

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

MUNICIPIO DE AGUAS BUENAS
AUDITORIA 2002-2003
30 DE JUNIO DE 2003

MUNICIPALITY OF AGUAS BUENAS
AGUAS BUENAS, PUERTO RICO

SINGLE AUDIT REPORT AND
FINANCIAL STATEMENTS
JUNE 30, 2003

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VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
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To the Honorable Mayoress and
Members of the Municipal Legislature
Municipality of Aguas Buenas, Puerto Rico

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying general-purpose financial statements of the Municipality of Aguas Buenas, Puerto Rico, as of June 30, 2003 and for the year then ended, as listed in the accompanying table of contents. These general-purpose financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit.

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

As discussed in Note 6, because of the inadequacy of the accounting records, we were unable to form an opinion regarding the amounts at which property and equipment are recorded in the General Fixed Assets Account Group of the accompanying general-purpose financial statements at June 30, 2003 amounting to \$14,635,214.

As more fully explained in Note 17, the Municipality has not determined the total estimated landfill closing and postclosing costs that will be recognized in the general-purpose financial statements, as required by the GASB No. 18, "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs".

In our opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary had records concerning property and equipment been adequate and the lack of a provision, if any, for liability of total landfill closing and postclosing costs, the general-purpose financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Municipality of Aguas Buenas as of June 30, 2003, and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Governmental Auditing Standards, we have also issued a report dated November 10, 2003, on our consideration of the Municipality of Aguas Buenas internal control over financial reporting and our tests of its compliance with certain provisions of laws, contracts and grants.

Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements of the Municipality of Aguas Buenas, Puerto Rico, taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audit of States, Local Governments, and Non-Profit Organizations, and is not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements, and in our opinion, is fairly stated, in all material respects, in relation to the general-purpose financial statements taken as a whole.

San Juan, Puerto Rico
November 10, 2003



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MUNICIPALITY OF AGUAS BUENAS

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2003

ASSETS AND OTHER DEBITS	Governmental Fund Types				Account Groups		Totals (Memorandum only)
	General	Special Revenue	Debt Service	Capital Project	General Fixed Assets	General Long-term Debt	
		\$1 460 594	\$1 848 604	\$ 476 997	\$ 327 967	\$ -	
Cash and cash equivalents	60 918	-	-	547 353	-	-	1 085 268
Cash with fiscal agent							
Accounts receivable:							
Municipal license tax (net of an allowance for bad debt of \$86,937)	55 638	-	-	-	-	-	55 638
Due from agencies	67 386	207 973	-	-	-	-	275 359
Due from other funds	210 358	-	-	-	-	-	210 358
Property and equipment	-	-	-	-	11 274 467	-	11 274 467
Land and buildings	-	-	-	-	3 360 747	-	3 360 747
Furniture, machinery and equipment	-	-	-	-	-	-	-
Other debits	-	-	-	-	-	-	-
Amount to be provided for the retirement of:							
Accrued vacations	-	-	-	-	-	743 583	743 583
General obligation bonds	-	-	-	-	-	1 800 021	1 800 021
Landfill obligations	-	-	-	-	-	350 000	350 000
Property tax advances	-	-	-	-	-	218 469	218 469
Claims and judgments	-	-	-	-	-	1 500 000	1 500 000
Other long-term debt	-	-	-	-	-	1 110 539	1 110 539
Amount available in debt service fund	-	-	-	-	-	227 979	227 979
Total assets and other debits	\$1 854 894	\$2 056 577	\$476 997	\$ 875 320	\$14 635 214	\$5 950 591	\$25 849 593

=====
Total assets and other debits
=====
\$25 849 593
=====

(Continues)

See notes to general-purpose financial statements.

MUNICIPALITY OF AGUAS BUENAS

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
(CONTINUED)
JUNE 30, 2003

	Governmental Fund Types				Account Groups		Totals (Memorandum only)
	General	Special Revenue	Debt Service	Capital Project	General Fixed Assets	General Long-term Debt	
<u>LIABILITIES, FUND EQUITY AND OTHER CREDITS</u>							
Liabilities							
Accounts payable	\$ 610 413	\$ 576 735	\$ 39 018	\$ -	\$ -	\$ -	\$1 226 166
and accrued expenses	-	-	-	-	-	218 469	218 469
Property tax advances	229 020	-	-	-	-	-	229 020
Due to other agencies	-	-	-	-	-	1 500 000	1 500 000
Claims and judgments	-	-	-	-	-	1 110 539	1 110 539
Other long-term debt	-	-	-	-	-	-	210 358
Due to other funds	-	210 358	-	-	-	743 583	743 583
Accrued compensated absences	-	-	-	-	-	-	-
General obligations bonds payable	-	-	210 000	-	-	2 028 000	2 238 000
Accrued landfill obligations	-	-	-	-	-	350 000	350 000
Deferred revenues	319 907	-	-	-	-	-	319 907
Municipal license tax	-	175 960	-	-	-	-	175 960
Federal Financial Assistance	-	-	-	-	-	-	-
Total liabilities	<u>1 159 340</u>	<u>963 053</u>	<u>249 018</u>	<u>-</u>	<u>-</u>	<u>5 950 591</u>	<u>8 322 002</u>
Fund equity and other credits							
Investment in general fixed assets	-	-	-	-	14 635 214	-	14 635 214
Fund balances:							
Designated for debt service	-	-	227 979	-	-	-	227 979
Reserved for restricted purposes	-	1 093 524	-	875 320	-	-	1 968 844
Unreserved	<u>695 554</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>695 554</u>
Total fund equity	<u>695 554</u>	<u>1 093 524</u>	<u>227 979</u>	<u>875 320</u>	<u>14 635 214</u>	<u>-</u>	<u>17 527 591</u>
Total liabilities, fund equity and other credits	\$1 854 894	\$2 056 577	\$476 997	\$ 875 320	\$14 635 214	\$5 950 591	\$25 849 593

See notes to general-purpose financial statements.

MUNICIPALITY OF AGUAS BUENAS

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
ALL GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED JUNE 30, 2003

	Governmental Fund Types			Totals
	General	Special Revenue	Debt Service	(Memorandum only)
<u>Revenues</u>				
Property taxes	\$ 1 206 582	\$ -	\$ 220 732	\$ 1 427 314
Municipal license tax	457 867	-	-	457 867
Licenses, fees and permits	375 257	-	-	375 257
Intergovernmental	4 484 372	3 898 801	-	8 482 938
Rent of properties	65 516	-	-	65 516
Interest	55 936	-	-	55 936
Other	172 023	356 507	-	528 530
Total revenues	<u>6 817 553</u>	<u>4 255 308</u>	<u>220 732</u>	<u>11 393 358</u>
<u>Expenditures</u>				
General government	4 053 617	-	-	4 053 617
Public safety	191 036	361	-	191 397
Public works	2 484 197	1 825 382	-	4 309 579
Health, sanitation and welfare	277 306	2 605 358	-	2 882 664
Education and recreation	166 397	-	-	166 397
Other	8 427	-	-	8 427
Capital outlays	-	-	-	56 681
Debt service:				
Principal retirement	-	-	520 805	520 805
Interest	-	-	176 456	176 456
Total expenditures	<u>7 180 980</u>	<u>4 431 101</u>	<u>697 261</u>	<u>12 366 023</u>
Excess of revenues over (under) expenditures	<u>(363 427)</u>	<u>(175 793)</u>	<u>(476 529)</u>	<u>(972 665)</u>

(Continues)

See notes to general-purpose financial statements.

MUNICIPALITY OF AGUAS BUENAS

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
ALL GOVERNMENTAL FUND TYPES
(CONTINUED)

FOR THE YEAR ENDED JUNE 30, 2003

	<u>Governmental Fund Types</u>				<u>Totals</u>
	<u>General</u>	<u>Special Revenue</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>(Memorandum only)</u>
Other financing sources (uses)					
Transfers in	\$	\$ 153 076	\$ 16 805	\$	\$ 169 881
Transfers out	(45 003)			(124 878)	(169 881)
Other	<u>124 248</u>				<u>124 248</u>
Total other financing sources and uses	<u>79 245</u>	<u>153 076</u>	<u>16 805</u>	<u>(124 878)</u>	<u>124 248</u>
Excess of revenues over (under) expenditures and other sources	(284 182)	(22 717)	(459 724)	(81 794)	(848 417)
Fund balances at beginning of year, as restated	<u>979 736</u>	<u>1 116 241</u>	<u>687 703</u>	<u>957 114</u>	<u>3 740 794</u>
Fund balances at end of year	\$ 695 554	\$ 1 093 524	\$ 227 979	\$ 875 320	\$ 2 892 377
	=====	=====	=====	=====	=====

See notes to general-purpose financial statements.

MUNICIPALITY OF AGUAS BUENAS

COMBINED STATEMENT OF REVENUES AND EXPENDITURES -
 BUDGET AND ACTUAL (BUDGETARY BASIS) -
 GENERAL AND DEBT SERVICE FUNDS
 FOR THE YEAR ENDED JUNE 30, 2003

	GENERAL FUND		DEBT SERVICE FUND		Variance
	Budget	Actual	Budget	Actual	Favorable (Unfavorable)
<u>Revenues</u>					
Property taxes	\$1 335 361	\$1 206 582	\$ 339 215	\$220 732	\$(118 483)
Municipal license tax	360 000	443 076			83 076
Licenses, fees and permits	276 192	375 257			99 065
Intergovernmental	4 435 989	4 484 372			48 383
Rent of properties	60 000	62 643			2 643
Interest	60 000	55 936			(4 064)
Other	205 960	290 746			84 786
Total revenues	<u>6 733 502</u>	<u>6 918 612</u>	<u>339 215</u>	<u>220 732</u>	<u>(118 483)</u>
<u>Expenditures</u>					
General government	3 601 960	3 523 378			78 582
Public safety	191 117	191 036			81
Public works	2 496 722	2 484 197			12 525
Health, sanitation and welfare	277 306	277 306			-
Education and recreation	166 397	166 397			-
Total current expenditures	6 733 502	6 642 314			91 188
Debt service					
Principal retirement and interest payment	-		339 215	448 080	(108 865)
Total expenditures	<u>6 733 502</u>	<u>6 642 314</u>	<u>339 215</u>	<u>448 080</u>	<u>(108 865)</u>
Excess of revenues over (under) expenditures	\$ -	\$ 276 298	\$ -	(\$227 348)	\$(227 348)

See notes to general-purpose financial statements.

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession, existence and legal personality separated and independent from the government of the Commonwealth of Puerto Rico under Law No. 81 of August 31, 1991, known as "Ley de Municipios Autónomos". The Municipality provides a full range of services including health, public works, environmental control, education, public safety, public housing and community development, culture and recreation as well as many other general and administrative services.

The Municipal Government is comprised of the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Legislature, which has fourteen members. The members of these branches are elected every four years in the Puerto Rico general elections.

Accounting policies

The accounting policies of the Municipality are in accordance with the accounting principles generally accepted in the United States of America applicable to governmental entities. The following is a summary of the most significant policies:

Financial reporting entity

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 Governmental Accounting Standards Board ("GASB"). The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

accountable for the entity. Financial accountability exists if the primary government 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 management has determined that there are no potential component units which should be included in the accompanying general-purpose financial statements.

Basis of presentation

The accounts of the Municipality are organized on the basis of funds and account groups, 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. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. Amounts in the "totals-memorandum only" columns in the combined general-purpose financial statements represent a summation of the financial statements line items of the fund types and account groups and are presented only for analytical purposes.

The summation includes a) fund types and account groups that use different basis of accounting, b) interfund transactions that have not been eliminated and c) the caption "amounts to be provided", which is not an asset in the usual sense. Consequently, amounts shown in the "totals-memorandum only" columns are not comparable to a consolidation and do not represent the total resources available or the total revenues and expenditures of the Municipality.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

The following fund types and account groups are used by the Municipality:

Governmental Funds Types

Governmental funds are used to account for the general government functions of the Municipality. The following are the Municipality's governmental fund types:

General Fund - The General Fund is the primary operating fund of the Municipality. It is used to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Fund - Special Revenue Fund is used to account for the proceeds of specific revenue sources (other than special assessments, expendable trusts, or major capital projects) that are legally restricted to expenditures for specified purposes.

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

Capital Project Fund - Capital Project Fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Account groups - Account groups are used to establish accounting control and accountability for the Municipality's general fixed assets and general long-term debt.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

The accounting and reporting treatment applied to the fixed assets and long-term liabilities associated with a fund are determined by its measurement focus. All governmental funds are accounted for on a spending "financial flow" measurement focus. This means that only current assets and current liabilities are generally included on their balance sheets. Their reported fund balance (net current assets) is considered a measure of "available spendable resources". Governmental fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Accordingly, they are said to present a summary of sources and uses of "available spendable resources" during a period.

Fixed assets used in governmental fund type operations (general fixed assets) are accounted for in the general Fixed Assets Account Group, rather than in governmental funds. Public domain ("infrastructure") general fixed assets consisting of certain improvements other than buildings, including roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, and lighting systems, are capitalized along with other general fixed assets. No depreciation has been provided on general fixed assets.

All fixed assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated fixed assets are valued at their estimated fair value on the date donated.

Long-term liabilities expected to be financed from governmental funds are accounted for in the General-Long Term Account Group, not in the governmental funds.

The two account groups are not "funds". They are concerned only with the measurement of financial position. They are not involved with measurement of results of operations. Since they do not affect net current assets, such long-term accounts are not recognized as governmental fund type expenditures or fund liabilities. They are instead reported as liabilities in the General Long-Term Debt Account Group.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

Basis of Accounting

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. Basis of accounting also relates to the timing of the measurements made, regardless of the measurement focus applied.

All governmental funds are accounted for using the modified accrual basis of accounting. Under the modified accrual basis, revenues are recognized when they become measurable and available to pay liabilities of the current period.

In applying the susceptible to accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially two types of these revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the Municipality. Therefore, revenues are recognized based upon the expenditures recorded. In the other, monies are virtually unrestricted as to purpose of expenditure and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the susceptible to accrual criteria is met.

Municipal license taxes are recorded as revenues when levied, even though a portion of the taxes may be collected in the following year. Licenses and permits, sale of property and miscellaneous revenues are recorded when received in cash because they are generally not measurable until actually received.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

The Municipality reports deferred revenues on its combined balance sheet. Deferred revenues arise when a potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when resources are received before the Municipality has a legal claim to them, as when grant monies are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred. Exceptions to this general rule include: (1) accumulated unpaid vacation and sick leave pay, and (2) principal and interest on general long-term debt, which is recognized when due.

Budgets and Budgetary Accounting

The Municipality follows these procedures in establishing the budgetary data reflected in the combined financial statements:

1. In accordance with the "Ley de Municipios Autónomos" of August 31, 1991, prior to June of each year, the Mayoress submits to the Municipal Assembly a proposed operating budget for the fiscal year commencing the following July 1st. The operating budget includes proposed expenditures and the means of financing them for the upcoming year, along with estimates for the current year and actual data for the last year.
2. The budget document is available for public inspection prior to its approval by the Municipal Assembly.
3. Prior to June 1 or 10 days after submitted to the Municipal Assembly, the budget is legally enacted through the issuance of an ordinance.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

4. The Mayoress is required by the "Ley de Municipios Autónomos" to present before October 15 the results of operations of the preceding year.

5. Formal budgetary integration is employed as a management control device during the year for the General Fund.

6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget. Adjustments made during the year are reflected in the budget information included in the combined financial statements.

7. Budgetary data for the Special Revenue funds has not been presented in the accompanying combined financial statements as such funds are budgeted over the life of the respective grant or project and not on an annual basis.

The budget is prepared on the budgetary basis of accounting. The actual results of operations, presented in the Statement of Revenues and Expenditures - Budget and Actual General Fund, is in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

The principal difference between the budgetary and GAAP bases are the following:

1. Nonbudgeted funds of current year included within the general fund are not included in the budgetary basis. These funds are composed principally of budgetary surpluses of prior years.
2. Other financing sources and uses transactions considered revenues and expenditures in budgetary basis.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

Compensated absences

The Municipality accounts for compensated absences in accordance with the provisions of Governmental Accounting Standards Board Statement No. 16 "Accounting for Compensated Absences".

The employees of the Municipality are granted thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation time accumulated is fully vested to the employees from the first day of work. In the event of resignation, an employee is reimbursed for accumulated vacation days up to the maximum allowed. Separation of employment prior to the use of all or part of the sick leave terminates all rights for compensation except that, in the event of retirement, an employee is reimbursed for accumulated sick leave days up to the maximum allowed of 90 days.

In governmental funds, compensated absences that are expected to be liquidated with expendable available financial resources are reported as an expenditure and fund liability in the fund that will pay for the compensated absences. The remainder of the compensated absences liability is reported in the general-long term debt account group.

Risk management

The Municipality is exposed to various risks of loss from torts, theft of, damage to, and destruction of assets, errors and omissions, employee injuries and illnesses, natural disasters, and other losses. Insurance coverage is obtained for claims arising from such matters.

Inventories

The general fund purchases office and printing supplies, gasoline, oil and other items. The cost of inventories is recorded as an expenditure and the inventory at the year-end is not recorded in the financial statements.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

Cash equivalents

The Municipality considers investment with original maturities of less than three months to be cash equivalents.

Pension Plan

The management of the Municipality adopted the provisions of Governmental Accounting Standards Board Statement (GASBS) No. 27 "Accounting for Pensions by States and Local Governmental Employers".

The GASBS No. 27 establishes standards of accounting and financial reporting for pension expenditures/expense and related pension liabilities, pension assets, note disclosures, and required supplementary information in the financial reports of state and local governmental employers. The statement defines that the pension expense is equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between statutory required and actual contributions.

Total columns (Memorandum only)

Total columns in the general-purpose financial statements are captioned "Totals-Memorandum Only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position or results of operations, in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation since interfund eliminations have not been made.

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MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

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

New accounting pronouncement

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments". This statement establishes new financial reporting requirements for state and local governments. The statement will require, among other, the inclusion of management's discussion and analysis of the entities' financial activities along with other required supplementary information. Entities such as the Municipality with total annual revenues of less than \$10 million should apply this statement for periods beginning after June 15, 2003.

Use of estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from those estimates.

NOTE 2 CASH

The Municipality is authorized to deposit only in institutions approved by the Department of the Treasury of the Commonwealth of Puerto Rico, and such deposits should be kept in separate accounts in the name of the Municipality. The Municipality's cash balances were entirely covered by Federal Depository Insurance Corporation or by collateral provided by the banks and held by the Department of the Treasury of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations. Cash with fiscal agent is maintained in Government Development Bank (GDB) for Puerto Rico and is not collateralized.

Proceeds from bonds issued by the GDB for the Municipality are held by the GDB and transferred to the Municipality as needed.

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 3 CASH WITH FISCAL AGENT

An annual special tax of 1% of the assessed value of all real property is levied by the Municipality. The proceeds of said tax are required to be credited to the Debt Service Fund for payment of General Obligation Bonds and Notes of the Municipality. The property taxes are collected and retained by the Municipal Revenues Collection Center as agent for the Municipality. At June 30, 2003, cash retained by the Municipal Revenues Collection Center amounted to \$476,997.

NOTE 4 MUNICIPAL LICENSE TAX

The Municipal license tax is levied annually based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Act of Puerto Rico. All taxpayers are required to file their declarations by April 25 of each year.

The municipal license tax rates are as follows:

- a. 1.50% for financial institutions
- b. 0.50% for all other organizations

Taxes are payable in two equal semi-annual installments on July 1 and January 1 of the following fiscal year. The amount levied could be paid with a five percent (5%) discount if payment is made before its due date on April 25.

Collection of taxes applicable to the next fiscal year are recorded as deferred revenues in the General Fund. The Municipality collected in advance during the current year \$319,907 corresponding to the next fiscal year municipal license tax.

NOTE 5 INTERGOVERNMENTAL REVENUES

Sources of intergovernmental revenues consist primarily of governmental payments from the Commonwealth of Puerto Rico and "in lieu of tax" payments from certain quasi-public corporations, such as the Puerto Rico Energy and Power Authority Grants and subsidies received from the Commonwealth of Puerto Rico including, among others, a general subsidy for capital improvements.

(Continues)

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 5 INTERGOVERNMENTAL REVENUES

All of these intergovernmental revenues are accounted for through the general fund except for those directly related to capital improvements which are accounted for through the capital project funds.

In addition to the above mentioned intergovernmental revenues the Municipality receives federal grants which are accounted for through the special revenue fund. The federal grants are recorded under the deferred method of accounting; and therefore, revenues are recognized based upon the expenditures recorded.

NOTE 6 PROPERTY AND EQUIPMENT

The Municipality commenced the recopilation of its property records to determine the amount invested in general property and equipment. This process requires the identification of all real and personal property through physical inventories and its subsequent valuation. This process has not been completed and the Municipality has not been able to determine its real investment in general property and equipment for recording in the accounts and its accuracy for inclusion in the combined financial statements.

The management of the Municipality has estimated its property and equipment and its changes during the year ended June 30, 2003 as follows:

<u>Asset class</u>	Balance July 1, 2002 (Unaudited)	<u>Additions</u>	<u>Retirements</u>	Balance June 30, 2003 (Unaudited)
Land and buildings	\$11 274 467	\$ -	\$ -	\$11 274 467
Furniture, machinery and equipment	<u>2 759 352</u>	<u>603 184</u>	<u>1 789</u>	<u>3 360 747</u>
	\$14 033 819	\$ 603 184	\$ 1 789	\$14 635 214
	=====	=====	=====	=====

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 7 COMPENSATED ABSENCES

Employees are entitled to 30 days vacations leave and 18 days sick vacations leave per year. A maximum of 60 days of regular vacations and 90 days for sick leave can be accumulated at the end of a calendar year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement.

In accordance with the above criteria the Municipality has accrued a liability for vacations earned but not taken by employees in the general long-term debt account group in the amount of \$743,583.

As per Law Number 156 of August 20, 1996, for fiscal years beginning on July 1, 1997, the employees will have the right to accumulate the excess of 90 days in sick leave until December 31st of each year. That excess should be paid to the employee before March 31st of the following year.

NOTE 8 DUE TO OTHER AGENCIES

The balance of this account at June 30, 2003 consists of the following:

General Fund:

Puerto Rico Water and Sewer Authority	\$ 3 129
General Service Administration	8 765
Department of Labor and Human Resources	41 156
Other municipalities	114 582
Retirement system	<u>61 388</u>
	\$229 020
	=====

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 9 DEBT SERVICE FUND

Sources of debt service fund consist primarily of the ad-valorem property taxes which are recognized as revenue when they are collected by the Municipal Revenue Collection Center. The Municipal Revenues Collection Center withholds these collections for the debt service requirements of the general obligations bonds issued by the Municipality. Principal and interest on these bonds are generally paid by the Governmental Development Bank from funds transferred from the Municipal Revenues Collection Center which were obtained from the ad-valorem taxes.

NOTE 10 LONG-TERM DEBT

The following is a summary of changes in general obligations for the year ended June 30, 2003:

Total debt as of June 30, 2002	\$2 532 000
Less: current retirement of principal	<u>(294 000)</u>
	2 238 000
Less: current portion	<u>(210 000)</u>
Total debt as of June 30, 2003	\$2 028 000 =====

The following is a summary of general bonds and special obligations as of June 30, 2003:

\$920,000 Public Work Bonds Serial 1995, due in annual principal installments ranging from \$10,000 to \$85,000 through July 1, 2020; interest rate is variable not to exceed 6.875%.	\$ 790 000
\$600,000 Public Works Bonds 1990, due in annual principal installments ranging from \$14,000 to \$48,000 through January 1, 2015; interest rate is 6% fixed.	417 000
\$400,000 Bond Anticipation Note due March 1, 2018, with a fixed interest rate of 5.63%.	316 000
\$420,000 Serial Bonds 1989, due in annual principal installment ranging from \$15,000 to \$50,000 through July 1, 2004; interest rate is variable not to exceed 8.6%.	<u>50 000</u>
Sub-total	<u>1 573 000</u>

(Continues)

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 10 LONG-TERM DEBT (CONTINUED)

Sub-total	\$1 573 000
\$255,000 General Obligation Notes, serial 1998-99 due in annual principal installments ranging from \$30,000 to \$45,000 through July 1, 2005; interest rate is variable not to exceed 7.00%.	85 000
\$570,000 General Obligation Notes, serial 2001-02 due in annual principal installments ranging from \$95,000 to \$135,000 through July 1, 2006; interest rate of 8.00%.	<u>370 000</u>
	\$2 028 000 =====

The annual requirements to amortize the general obligation bonds outstanding as of June 30, 2003 during the next five years and thereafter are as follows:

<u>Year ending</u> <u>June 30,</u>	<u>Total</u>
2004	\$ 267 000
2005	234 000
2006	207 000
2007	79 000
2008	82 000
Thereafter	<u>1 159 000</u>
	\$2 028 000 =====

The Municipality is subject to certain laws of the Commonwealth of Puerto Rico which limit the amount of bond debt to 10% of the assessed valuation of the real property located in the Municipality of Aguas Buenas.

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 11 OTHER LONG-TERM DEBT

Other long-term debt consists of the following balances:

Puerto Rico Health Insurance Administration	\$ 720 834
Municipal Revenue Collection Center	<u>389 705</u>
Total	\$1 110 539 =====

The amount due to the Puerto Rico Health Insurance Administration is related with the implementation of Act No. 72 of September 7, 1993, which establishes a contribution for the medical services covered by the Health Reform based on the operational budget of the municipalities. This amount is amortized using the Municipality's lottery income.

The amount due to the Municipal Revenue Collection Center is related with an obligation to guarantee a line of credit negotiated by this agency with the Governmental Development Bank for the payment in advance of the bond issuance made by a subsidiary of the mentioned bank for the purchase of the municipalities uncollected property tax debt amounts for the years 1974 to 1996 made in prior years. The Municipality will guarantee the maximum amount of \$389,705 of this line of credit. The terms of the financing is 30 years with a due date of December 1, 2032 with an interest rate of 6.50% for the first five years and a variable rate for the next twenty-five years. The source of revenue for the payment of this debt will be the net increase of .48% of the intergovernmental funds collected from the central government and the collections of the property tax debts.

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN

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

The System provides retirement, death and disability benefits pursuant to Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained age of at least fifty-eight (58) years and have completed at least ten (10) 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 multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least thirty years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

(Continues)

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

No benefit is payable if the participant receives a refund of his accumulated contributions.

Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447, to establish, among others, a defined contribution savings plan program (the Program) to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000 and former employees who participated in the defined benefit pension plan, received a refund of their contribution and are rehired on or after January 1, 2000, become members of the Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the defined benefit pension plan, had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interest thereon to the Program.

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to his/her individual account established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant account semi-annually.

The Municipality is required by Act No. 305 to contribute 9.275% of the participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan.

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for monthly benefit during the participant's life and 50% of such monthly benefit to the participant's spouse in case of the participant's death. Participants with a balance of \$10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in the participant's account will be paid in a lump sum to his/her beneficiaries. Participants have the option of a lump sum or purchasing an annuity contract in case of permanent disability.

(Continues)

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the salary in excess of \$550. The Municipality of Aguas Buenas contributions are 9.275% of gross salary. Total employee and employer contributions during the year ended June 30, 2003 for the Municipality of Aguas Buenas amounted to approximately \$90,000 and \$110,000, respectively. Total payroll covered for the year was approximately \$1,200,000.

For the two preceding fiscal years, the Municipality of Aguas Buenas contributed approximately \$99,000 and \$107,000, respectively.

Additional information on ERS is provided in its financial statements for the year ended June 30, 2003, a copy of which can be obtained from Lcda. Marisol Marchand, Administrator, Retirement System Administration, PO Box 42003, San Juan, Puerto Rico 00940.

NOTE 13 PROPERTY TAXES

A. Annual Revenues

The Municipal Revenue Collection Center (CRIM) is responsible for the assessment of all real and personal property located within the Municipality of Aguas Buenas and for the levy, administration and collection of the corresponding taxes.

The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are established at the estimated current value existing in the year 1957 and of personal property at the current value at the date of assessment. The annual tax rate for fiscal year ended June 30, 2003 is 8.08% for real property and 6.08% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico.

(Continues)

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 13 PROPERTY TAXES (CONTINUED)

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first \$15,000 of the assessed valuation of owner occupied residential units. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Department of the Treasury, instead of the property taxpayer, becomes the source of payment in these cases.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000. However, the Municipality receives the full amount levied.

The amounts advanced during the year to the Municipality by the CRIM are recorded as property taxes revenues in the general fund. No income was recognized from property taxes levied but not collected because the Municipality is not able to determine the amount of such receivable at June 30, 2003. The records for such receivables are kept and maintained by the Municipal Revenue Collection Center.

Advances in excess of actual collections received by the Municipality are recorded as a debt in the General Long Term Debt Account Group. The balance of the excess of property taxes collected by the Municipality amounted to \$114,839 as of June 30, 2003. The terms of the financing of this debt is 30 years with a due date of July 1, 2032 with a variable interest rate subject to the LIBOR rate. The source of revenue for the payment of this debt is the net increase of .48% of the intergovernmental funds collected from the central government.

The additional tax is recorded as revenue in the Debt Service Fund when collected, and notified to the Municipality by the Municipal Revenue Collection Center.

(Continues)

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 13 PROPERTY TAXES (CONTINUED)

B. Prior year advances

Prior to 1994, the Department of the Treasury was the agency responsible for the assessment of real property and for the administration and collection of the related taxes. Amounts advanced by the Secretary of the Treasury to the Municipality of Aguas Buenas, that had not been amortized through the collections of property taxes amounted to \$103,630 as of June 30, 2003.

NOTE 14 FUND EQUITY (RESERVES AND DESIGNATIONS)

The fund balance of the General Fund as of July 1, 2002 has been adjusted by \$180,424 in order to eliminate accounts payable recorded in prior years. The fund balance was restated as follows:

Fund balance at beginning of year	\$ 799 312
Accounts payable from prior years eliminated	<u>180 424</u>
Fund balance at beginning of year, as restated	\$ 979 736 =====

The fund balance of the Special Revenue Fund as of July 1, 2002 has been adjusted by \$1,116,241 in order to eliminate old balances of deferred revenues of prior years. The fund balance was restated as follows:

Fund balance at beginning of year	\$ -
Deferred revenues old balances eliminated	<u>1 116 241</u>
Fund balance at beginning of year, as restated	\$1 116 241 =====

Designated for debt service - In accordance with legal restrictions, these amounts are reserved for payments of principal and interest of general long-term debt maturing in later years. The resources for this reserve arise from the additional special contribution of property taxes.

Reserved for restricted purposes - These amounts are legally segregated for future capital outlays or other specific future use.

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 15 BUDGETARY COMPARISONS

As explained in Note 1, the Statement of Revenues and Expenditures-Budget and Actual, was prepared in accordance with the budgetary basis. This method is not in accordance, in some aspects, with generally accepted accounting principles.

Adjustments necessary to reconcile the revenues and expenditures of the General Fund at the end of the year, from the generally accepted accounting principles to budgetary basis, are as follows:

	<u>General Fund</u>		<u>Debt Service Fund</u>	
	<u>Revenues</u>	<u>Expenditures</u>	<u>Revenues</u>	<u>Expenditures</u>
Generally accepted accounting principles (GAAP) basis	\$6 817 553	\$7 180 980	\$220 732	\$ 697 261
Plus other financing sources considered revenues in budgetary basis	124 248			
Less current revenues included in GAAP basis but not in budgetary basis	(23 189)			
Less current expenditures included in GAAP basis but not in budgetary basis		(555 471)		
Plus other financing use considered expenditure in budgetary basis		16 805		
Less current portion of long-term debt not considered in budgetary basis				(249 181)
Budgetary basis	<u>\$6 918 612</u> =====	<u>\$6 642 314</u> =====	<u>\$ 220 732</u> =====	<u>\$448 080</u> =====

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 16 CLAIMS AND JUDGMENT

Litigations

The Municipality is a defendant in a case where the plaintiffs claim unjust separation of employment and damages thereon. The Supreme Court decided against the Municipality. The amount to be awarded to the plaintiffs was estimated to \$1,500,000. This amount was recorded in the general long-term debt account group as of June 30, 2003. The Municipality expects to finance this obligation with a loan.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in the discovery stage. Certain of these claims are covered by the existing insurance. Legal counsel cannot determine the final outcome of these claims with the information currently available. As a result, the accompanying general-purpose financial statements do not include adjustments, if any, that could result from the resolution of these legal proceedings.

Federal Financial Assistance

The Municipality receives financial assistance from the federal government in the form of grants. All grants are subject to financial and compliance audits by the grantor agencies, which could result in requests for reimbursement by the grantor agencies for expenditures, which are disallowed under the terms of the grants. The amount, if any, of expenditures which may disallowed by the grantor agencies cannot be determined at this time. The Municipality's administration believes that such disallowance, if any, will not have a material adverse effect on the financial position of the Municipality.

NOTE 17 MUNICIPAL LANDFILL

State and federal laws and regulations requires to the Municipality to carry out certain closure work when it stops accepting waste and to perform certain maintenance and monitoring functions at site in the following years. In accordance with GASB No. 18 "Accounting for Municipal Solid Waste Landfill Closure and Post closure Care Costs" the Municipality must has to perform a study of the closing and post closing costs in order to recognize a provision for those costs.

(Continues)

MUNICIPALITY OF AGUAS BUENAS

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 17 ESTIMATED SOLID WASTE LANDFILL COSTS (CONTINUED)

The Municipality operated a solid waste landfill that was closed during 1994. Total closure costs incurred as of June 30, 2003 were approximately \$950,000 and there is a provision for an additional \$350,000 that is reported in the general long-term debt account group. The closure costs incurred were mostly provided by federal awards under the State Block Grant Program.

The Municipality is still in process of performing tests in the landfill site in order to assess a final settlement of closure and post-closure costs. A preliminary estimate of these costs is not available as of June 30, 2003. Accordingly, no provision for future closure and post closure costs was recognized in the accompanying general-purpose financial statements.

NOTE 18 ESPIRITU SANTO HOUSING PROJECT

On March 1st, 1998 the Municipality signed a Multiple Family Housing Assumption Agreement with the U.S. Farmers Home Administration for the transfer and assumption of the mortgage loan of the Multi Family Housing Project Espiritu Santo. This project consist of a housing development that includes land, buildings and improvements providing 50 dwelling units located in Aguas Buenas, Puerto Rico. The project is operated under Section 515 of the USDA-Rural Development and regulated by the U.S. Department of Housing and Urban Development and the USDA Rural Development with respect to rental charges and operating methods. The project is also subject to Section 8 Housing Assistance Payments agreement with HUD and a significant portion of the Project's rental income is received from HUD. The management of the Municipality did not consider this entity as a component unit to be included in the general-purpose financial statements. Audited financial statements of the project at June 30, 2003 are available from the Municipality.

**SUPPLEMENTARY INFORMATION AND ADDITIONAL REPORTS
REQUIRED BY THE SINGLE AUDIT ACT**

MUNICIPALITY OF AGUAS BUENAS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

Federal Grantor/Passed-Through Grantor <u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Passed-Through Grantor's Number</u>	<u>Expenditures (Modified Accrual Basis)</u>
U.S. Department of Housing and Urban Development Direct Programs: Section 8 - Housing Choice Vouchers (RQ082 V0)	14.871	N/A	\$1 245 133
Passed-through - Office of the Commissioner of Municipal Affairs Program: State Block Grant	14.228	98-47	1 825 382
U.S. Department of Agriculture - Passed-through Department of Education Program: Child and Adult Care Food	10.558	N/A	41 108
U.S. Department of Federal Emergency Management Agency Program: Disaster Assistance	83.516	842-DR-PR	340 396
U.S. Department of Health and Human Services Passed-through - Family and Children Administration: Program: Childcare and Development Block Grant	93.575	N/A	443 397
U.S. Department of Transportation Passed-through Puerto Rico Highway Authority Program: Federal Transit - Formula Grants	20.507	N/A	<u>3 385</u>
Total Expenditures of Federal Awards			\$3 898 801 =====

CFDA - Catalog of Federal Domestic Assistance
N/A Not available

MUNICIPALITY OF AGUAS BUENAS

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

NOTE 1 BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Municipality of Aguas Buenas and is prepared on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations". Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- a. The accompanying Schedule of Expenditures of Federal Awards is prepared from Municipality's accounting records and is not intended to present financial position or the results of operations.
- b. The financial transactions are recorded by the Municipality in accordance with the terms and conditions of the grants, which are consistent with generally accepted accounting principles.
- c. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

NOTE 3 RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Expenditures of federal awards are reported in the Municipality's Combined Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Type as follows:

<u>Description</u>	<u>Special Revenue</u>
Federal program expenditures	\$3 898 801
State and Municipal expenditures	<u>532 300</u>
Total expenditures	\$4 431 101 =====

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
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To the Honorable Mayoress and
Members of the Municipal Assembly
Municipality of Aguas Buenas, Puerto Rico

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

We have audited the general-purpose financial statements of the Municipality of Aguas Buenas, Puerto Rico as of and for the year ended June 30, 2003, and have issued our report thereon dated November 10, 2003 which was qualified for our inability to apply audit procedures over property and equipment and the lack of a provision, if any, for liability of landfill closing and post closing costs. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Municipality's 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 no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the 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 the Municipality's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs, Part II. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting 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 misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe that the reportable conditions described above are material weaknesses.

This report is intended for the information and use of the management and members of the Municipal Legislature of the Municipality of Aguas Buenas, Puerto Rico, federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

San Juan, Puerto Rico
November 10, 2003

Stamp 1933720 was affixed
to the original.

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

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To the Honorable Mayoress and
Members of the Municipal Assembly
Municipality of Aguas Buenas, Puerto Rico

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

Compliance

We have audited the compliance of the Municipality of Aguas Buenas, Puerto Rico (The Municipality) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2003. The Municipality's major federal programs are identified in the accompanying Schedule of Findings and Questioned Costs. Compliance with requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

In our opinion, the Municipality of Aguas Buenas, Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs.

Internal Control Over Compliance

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

Our consideration of the internal control over 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 the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

San Juan, Puerto Rico
November 10, 2003

Stamp 1933721 was affixed
to the original.

**SCHEDULE OF CURRENT YEAR
FINDINGS AND QUESTIONED COSTS**

MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expressed a qualified opinion on the general-purpose financial statements of the Municipality of Aguas Buenas, Puerto Rico.
2. A reportable condition related to internal control over financial reporting was noted by the audit of the financial statements and reported in Part II of this schedule.
3. No instances of non-compliance material to the financial statements of the Municipality of Aguas Buenas, Puerto Rico were disclosed during the audit.
4. There were no material weaknesses or reportable conditions noted on internal controls over major federal award programs.
5. The auditors' report on compliance for the major federal award program for the Municipality of Aguas Buenas, Puerto Rico expresses an unqualified opinion.
6. Audit findings related to the major federal award programs for the Municipality of Aguas Buenas, Puerto Rico are reported in Part III of this Schedule.
7. The programs tested as major programs included: Community Development Block Grant, CFDA Number 14.228, Section 8, Housing Choice Vouchers, CFDA Number 14.871, and Childcare and Development Block Grant, CFDA Number 93.575.
8. The threshold for distinguishing Type A and Type B programs were \$300,000.
9. The Municipality did not qualify as a low-risk auditee.

MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

PART II FINDINGS

FINDING NUMBER 03-II-01 Reportable condition over property, plant and equipment

CONDITION

During our examination of the Municipality's records and reports over property and equipment, we noted the following deficiencies:

- a. The computerized property records and reports did not reconcile with the ending balances reported in the financial statements.
- b. The construction in Progress account is not properly recorded as part of the fixed assets.
- c. There are not adequate procedures for the valuation and recording of the real estate property.

CRITERIA

Article 10-002 of the State Act Number 81 of August 30, 1991, as amended, and federal regulations require the Municipality to maintain adequate and updated records of property.

EFFECT

Incomplete and inaccurate property records prevent adequate controls over property purchased by the Municipality.

CAUSE

There are no procedures established for the reconciliation and maintenance of the property ledger as required by State and Federal regulations.

RECOMMENDATION

The Municipality should implement internal control procedures in the property area in order to comply with the above requirement.

GRANTEE RESPONSE

See grantee's corrective action plan.

MUNICIPALITY OF AGUAS BUENAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

PART III FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT

Program

U.S. Department of Housing and Urban Development (HUD)

- A. Section 8 Housing Choice Vouchers - CFDA No. 14.871,
Grant Period - year ended June 30, 2003

FINDINGS NUMBER 03-III-02 Reportable condition over housing quality inspections

CONDITION

During our evaluation of the Municipality's Section 8 internal control procedures we found that in 2 of 25 cases examined the Municipality failed to conduct the annual inspection of the leased unit. Also, we found that in 4 of 5 cases examined the Municipality failed to perform the follow-up reinspection after the approved period for the corrections of deficiencies for units that fail or pass with conditions the annual housing quality inspection.

CRITERIA

HUD regulations requires the Municipality to inspect the units leased under the program at least annually in order to determine if the units meet the housing quality standards. Also, it is required follow up reinspection for the units that failed to pass the annual inspection in order to verify if the deficiencies found were corrected during the period approved by the Municipality.

EFFECT

The Municipality is not in compliance with the federal regulation.

CAUSE

The deficiencies in these units did not guarantee a safe housing to families under the Section 8 Program.

RECOMMENDATION

The Municipality must implement the necessary internal control procedures in order to comply with this federal requirement.

QUESTIONED COST None

GRANTEE'S RESPONSE

See grantee's corrective action plan.

MUNICIPALITY OF AGUAS BUENAS

STATUS OF PRIOR YEAR AUDIT FINDINGS

In the Single Audit Report for 2002 we presented to the Municipality our comments and recommendations on certain aspects that were considered deviations from compliance requirements, rules and regulations of the federal funds programs.

During the current audit we followed-up on the matters communicated in the 2002 report and noted the following:

Program

A. Community Development Block Grant and Section 8 - Housing Choice Vouchers

Finding No. 1

The Municipality has not followed adequate procedures to account for the fixed assets acquired with federal funds or other sources of funds.

Status: This finding was repeated this year.