

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

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



guzmán torres & co., psc
certified public accountants & business advisors

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO
BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2008

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF NARANJITO

YEAR ENDED JUNE 30, 2008

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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, 2008, 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.

Except as discussed in the following paragraph, 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.

We were unable to obtain a discussion or evaluation from the Municipality of Naranjito's outside legal counsel of the pending or threatened litigation described in Note 14.

In our opinion, except for the effect of the adjustments, if any, as might have been determined to be necessary had we been able to obtain a discussion or evaluation of pending or threatened litigation from the Municipality of Naranjito's outside legal counsel as discussed in the preceding paragraph, 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, 2008, 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 34 through 34 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.

Guzman Torres & Co., PSC
GUZMAN TORRES & CO., PSC.

December 30, 2008
San Juan, Puerto Rico
License No. 168

Stamp No. 2382969 was affixed to the original of this report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

MANAGEMENT'S AND DISCUSSION ANALYSIS

YEAR ENDED JUNE 30, 2008

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, 2003. 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 \$ 3,519,803.
- In the fund financial statements, the governmental activities revenue decrease \$1,912,473 (or 11%) while governmental activities expenditures decrease 3,066,727 (or 18%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, a decrease of \$ 862,850.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$1,033,358.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

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MUNICIPALITY OF NARANJITO

MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

information is useful in evaluating the Municipality's near term financial requirements.

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 \$52,939,862 at the end of 2008, compared to

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

\$49,420,059 at the end of the previous year. Such increase in the total assets is mainly due to the capitalization of infrastructure assets.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Condensed Statement of Net Assets
June 30, 2008

Current assets	\$ 13,835,881
Capital assets	<u>50,319,115</u>
Total assets	<u>64,154,996</u>
Current liabilities	1,650,774
Noncurrent liabilities	<u>9,564,360</u>
Total liabilities	<u>11,215,134</u>
Invested in capital assets, net of related debt	42,686,115
Restricted	10,882,572
Unrestricted (deficit)	<u>(628,825)</u>
Total net assets	<u>\$ 52,939,862</u>

Changes in Net Assets

The Municipality's net assets increased by \$ 3,519,803. Approximately 28 percent of the Municipality's total revenue came from taxes, while 67 percent resulted from grants and contributions, including federal aid. 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, and health and welfare services. 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, 2008

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Condensed Statement of Activities
June 30, 2008

Program revenues:	
Charges for services	\$ 100,524
Operating grants and contributions	2,907,268
Capital grants and contributions	2,478,271
General revenues:	
Property taxes	2,038,696
Municipal license tax	1,358,287
Municipal sales and use tax	1,237,690
Grants and contributions not restricted to specific programs	5,522,153
Interest and investment earnings	394,379
Miscellaneous	<u>255,684</u>
Total revenues	<u>16,292,952</u>
Expense:	
General government	5,881,734
Public safety	315,561
Public works	3,229,709
Culture and recreation	349,273
Health and welfare	2,429,563
Community development	321,803
Economic development	53,666
Interest on long-term debt	<u>191,840</u>
Total expenses	<u>12,773,149</u>
Change in net assets	3,519,803
Net assets, beginning of year as restated	<u>49,420,059</u>
Net assets, end of year	<u>\$52,939,862</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

MANAGEMENT'S AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2008

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 \$11,715,951 a decrease of \$1,071,480 in comparison with the prior year. There are reservations of fund balance amounting to \$9,738,867. 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 (\$19,000), 2) to pay for capital projects (\$9,289,100) and 4) for other purposes (\$430,767).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2008, the general fund has a fund balance of \$833,379.

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, 2008

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2008, amounts to \$59,819,706, with an accumulated depreciation of \$(9,500,591), leaving a net book value of \$ 50,319,115. 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 \$7,444,314 in terms of net book value. Depreciation charges for the year totaled \$ 948,923.

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, 2008 the Municipality has \$9,289,100 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, 2008

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal 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 2008-2009 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, 2008

Governmental
Activities

Assets

Cash and cash equivalents	\$ 8,534,255
Cash with fiscal agent	4,828,208
Accounts receivable:	
Municipal license tax	4,262
Intergovernmental	469,156
Capital assets	
Land, improvements, and construction in progress	38,520,709
Other capital assets, net of depreciation	11,798,406
Total capital assets	<u>50,319,115</u>
 Total assets	 <u>64,154,996</u>

Liabilities

Accounts payable and accrued liabilities	697,629
Due to other governmental entities	86,556
Deferred revenues:	
Municipal license tax	619,525
Federal grant revenues	247,064
Noncurrent liabilities:	
Due within one year	440,276
Due in more than one year	<u>9,124,084</u>
 Total liabilities	 <u>11,215,134</u>

Net Assets

Invested in capital assets, net of related debt	42,686,115
Restricted for:	
Capital projects	9,289,100
Debt service	1,162,705
Federal and state grant funds	430,767
Unrestricted (deficit)	<u>(628,825)</u>
 Total net assets	 <u>\$ 52,939,862</u>

Commonwealth of Puerto Rico
Municipality of Naranjito
Statement of Activities
For the Year Ended June 30, 2008

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	\$ 5,881,734	\$ 71,651	\$ 760,058		\$ (5,050,025)
Public safety	315,561	3,648	98,888		(213,025)
Public works	3,229,709	22,125	611,683	1,338,407	(1,257,494)
Health and welfare	2,429,563		1,046,701		(1,382,862)
Culture and recreation	349,273	3,100	8,971	1,139,864	802,662
Community development	321,803		380,967		59,164
Economic development	53,666				(53,666)
Interest on long-term debt	191,840				(191,840)
Total governmental activities	\$ 12,773,149	\$ 100,524	\$ 2,907,268	\$ 2,478,271	\$ (7,287,086)
General revenues:					
Property taxes					2,038,696
Municipal license tax					1,358,287
Municipal sales and use tax					1,237,690
Grants and contributions not restricted to specific programs					5,522,153
Interest and investment earnings					394,379
Miscellaneous					255,684
Total general revenues					10,806,889
Change in net assets					3,519,803
Net assets - beginning					49,420,059
Net assets - ending					\$ 52,939,862

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

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

	General Fund	Special Revenue State and Federal Grants	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Cash and cash equivalents	\$ 1,538,729	\$ 1,089,569	\$ 5,905,957	\$ -	\$ 8,534,255
Cash with fiscal agent		3,583	3,661,920	1,162,705	4,828,208
Accounts receivable:					
Municipal license tax	4,262				4,262
Intergovernmental	469,156				469,156
Due from other funds	365,768				365,768
Total assets	<u>\$ 2,377,915</u>	<u>\$ 1,093,152</u>	<u>\$ 9,567,877</u>	<u>\$ 1,162,705</u>	<u>\$ 14,201,649</u>
Liabilities and Fund Balances					
Liabilities :					
Accounts payable and accrued liabilities	\$ 369,299	\$ 49,553	\$ 278,777	\$ -	\$ 697,629
Due to other governmental entities	86,556				86,556
Due to other funds		365,768			365,768
Deferred revenues:					
Municipal license tax	619,525				619,525
Intergovernmental	469,156				469,156
Federal grant revenues		247,064			247,064
Total liabilities	<u>1,544,536</u>	<u>662,385</u>	<u>278,777</u>	<u>-</u>	<u>2,485,698</u>
Fund balances:					
Reserved for:					
Encumbrances	19,000				19,000
Capital projects			9,289,100		9,289,100
Other purposes		430,767			430,767
Reserved reported in nonmajor funds:					
Debt service fund				1,162,705	1,162,705
Unreserved:					
Undesignated	814,379				814,379
Total fund balances	<u>833,379</u>	<u>430,767</u>	<u>9,289,100</u>	<u>1,162,705</u>	<u>11,715,951</u>
Total liabilities and fund balances	<u>\$ 2,377,915</u>	<u>\$ 1,093,152</u>	<u>\$ 9,567,877</u>	<u>\$ 1,162,705</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	50,319,115
Accrual basis of accounting accounts receivable recognized in government-wide financial statements	469,156
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds	<u>(9,564,360)</u>
Net assets of governmental activities	<u>\$ 52,939,862</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, 2008

	General Fund	Special Revenue State and Federal Grants	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
Revenues					
Property taxes	\$ 2,038,696			\$ 314,512	\$ 2,353,208
Municipal sales and use tax	1,043,775			306,827	1,350,602
Municipal license taxes	930,863				930,863
Licenses, permits and other local taxes	311,857				311,857
Intergovernmental	5,372,174	989,705	2,478,272		8,840,151
Rent of property	93,775				93,775
Fines and forfeitures	3,648				3,648
Interest	394,379				394,379
Charge for services	3,100				3,100
Federal grants		1,326,813			1,326,813
Miscellaneous	108,485		123,510		231,995
Total revenues	\$ 10,300,752	\$ 2,316,518	\$ 2,601,782	\$ 621,339	\$ 15,840,391
Expenditures					
Current:					
General government	6,405,150	588,127	4,220		6,997,497
Public safety	448,116	258,127			706,243
Public works	2,136,389	712,751	4,518,253		7,367,393
Health and welfare	1,798,849	1,020,493			2,819,342
Culture and recreation	338,959	15,895	1,167,005		1,521,859
Community development		556,031			556,031
Economic development		53,666			53,666
Debt service:					
Principal				263,000	263,000
Interest				191,840	191,840
Total expenditures	11,127,463	3,205,090	5,689,478	454,840	20,476,871
Excess (deficiency) of revenues over (under) expenditures	(826,711)	(888,572)	(3,087,696)	166,499	(4,636,480)
Other financing sources (uses)					
Long-term debt issued			3,565,000		3,565,000
Transfers in				36,139	36,139
Transfers out	(36,139)				(36,139)
Total other financing sources (uses)	(36,139)	-	3,565,000	36,139	3,565,000
Net changes in fund balances	(862,850)	(888,572)	477,304	202,638	(1,071,480)
Fund balance, beginning	1,696,229	1,319,339	8,811,796	960,067	12,787,431
Fund balance, ending	\$ 833,379	\$ 430,767	\$ 9,289,100	\$ 1,162,705	\$ 11,715,951

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

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, 2008

Net Change in Fund Balances - Total Governmental Funds \$ (1,071,480)

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. 8,767,067

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. -

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 (948,922)

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. (373,830)

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. 448,968

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 (3,302,000)

Change in Net Assets of Governmental Activities \$ 3,519,803

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2008

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 ("USGAAP") as applicable to governmental units.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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, as amended by the GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units an amendment of GASB Statement 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, the Municipality does not have component units to include within its reporting entity.

B. Government-wide and fund financial statements

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

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

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

Special Revenue Fund - State 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, 2008

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

C. Financial reporting presentation

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

General Fund- 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 ("USGAAP") 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, 2008

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 expenditures in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

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

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, 2008

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

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, 2008

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, 2008

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

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

10. Risk financing- The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2008 amounted to approximately \$217,000. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$163,000 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 following table details the difference:

Bonds and Notes Payable	(\$ 7,633,000)
Accrued compensated absences	(1,115,170)
Property tax debt-Law 42	(700,161)
LIMS-Repayment Plan	(37,611)
Due to other governmental entity -Law 146	(75,204)
Property tax debt - Treasury Department	(3,214)
Accrual basis of accounting accounts receivable	469,156
Capital assets, net of depreciation	50,229,115
Net adjustment to increase fund balance total governmental funds to arrive at net assets-governmental activities	<u>\$ 41,133,911</u>

2. DEPOSITS

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

2. DEPOSITS (CONTINUED)

The Municipality's bank balances in commercial banks of approximately \$1,500,000, \$1,100,000 and \$5,900,000 in the general fund, special revenue fund – federal and state grants, and capital projects fund, respectively, were fully collateralized at June 30, 2008.

The deposits at GDB of \$3,583 that is restricted for specific purposes in the special revenue fund, \$ 3,661,920 in the capital projects fund and \$1,162,705 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.

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, 2008, the tax rates were as follows:

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

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2008, net of allowance for uncollectible accounts.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

3. RECEIVABLES (CONTINUED)

B. *Property Tax*- Property tax receivable in the general fund represents the balance owed from the Municipal Revenue Collection Center (CRIM) at June 30, 2008, as described in Note 6. Also, part of this property tax receivable represents the amount due from the CRIM related to delinquent debts. Following is a detail of the property tax receivables:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM)	\$ <u>469,156</u>
Total	\$ <u>469,156</u>

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2008, and interfund transfers during the fiscal year ended at June 30, 2008, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund - State Federal Grants	Payroll Transfer and Reimbursable Expenditures	\$ <u>365,768</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2008, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to

<u>Governmental Activities:</u>	<u>Balance July 1, 2007</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2008</u>
Capital asset, not being depreciated:				
Land	\$ 21,914,897	\$ -	\$ -	\$ 21,914,897
Construction in progress	<u>9,522,528</u>	<u>7,454,163</u>	<u>(370,879)</u>	<u>16,605,812</u>
Total capital assets not being depreciated	<u>31,437,425</u>	<u>7,454,163</u>	<u>(370,879)</u>	<u>38,520,709</u>
Capital assets, being depreciated:				
Buildings	\$ 5,104,316	\$ -	\$ -	\$ 5,104,316
Buildings improvements	2,497,891	386,381	-	2,884,272
Infrastructure	4,736,721	266,591	-	5,003,312
Infrastructure improvements	2,158,568	430,210	-	2,588,778
Equipment	1,408,148	134,309	(7,125)	1,535,332
Furnishing	207,147	38,406	(3,146)	242,407
Works of art	605	-	-	605
Computers	181,902	31,615	(8,307)	205,210
Vehicles	<u>3,752,023</u>	<u>25,392</u>	<u>(42,650)</u>	<u>3,734,765</u>
Total capital assets being depreciated	<u>\$ 20,047,321</u>	<u>\$ 1,312,904</u>	<u>\$ (61,228)</u>	<u>\$ 21,298,997</u>
Less accumulated depreciation for:				
Buildings	\$ (1,780,691)	\$ (127,608)	\$ -	\$ (1,908,299)
Buildings improvements	(229,660)	(66,770)	-	(296,430)
Infrastructure	(1,988,304)	(124,200)	-	(2,112,504)
Infrastructure improvements	(241,065)	(154,830)	-	(395,895)
Equipment	(1,039,005)	(136,258)	4,299	(1,170,964)
Furnishing	(163,065)	(17,998)	3,022	(178,041)
Works of art	(605)	-	-	(605)
Computers	(138,978)	(27,979)	8,306	(158,651)
Vehicles	<u>(3,028,572)</u>	<u>(293,280)</u>	<u>42,650</u>	<u>(3,279,202)</u>
Total accumulated depreciation	<u>\$ (8,609,945)</u>	<u>\$ (948,923)</u>	<u>\$ 58,277</u>	<u>\$ (9,500,591)</u>
Total capital assets being depreciated, net	<u>\$ 11,437,376</u>	<u>\$ 363,981</u>	<u>\$ (2,951)</u>	<u>\$ 11,798,406</u>
Governmental activities capital assets, net	<u>\$ 42,874,801</u>	<u>\$ 7,818,144</u>	<u>\$ (373,830)</u>	<u>\$ 50,319,115</u>
depreciation:				

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 282,486
Public safety	60,847
Public works	390,421
Culture and recreation	49,361
Health and welfare	849
Community development	164,879
Education	<u>80</u>

Total depreciation expense-governmental activities \$ 948,923

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

<u>Description</u>	<u>General Fund</u>	<u>Special Revenue Fund - State & Local Grants</u>	<u>Capital Projects Fund - State & Local Grants</u>	<u>Other Governmental Fund</u>	<u>Total</u>
Accounts payable	\$ 360,409	\$ 49,553	\$ 278,777	\$ -	\$ 688,739
Accrued liabilities	<u>8,890</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,890</u>
Total	<u>\$ 369,299</u>	<u>\$ 49,553</u>	<u>\$ 278,977</u>	<u>\$ -</u>	<u>\$ 697,629</u>

7. MUNICIPAL SALES AND USE TAX

On November 8, 2006, the Municipal Legislature approved the Ordinance No. 7, Series 2006-2008, which imposes a Municipal Citizen's Contribution (sales and use tax) of 1.5%. The collection of said Contribution began on November 15, 2006. The Municipality collected approximately \$1,350,000 during the year ended on June 30, 2008.

8. DUE TO OTHER GOVERNMENTAL ENTITIES

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

<u>Governmental Entity</u>	<u>Amount</u>
General Services Administration	\$ 1,573
State Insurance Fund	45,325
Retirement System Administration	1,839
Treasury Department	7,117
Puerto Rico Telephone	17,226
Puerto Rico Aqueduct and Sewer Authority	<u>1,313</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Commonwealth of Puerto Rico Employee Association	12,163
Total	\$ 86,556

9. 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 \$469,156. In the governmental funds, the entire receivable has been offset by deferred revenue since the excess was not available to pay liabilities of the current period. In the government-wide financial statements, the entire receivable is recognized as revenue.

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, 2008, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$ 3,214 and is payable as follows:

<u>Year Ending</u> <u>June 30,</u>	<u>Amount</u>
2009	\$ 921
2010	921
2011	921
2012	<u>451</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

Total	<u>\$ 3,214</u>
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9. PROPERTY TAXES (CONTINUED)

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

The annual tax rate is 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.

10. DEFERRED REVENUES

- A. Municipal License Tax- The deferred revenues of approximately \$619,000 in the general fund relates to municipal license tax collected in fiscal year 2007-08 that will be earned in fiscal year 2008-09.
- B. 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	\$ 217,327
Other Federal Grants	<u>29,737</u>
Total	<u>\$ 247,064</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

11. LONG-TERM LIABILITIES

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

Description	Beginning Balance	Borrowings or Additions	Payments or Deductions	Ending Balance	Due Within One Year
Bonds and Notes Payable	\$4,331,000	\$3,565,000	(\$ 263,000)	\$7,633,000	\$ 294,000
Compensated Absences	1,086,123	29,047		1,115,170	119,500
Property Tax Debt- Law 42	712,157	-	(11,996)	700,161	12,751
LIMS- Repayment Plan	47,014	-	(9,403)	37,611	9,970
Due to other governmental entity - Law 146	78,338	-	(3,134)	75,204	3,134
Property Tax Debt- Treasury	<u>4,135</u>	<u>-</u>	<u>(921)</u>	<u>3,214</u>	<u>921</u>
Total	<u>\$ 6,258,767</u>	<u>\$ 3,594,047</u>	<u>(\$ 288,454)</u>	<u>\$ 9,564,360</u>	<u>\$ 440,276</u>

1. Legal debt margin- The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (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. Bonds and notes payable outstanding at June 30, 2008 are as follows:

Type of bonds	Maturity Date	Original Amount	Range of Interest Rates	Balance at June 30, 2008
1995 Series	7-1-16	400,000	6.00 % to 8.00%	\$ 225,000
1998 Series	1-1-15	275,000	4.50%	150,000
2001 Series	7-1-24	56,000	4.50%	43,000
2001 Series	7-1-25	38,000	4.50%	30,000
2002 Series	7-1-10	475,000	2.70% to 5.00%	85,000
2004 Series	7-1-10	785,000	5.00% to 6.00%	380,000
2007 Series	7-1-32	3,195,000	7.50%	3,155,000
2008 Series	7-1-14	880,000	3.93% to 7.25%	880,000
2008 Series	7-1-32	2,685,000	3.93% to 7.25%	<u>2,685,000</u>
Total general obligation bonds				<u>\$ 7,633,000</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

11. LONG-TERM LIABILITIES (CONTINUED)

These bonds are payable from the special 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 and notes payable are as follows:

<u>Year Ending</u> <u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 294,000	393,233
2010	385,000	512,442
2011	415,000	488,186
2012	296,000	467,541
2013	317,000	444,145
2014-2018	1,306,000	1,903,717
2019-2023	1,121,000	1,506,612
2024-2028	1,559,000	1,018,064
2029-2034	<u>2,940,000</u>	<u>338,149</u>
Total	<u>\$ 7,633,000</u>	<u>\$ 7,072,089</u>

3. Property Tax Debt- This amount represent the balance owed to the CRIM at June 30, 2008 as described in Note 9, from property tax advances in excess of actual collections.
4. Compensated absences- The government-wide statement of net assets includes approximately \$1,115,000 of accrued sick leave and vacations benefits, representing the Municipality's commitment to fund such costs from future operations.
5. Due to other governmental entity - This amount represents the balance owed to the Government Development Bank related to a loan to pay a debt to the CRIM from the accounts sold to a collection agency, as described in Note 9.

12. PENSION PLAN

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

12. PENSION PLAN (CONTINUED)

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

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

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

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employer contributions during the year ended June 30, 2008 amounted to approximately \$309,000. This amount represented 100% of the required contribution.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

12. PENSION PLAN (CONTINUED)

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

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

13. RISK MANAGEMENT

The Property Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Department Division submits the data regarding the Municipality's properties to the Area of 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. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

14. 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2008

14. CONTINGENCIES (CONTINUED)

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

BUDGETARY COMPARISON SCHEDULE-GENERAL FUND

YEAR ENDED JUNE 30, 2008

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Property taxes	\$ 1,775,530	\$ 1,775,530	\$ 2,038,696	\$ 263,166
Municipal license tax	900,000	900,000	1,021,502	121,502
Municipal sales and use tax	989,800	989,800	930,863	(58,937)
Licenses, permits and other local taxes	205,000	205,000	311,857	106,857
Charges for service	3,000	3,000	3,100	100
Intergovernmental	6,030,871	6,030,871	5,372,174	(658,697)
Rent of property	75,000	75,000	93,775	18,775
Fines and forfeitures	8,000	8,000	3,648	(4,352)
Interest	120,000	120,000	394,379	274,379
Miscellaneous	52,000	52,000	108,485	56,485
Total revenues	<u>10,159,201</u>	<u>10,159,201</u>	<u>10,278,479</u>	<u>119,278</u>
Budget carryover (1)	-	1,920,481	1,920,481	-
Total revenues after carryover	<u>10,159,201</u>	<u>12,079,682</u>	<u>12,198,960</u>	<u>119,278</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	\$ 5,333,663	\$ 7,059,957	\$ 6,407,150	\$ 652,807
Public safety	506,516	489,816	448,116	41,700
Public works	1,965,186	2,216,548	2,136,389	80,159
Health and welfare	1,949,384	1,915,209	1,798,849	116,360
Culture and recreation	366,077	359,777	338,959	20,818
Operating transfer to other funds	38,375	38,375	36,139	2,236
Total expenditures, encumbrances and other financing uses	<u>10,159,201</u>	<u>12,079,682</u>	<u>11,165,602</u>	<u>914,080</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>-</u>	<u>-</u>	<u>1,033,358</u>	<u>1,033,358</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 12,198,960
Differences-budget to USGAAP:				
Non-budgeted revenues				22,273
Budget carryover				(1,920,481)
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,300,752</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 11,165,602
Differences-budget to USGAAP:				
Prior year encumbrances recorded as current year expenditures for USGAAP basis				17,000
Current year encumbrances recorded as expenditures for budgetary purposes				(19,000)
Total expenditures and other financial uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 11,163,602</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

NOTES TO BUDGETARY COMPARISON SCHEDULE-GENERAL FUND

YEAR ENDED JUNE 30, 2008

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

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

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2008 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2008.

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



guzmán 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, 2008 and have issued our report there on dated December 30, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

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., P.S.C.

GUZMAN TORRES & CO., PSC.

December 30, 2008
San Juan, Puerto Rico
License No. 168

Stamp No. 2382970 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**



guzmán 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, 2008. 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, 2008.

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, 2008, and have issued our report thereon dated December 30, 2008. 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.
GUZMAN TORRES & CO., PSC.

December 30, 2008
San Juan, Puerto Rico
License No. 168

Stamp No. 2382971 was affixed to the original report.

**MUNICIPALITY OF NARANJITO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2008**

**MUNICIPALITY OF NARANJITO
SCHEDULE OF EXPENDITURE OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2008**

<u>FEDERAL GRANTOR/PASS THROUGH GRANTOR PROGRAM TITLE</u>	<u>FEDERAL CFA NUMBER</u>		<u>EXPENDITURES</u>
US Department of Housing and Urban Development			
Passed through the Puerto Rico Office of the Commissioner of Municipal Affairs State Block Grant Program			
Small Cities Program-	14.219	→	\$ 546,812
Direct Program:			
Section 8 – Lower Income Housing Assistance Payment Program	14.856	→	<u>754,761</u>
Total US Department of HUD			<u>1,301,573</u>
US Department of Health and Human Service (HHS):			
Passed through Office of Governor Special Program of aging:			
CE Title III, Part B – Grant for Supportive Child Care	93.044		18,268
	93.575		<u>108,745</u>
			<u>127,013</u>
US Department of Agriculture			
Direct program:			
Nutrition Assistance of Puerto Rico	10.566		<u>36,440</u>
Total of Federal Awards			<u>\$1,465,026</u>

→ Mayor program

Section 8	14.871
SBGP	14.219

**MUNICIPALITY OF NARANJITO
SCHEDULE OF FINDING AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2008**

**MUNICIPALITY OF NARANJITO
SCHEDULE OF FINDING AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2008**

**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
----------------	---------------------------------

14.856	Section 8
14.219	SBGP

Dollar threshold used to distinguish
 Between type A and type B programs:
 Audited qualified as low-risk audited?

\$300,000
 ___ Yes X No

**MUNICIPALITY OF NARANJITO
SCHEDULE OF FINDING AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2008**

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, 2008 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, 2008**

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

During our audit we selected a sample of 60 checks for a total amount observed of \$2,206,064.57 and we noted the following:

- In 5 cases the canceled check were not found
- In 4 cases the voucher to request check were not signed by the Director of Finance
- In 19 cases the voucher to request check were not signed by the Executive Director
- In 3 cases the voucher to request check were not signed by the person in-charge of made the payments (Oficial Pagador).
- In 3 cases the voucher to request check were not signed by the accounting person in charge of analize the payments. (Oficial Pre interventor)

**MUNICIPALITY OF NARANJITO
SCHEDULE OF FINDING AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2008**

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS:

Finding 1:

Disbursement Test Section 8 Program CFDA #14.871:

Condition:

During our audit we selected a sample of 60 checks for a total amount observed of \$80,930.75 and we noted the following:

- In 6 cases the canceled check was not available for examination.
- In 1 case the voucher to request check were not signed by the Director of Finance.
- In 5 cases the voucher to request check were not signed by the Executive Director.
- In 1 case the voucher to request check were not signed by the "Pagador Oficial".
- In 12 cases the voucher attach documents not have the payment seal.

Criteria:

OMB Circular A-87, Cost Principle for State and Local Government, Attachment A establish that cost paid with federal funds should be adequately documented to be allowable.

Effects:

The program might have been charged with unallowable expense or unauthorized payments might have been issued.

Cause:

Inconsistency in application of procedures for preparing disbursements.

Questioned Cost:

None

**MUNICIPALITY OF NARANJITO
SCHEDULE OF FINDING AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2008**

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS:

Finding 2:

Eligibility for individuals test, Section 8 Program CFDA #14.871:

Condition:

During our audit procedures related to eligibility of the program participants we selected a sample of 25 individuals and we noted the following:

- In 1 case the participant not signed the release form to allow the PHA to obtain information from third parties (form HUD-9886).
- In 1 case the participant not signed the rent contract.
- In 4 cases the rent properties not pass the tenant inspection or tenant certification.

Criteria:

Compliance Supplement for the Circular A-133 for the Department of Housing and Urban Development for the Section 8 Housing Choice Voucher (CFDA14.871) established that an application form should be completed by individuals.

Effect:

The grantee might have been approved individuals without proper documentation.

Cause:

Inconsistency in application of procedures for approval of new individuals.

Questioned Cost:

None.

**MUNICIPALITY OF NARANJITO
SCHEDULE OF FINDING AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2008**

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS:

Finding 3:

Disbursement Test SBGP Program CFDA #14.219:

Condition:

During our audit we selected a sample of 60 checks for a total amount observed of \$372,012.51 and we noted the following:

- In 5 cases the canceled check was not available for examination.
- In 2 cases the voucher to request check were not signed by the Director of Finance.
- In 1 case the voucher to request check were not signed by the Executive Director.
- In 68 cases the voucher to request check were not signed by the person in charge of made payments (Pagador Oficial)
- In 100 cases the vouchers do not have the evidence that the services or product were received.
- In 6 cases the requisition from was not found.

Criteria:

OMB Circular A-87, Cost Principle for State and Local Government, Attachment A establish that cost paid with federal funds should be adequately documented to be allowable.

Effects:

The program might have been charged with unallowable expense or unauthorized payments might have been issued.

Cause:

Inconsistency in application of procedures for preparing disbursements.

Questioned Cost:

None

**MUNICIPALITY OF NARANJITO
STATUS OF PRIOR YEAR UNCORRECTED
AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2008**

**MUNICIPALITY OF NARANJITO
STATUS OF PRIOR YEARS UNCORRECTED AUDITS FINDINGS
FOR THE YEAR ENDED JUNE 30, 2008**

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, 2008. 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, 2008, encompass unresolved findings mentioned in the audit report for the fiscal year ended June 30, 2007, dated December 30, 2007.

**MUNICIPALITY OF NARANJITO
SCHEDULE OF PRIOR YEARS UNCORRECTED FINDINGS
FOR THE YEAR ENDED JUNE 30, 2008**

AUDIT REPORT	QUESTIONED COST	ACTUAL STATUS
SINGLE AUDIT REPORT FOR THE YEAR ENDED JUNE 30,2003		
Accounting Records and Reports:		
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.

**MUNICIPALITY OF NARANJITO
EXHIBIT I
MANAGEMENT RESPONSE TO FINDINGS
JUNE 30, 2008**

January 7, 2009

Corrective Actions Plan
Audit Report 2007-2008

The Finance Director will coordinate with the Municipality Affairs Commissioner's Office (OCAM) the following corrections to the accounting records:

Section II – Financial Statements Findings

Accounting Records and Report

- Will make the necessary adjustments to correct the computerized system and reconcile with the manual accounting system. This work is now in process.
- The new computerized system will segregate encumbrance and accounts payable.
- The subsidiary ledger is projected to be working properly by the end of fiscal year 2007-2008.
- The construction in progress cost will be accounted in the new computerized system. The personnel from OCAM are offering technical support to make it possible.

Disbursement Test

- All vouchers will be signed by the Major and the Finance Director.
- All checks will be signed by the Finance Director.

Section III – Federal Awards Findings

Also, the Finance Director is working in the coordination of the correction of the following federal awards findings:

Section 8

- There are isolated cases and will make the necessary adjustments to correct them. Will make evidence canceled checks and the voucher to request check will be signed by the Finance Director.
- Beginnings in September 11, 2006 the application form for the program is used for comply with the federal regulation, only for new cases. These cases in which the application form did not found, are cases prior to September 11, 2006.

The OCAM is offering technical support to the Municipality for all matters mentioned above. Also the Municipality contract outsourcer's technical support to correct all findings in a timely manner.

Cordially,

Rafael Pedrosa
Finance Director