>	<u>19,509,785</u>	<u>2,602,575</u>	<u>(1,943,328)</u>	<u>20,169,032</u>
<b>Capital assets, being depreciated:</b>				
Buildings	\$ 5,039,316	65,000		\$ 5,104,316
Buildings improvements	799,852	1,696,249		2,496,101
Infrastructure	934,072	19,935		954,007
Infrastructure improvements	257,809	1,505,817		1,763,626
Equipment	1,151,274	185,048	(7,251)	1,329,071
Furnishing	168,338	25,186	(2,945)	190,579
Works of art	605			605
Computers	123,841	26,205	(1,135)	148,911
Vehicles	<u>3,417,214</u>	<u>217,859</u>	<u>-</u>	<u>3,635,073</u>
<b>Total capital assets being depreciated</b>	<u>\$ 11,892,321</u>	<u>\$ 3,741,299</u>	<u>(11,331)</u>	<u>\$ 15,622,289</u>
<b>Less accumulated depreciation for:</b>				
Buildings	(\$ 1,526,829)	(\$ 126,254)		(\$ 1,653,083)
Buildings improvements	(117,007)	(50,207)		(167,214)
Infrastructure	(184,796)	(23,676)		(208,472)
Infrastructure improvements	(26,095)	(81,178)		(107,273)
Equipment	(838,653)	(104,402)	6,925	(936,130)
Furnishing	(139,513)	(13,149)	2,638	(150,024)
Works of art	(605)			(605)
Computers	(105,510)	(14,431)	1,135	(118,806)
Vehicles	<u>(2,291,714)</u>	<u>(373,186)</u>	<u>-</u>	<u>(2,664,900)</u>
<b>Total accumulated depreciation</b>	<u>(\$ 5,230,722)</u>	<u>(\$ 786,483)</u>	<u>10,698</u>	<u>(\$ 6,006,507)</u>
<b>Total capital assets being depreciated, net</b>	<u>\$ 6,661,599</u>	<u>2,954,816</u>	<u>(633)</u>	<u>\$ 9,615,782</u>
<b>Governmental activities capital assets, net</b>	<u>\$ 26,171,384</u>	<u>\$ 5,557,391</u>	<u>\$ (1,943,961)</u>	<u>\$ 29,784,814</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**5. CAPITAL ASSETS (CONTINUED)**

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

**Governmental activities:**

General government	\$ 345,777
Public safety	51,830
Public works	210,815
Culture and recreation	28,942
Health and welfare	796
Community development	<u>148,323</u>
<b>Total depreciation expense-governmental activities</b>	<b><u>\$ 786,483</u></b>

**6. PROPERTY TAXES**

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

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. At the date of the release of these financial statements, the CRIM issued the preliminary liquidation noting that the collections exceeded advances by \$292,914. Such amount was presented in the general fund in the fund financial statements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

On December 31, 1992 the Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2006, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$ 5,056 and is payable as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2007	\$ 921
2008	921
2009	921
2010	921
2011-2013	<u>1,372</u>
<b>Total</b>	<b><u>\$ 5,056</u></b>

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 7.83% for real property and 5.83% 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) 1.00% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DEFERRED REVENUES

A. **Municipal License Tax**- The deferred revenues of approximately \$633,023 in the general fund relates to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

**7. DEFERRED REVENUES (CONTINUED)**

**B. Federal Government-** The deferred revenues presented in other governmental funds 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>
Section 8 Housing Choice Voucher	\$ 189,864
Other Federal Grants	<u>44,090</u>
<b>Total</b>	<b><u>\$ 233,954</u></b>

**8. LONG-TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2006, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds and Notes Payable	\$ 1,631,000	\$ -	(\$ 272,000)	\$1,359,000	\$ 223,000
Compensated Absences	1,274,318	195,754	-	1,470,072	141,900
Property Tax Debt- Law 42	588,190	145,875	(10,620)	723,445	11,288
LIMS- Repayment Plan	-	64,243	(8,362)	55,881	8,867
Property Tax Debt- Treasury	<u>5,977</u>	<u>-</u>	<u>(921)</u>	<u>5,056</u>	<u>921</u>
<b>Total</b>	<b><u>\$ 3,499,485</u></b>	<b><u>\$ 405,872</u></b>	<b><u>(\$ 291,903)</u></b>	<b><u>\$ 3,613,454</u></b>	<b><u>\$ 385,976</u></b>

- 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 (excluding notes payable to the Land Authority), is paid with unrestricted funds.
- 2. Bonds and notes payable-** The Municipality issues general and special obligation bonds and notes to provide funds for the acquisition and construction of major capital facilities. The Municipality did not issue bonds and notes during the current year. Bonds and notes payable outstanding at June 30, 2006 are as follows:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

**8. LONG-TERM LIABILITIES (CONTINUED)**

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2006</u>
1984 Series	1-1-07	\$ 143,000	5.00%	\$ 10,000
1995 Series	7-1-16	400,000	6.00 % to 8.00%	265,000
1998 Series	1-1-15	275,000	4.50%	180,000
2001 Series	7-1-24	56,000	4.50%	47,000
2001 Series	7-1-25	38,000	4.50%	32,000
2002 Series	7-1-10	475,000	2.70% to 5.00%	230,000
2004 Series	7-1-10	785,000	5.00% to 6.00%	<u>595,000</u>
<b>Total general obligation bonds</b>				<b><u>\$ 1,359,000</u></b>

These bonds are payable from the ad valorem property tax of 1.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 223,000	\$ 59,055
2008	223,000	46,467
2009	244,000	36,798
2010	170,000	27,842
2011	180,000	22,243
2012-2016	274,000	49,690
2017-2021	25,000	7,875
2022-2026	<u>20,000</u>	<u>2,115</u>
<b>Total</b>	<b><u>\$ 1,359,000</u></b>	<b><u>\$ 252,085</u></b>

3. **Property Tax Debt-** This amount represent the balance owed to the Treasury Department at June 30, 2006 as described in Note 6, from property tax advances in excess of actual collections.
4. **Compensated absences-** The government-wide statement of net assets includes approximately \$1,470,000 of accrued sick leave and vacations benefits, representing the Municipality's commitment to fund such costs from future operations.
5. **Due to other governmental entities -** These amounts represent the balance owed to the Government Development Bank related to the line of credit to pay a debt to the CRIM from the accounts sold to a collection agency.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**9. PENSION PLAN**

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

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

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

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 employer contributions during the year ended June 30, 2006 amounted to approximately \$243,000.

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 NARANJITO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2006**

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**9. 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, 2006, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

**10. RISK MANAGEMENT**

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

**11. CONTINGENCIES**

The Municipality is a defendant in several legal proceedings that arise in the ordinary course of the Municipality's activities. Certain of these claims are covered by insurance. The administration believes that the ultimate liability, if any, would not be significant. As a result, the accompanying basic financial statements do not include adjustments, if any, that could result from the resolution of these legal proceedings.

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 or grantee. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

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**12. BEGINNING FUND BALANCES AND NET ASSETS RESTATEMENT:**

The beginning Fund Balance for General Fund has been restated by approximately \$103,854 to properly presents the previously reported fund balances at June 30, 2005. The restatement is mainly due to the decrease in accounts payables related to prior years.

The beginning Net Assets for Governmental Activities has been restated by approximately \$103,854 to properly present the previously reported Net Assets at June 30, 2005. The restatement is mainly due to fund balance restatements described above.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO**

**BUDGETARY COMPARISON SCHEDULE-GENERAL FUND**

**YEAR ENDED JUNE 30, 2006**

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
<b>REVENUES AND OTHER FINANCING SOURCES:</b>				
Property taxes	\$ 1,263,929	\$ 1,360,233	\$ 1,360,233	\$ -
Municipal license tax	834,814	926,386	956,632	30,246
Licenses, permits and other local taxes	330,00	330,000	331,210	1,210
Charges for service	23,500	23,500	3,525	(19,975)
Intergovernmental	6,225,775	6,225,775	5,907,590	(318,185)
Rent of property	95,000	95,000	76,715	(18,285)
Fines and forfeitures	5,000	5,000	9,010	4,010
Interest	170,000	357,265	428,547	71,282
Miscellaneous	<u>30,000</u>	<u>178,576</u>	<u>295,923</u>	<u>117,347</u>
<b>Total revenues</b>	<u><b>8,978,018</b></u>	<u><b>9,501,735</b></u>	<u><b>9,369,385</b></u>	<u><b>(132,350)</b></u>
<b>EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:</b>				
Current:				
General government	\$ 4,981,140	\$ 5,307,405	\$ 5,257,727	\$ 49,678
Public safety	374,718	372,238	347,181	25,057
Public works	1,637,680	1,659,424	1,518,692	140,732
Health and welfare	1,628,207	1,692,407	1,619,342	73,065
Culture and recreation	356,273	299,009	284,330	14,679
Operating transfer to other funds	<u>                    </u>	<u>171,252</u>	<u>171,252</u>	<u>-</u>
<b>Total expenditures, encumbrances and other financing uses</b>	<u><b>8,978,018</b></u>	<u><b>9,501,735</b></u>	<u><b>9,198,524</b></u>	<u><b>303,211</b></u>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)</b>	<u><b>-</b></u>	<u><b>-</b></u>	<u><b>170,861</b></u>	<u><b>170,861</b></u>
<b>Explanation of Differences:</b>				
<b>Sources/inflows of resources:</b>				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 9,369,385
Differences-budget to GAAP:				
GAAP adjustments to revenues				<u>259,579</u>
<b>Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances</b>				<u><b>\$ 9,628,964</b></u>
<b>Uses/outflows of resources:</b>				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 9,198,524
Differences-budget to GAAP:				
Non-budgeted expenditures				22,771
Prior year encumbrances recorded as current year expenditures for GAAP basis				14,200
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(14,200)</u>
<b>Total expenditures and other financial uses as reported on the statement of revenues, expenditures, and changes in fund balances</b>				<u><b>\$ 9,221,295</b></u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF NARANJITO

NOTES TO BUDGETARY COMPARISON SCHEDULE-GENERAL FUND

YEAR ENDED JUNE 30, 2006

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**1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

**A. Budgetary Control**

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

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2006 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2006.



**Guzman Torres & Co., PSC**  
Certified Public Accountants & Business Advisors

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

Hon. Mayor and Members of  
the Municipal Assembly  
Municipality of Naranjito  
Naranjito, Puerto Rico

We have audited the general-purpose financial statement of Municipality of Naranjito as of and for the year ended June 30, 2006 and have issued our report there on dated December 31, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether Municipality of Naranjito general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of 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 that are required to be reported under Government Auditing Standards which are described in the accompanying schedule of finding and questioned costs as items Section II-I Accounting Records and Report.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Municipality of Naranjito internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Municipality of Naranjito's ability to record, process, summarize and report financial data consistent with the assertions of management in the general purpose financial statement. Reportable conditions are described in accompanying schedule of findings and questioned cost as items Section II-I Accounting Systems and Reports.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matter in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions described above is a material weakness.

This report in intended for the information of the management of Municipality of Naranjito, and Naranjito Municipal Assembly. However, this report is a matter of public record and its distribution is not limited.

*Guzmán Torres & Co.'s P.S.C.*

GUZMAN TORRES & CO., PSC.

December 30, 2006  
San Juan, Puerto Rico  
License No. 168

Stamp No. 2186691 was affixed to the original of this report.

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



**Guzman Torres & Co., PSC**  
Certified Public Accountants & Business Advisors

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

**Honorable Major and Members  
of the Municipal Assembly  
Municipality of Naranjito  
Naranjito, Puerto Rico**

**Compliance:**

We have audited the compliance of Municipality of Naranjito, with the types of compliance requirements described in the US Office of Management and Budget (OMB) Circular A - 133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2006. Municipality of Naranjito major federal programs are identified in the summary of auditor's results section of the accompanying schedule and questioned costs. Compliance with the requirements of laws regulations, contract and grants applicable to each of this major federal programs is responsibility of Municipality of Naranjito management. Our responsibility is to express an opinion on the Municipality of Naranjito compliance based on our audit.

We conducted our audit in accordance with auditing standard 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 United States; OMB Circular A - 133, Audits of States and Local Governments, and Non Profit Organizations. Those standards and OMB Circular A - 133 require that we plan and perform the audit obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major program occurred. An audit includes, examining, on a test basis, evidence about Municipality of Naranjito compliance with those requirements and performing such other procedures as we consider necessary in the circumstance. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Municipality of Naranjito compliance with those requirements.

In our opinion, Municipality of Naranjito complied, in all material respect, with the requirements referred to above that are applicable to each of its major programs for the year ended June 30, 2006.

## **Internal Control Over Compliance**

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

Our consideration of the internal control compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of law, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We note no matters involving the internal control over compliance and its operations that we consider to be material weakness.

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Municipality of Naranjito, Puerto Rico, as of and for the year ended June 30, 2006, and have issued our report thereon dated December 30, 2006. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Naranjito, Puerto Rico, basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. 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.

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

*Guzman Torres & Co., P.S.C.*

**GUZMAN TORRES & CO., PSC.**

December 30, 2006  
San Juan, Puerto Rico  
License No. 168

Stamp No. 2186692 was affixed to the original report.

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006**

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF EXPENDITURE OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006**

<b>FEDERAL GRANTOR/PASS THROUGH GRANTOR PROGRAM TITLE</b>	<b>FEDERAL CFA NUMBER</b>		<b><u>EXPENDITURES</u></b>
<b>US Department of Housing and Urban Development</b>			
Passed through the Puerto Rico Office of the Commissioner of Municipal Affairs State Block Grant Program			
Small Cities Program-	14.219	→	\$ 865,403
Direct Program:			
Section 8 – Lower Income Housing Assistance Payment Program	14.856	→	<u>667,152</u>
Total US Department of HUD			<u>1,532,555</u>
<b>US Department of Health and Human Service (HHS):</b>			
Passed through Office of Governor Special Program of aging:			
CE Title III, Part B – Grant for Supportive Child Care	93.044 93.575		13,970 <u>144,088</u> <u>158,058</u>
<b>US Department of Agriculture</b>			
Direct program:			
Nutrition Assistance of Puerto Rico	10.566		<u>18,209</u>
Total of Federal Awards			<u>\$1,708,822</u>
→ Mayor program			
SBGP	14.219		
Section 8	14.856		

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF FINDING AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006**

**SECTION I – SUMMARY OF AUDITOR’S RESULTS  
Financial Statements**

**Type of auditor’s report issued**

**Unqualified**

Internal control over financial reporting:

- Material weakness(es) identified?
- Reportable condition(s) identified that are not considered to be material weaknesses?

\_\_\_ Yes      X No  
X Yes      \_\_\_ None reported

Noncompliance material to financial statements noted?

\_\_\_ Yes      X No

**Federal Awards**

Internal control over major program:

- Reportable condition(s) identified that are not considered to be material weakness(es)

\_\_\_ Yes      X None reported

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

Any audit findings disclosed that are Required to be reported in accordance With section 510(a) of Circular A-133?

\_\_\_ Yes      X No

Identification of major programs:

CFDA Number(s)

Name of Federal Program Cluster

14.219  
14.856

State Block Grant Program  
Section 8

Dollar threshold used to distinguish Between type A and type B programs:

\$500,000

Audited qualified as low-risk audited?

\_\_\_ Yes      X No

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF FINDING AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006**

**SECTION II – FINACIAL STATEMENTS FINDINGS**

The Municipality of Naranjito has been subject to various audits and program monitoring compliance over the past years. Most of the audit finding for the year ended June 30, 2006 are repetitive in nature because in most instance corrective action are in process and are included below for follow-up purpose.

**ACCOUNTING RECORDS AND REPORTS:**

Our study and evaluation of the Municipality's accounting records and related internal control procedure disclosed the following:

- A- As part of the responsibilities of the office of the Commissioner of Municipal Affairs an uniform accounting system was installed in the Municipality. At, present, transaction are accounted through manual and computerized accounting system. However, differences in balance were noted in both systems and no reconciliation was performed. Moreover, the Municipal did not comply with Law No. 81 of 1991, ("Ley de Municipios Autonomos del Estado Libre Asociado de Puerto Rico"). This law provides for constitution, organization, administration and operation of the Municipalities' government. Also, it provides for the modernization of the systems and procedures in order to establish efficient accounting control and operating procedures.
  
- B- The accounting records kept by the Municipality cannot perform the following information:
  - 1. Provide for a balance separate self balancing accounts group that compose its assets, liabilities, fund equity, revenue and expenditures as required by GAAP.
  - 2. provide for a proper segregation between encumbrances and accounts payable.
  - 3. The Municipality is not utilizing properly the subsidiary ledger provide for a subsidiary ledger of general long term debt.

We believe the Municipality shall assign this responsibility to special task force composed of personnel from different divisions of the Municipality to have this system working at full capacity shortly. The benefits to be derived will exceed the extra effort needed.

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF FINDING AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006**

**SECTION II – FINANCIAL STATEMENTS FINDINGS**

**ACCOUNTING RECORDS AND REPORTS (CONTUNUED):**

As part of this process, a comprehensive plan should be established to evaluate the operations of the system as well as to establish the necessary input and output control system.

- C- During our examination of the Municipality's property records we noted the following:
1. No system has been established to gather all capitalizable cost of construction progress.
  2. Not all property is identified by prenumbered labels to indicate the Municipality's ownership.
  3. Acquisition of property is not included in the property an equipment ledger.

An accounting system must make it possible to:

- A Present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles; and
- B Determine and demonstrate compliance with finance, legal and contractual provisions.

In order to streamline the accounting and reporting system and provide proper closing of records and adequate and timely information, we recommend that the Municipality's system be modified through the implementation of the appropriate accounting records and procedures.

**DISBURSEMENT TEST**

**Finding:**

During our audit we selected a sample of 60 checks for a total amount observed of \$421,285 and we noted the following:

- In 14 cases no evidence of quotations was found.
- In one voucher no signature were found for the Finance Director and Major.
- In 2 cases the voucher form were not signed by the Major.
- In 6 cases, checks were signed by a person other by the Finance Director.

**Questioned Cost:**  
None

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF FINDING AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006**

**SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS:**

**SECTION 8**

**Finding 1:**

The municipality do not provide for a private office space for interview with tenants. All interviews were made in an open office space. Under HUD regulation the municipality should provide a private office for interview with tenants.

**Questioned Cost:**

None.

**Finding 2:**

During our disbursement test in this program we select 40 checks for a total of \$19,495 and we noted the following:

- In one case the voucher to request check was not signed by the Finance Director
- In three cases the supporting documents included in the payment were not cancelled with a "PAID" stamp.
- One check was not signed but cleared by the bank.

**Questioned Cost:**

None.

**Finding 3:**

During our procedures related to eligibility of the program participants (25 participants selected), none of the files have an application form for the program. Federal regulation required that an application form be part of the participant file.

**Questioned Cost:**

None.

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF FINDING AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006**

**SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS:**

**SBGP Program**

**Finding:**

In our disbursement test we selected a sample of 50 checks for a total of \$512,055 and noted the following:

- In 14 cases the request for services or supplies were not prepared.

**Questioned Cost:**

None.

**MUNICIPALITY OF NARANJITO  
STATUS OF PRIOR YEAR UNCORRECTED  
AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006**

**MUNICIPALITY OF NARANJITO  
STATUS OF PRIOR YEARS UNCORRECTED AUDITS FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006**

The Municipality of Naranjito, has been subjected to various audits and program monitoring compliance over past years. Following is a summary of audit findings for which final determination and/or corrective action are in process. Most of these findings still prevail for the year ended June 30, 2006. This summary includes a brief description of the findings and their status. Repeat findings from the audit report for the year ended June 30, 2004, are included as current year findings for the current year audit report. Therefore, findings included in the audit report for the year ended June 30, 2006, encompass unresolved findings mentioned in the audit report for the fiscal year ended June 30, 2004, dated January 15, 2005.

**MUNICIPALITY OF NARANJITO  
SCHEDULE OF PRIOR YEARS UNCORRECTED FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006**

<b>AUDIT REPORT</b>	<b>QUESTIONED COST</b>	<b>ACTUAL STATUS</b>
<b>SINGLE AUDIT REPORT FOR THE YEAR ENDED JUNE 30, 2003</b>		
<b>Accounting Records and Reports:</b>		
1. Differences in balance in manual and computerized accounting reports without any reconciliation been made in both systems.	\$ - 0 -	Conditions continues see current year findings.
2. The accounting records kept by the Municipality can not prefer the Following forms:		
a. provide for a self-balancing group accounts that compose its assets, liabilities fund balances, revenue and expenditures.	\$ - 0 -	Conditions continues see current year findings.
b. Provide proper segregation between encumbrances and account payable	\$ - 0 -	Conditions continues see current year findings.
c. Provide for a subsidiary of Long Term Debt.	\$ - 0 -	Conditions continues see current year findings.
3. During our examination of the Municipality's property records we noted the following:		
a. No system has been established to gather all capitalizable costs of construction in progress.		Conditions continues see current year findings.
b. Not all property is identified by renumbered labels to indicate the Municipality's ownership.		Conditions continues see current year findings.