

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE AGUAS BUENAS**

**AUDITORIA 2003-2004**

**30 DE JUNIO DE 2004**

**MUNICIPALITY OF AGUAS BUENAS**

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*CAH/105-9081*

# VALDES, GARCIA & MARIN

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

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## INDEPENDENT AUDITORS' REPORT

Mayor and Members of the Municipal Legislature  
Municipality of Aguas Buenas  
Aguas Buenas, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Aguas Buenas, Puerto Rico, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Aguas Buenas as of June 30, 2004 and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated January 12, 2005 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

As described in Note 1, the Municipality has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for States and Local Governments: "GASB Statement No. 37 Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus-an amendment of GASB Statements No. 21 and No. 34; GASB Statement No. 38 "Certain Financial Statements Note Disclosures" and GASB Statement No. 41 "Budgetary Comparison Schedules - Perspective Differences-an amendment of GASB Statement No. 34, as of June 30, 2004.

The Management's Discussion and Analysis on pages 3 through 8 and the Budgetary Comparison Schedule - General Fund on page 36 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 our opinion on the financial statements that collectively comprise the Municipality of Aguas Buenas, Puerto Rico basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations", and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.



San Juan, Puerto Rico  
January 12, 2005

Stamp 2023336 was affixed  
to the original

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

On July 1, 2003 the management of the Municipality of Aguas Buenas implemented Statement No. 34 of the Government Accounting Standards Board (GASB) "*Basic Financial Statement and Management's Discussion and Analysis-for State and Local Government*".

Our discussion and analysis of the Municipality of Aguas Buenas, financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2004. Please read in conjunction with the Municipality's financial statements.

**FINANCIAL HIGHLIGHTS**

1. The Municipality's total net assets increased by \$1,487,461 during 2004.
2. The assets of the Municipality's on the government-wide basis, exceeded its liabilities at the close of fiscal year 2004 by \$11,667,526 (net assets).
3. At the close of the current fiscal year, the Municipality's government funds reported combined ending fund balances of \$2,951,997 a decrease of only \$34,903 in comparison with the prior year. Approximately 28 percent of the total combined fund balances is unreserved.
4. The General Fund, on current financial resources basis, reported an excess of revenues and other financial sources over expenditures and other financing uses of \$63,546.
5. On a budgetary basis, actual revenues exceeded actual expenditures by \$291,352.
6. The investment in Capital Assets as of June 30, 2004 was \$15,787,586 (net depreciation).
7. Long term-debt increased to \$7,437,057 approximately 25 percent with respect to prior year.

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**USING THIS ANNUAL REPORT**

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 9 - 10) provide information about the activities of the Municipality as a whole and present a longer-term view of the Municipality's finance. Fund financial statements start on page 11. For government activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statement also reported the Municipality's operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds. The remaining statements provide financial information about activities for which the Municipality acts solely as a trustee or agent for the benefit of those outside of the government.

**REPORTING THE MUNICIPALITY AS A WHOLE**

One of the most important questions asked about the Municipality's finances is "Is the Municipality as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities in a way that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

**MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

These two statements report the Municipality's net assets and changes in them. You can think of the Municipality's net assets (the difference between assets and liabilities) as one way to measure the Municipality's financial health, or financial position. Over time, increases or decreases in the Municipality's net assets are one indicator of whether its financial health is improving or deteriorating.

The Statement of Net Assets and the Statement of Activities is commonly divided into three kinds of activities:

- Governmental activities
- Business-type activities
- Component units

**The Municipality of Aguas Buenas reports all its activities as governmental activities.**

**REPORTING THE MUNICIPALITY'S MOST SIGNIFICANT FUNDS**

**Fund Financial Statement**

The fund financial statements begin on page 11 and provide detailed information about the most significant funds, not the Municipality as a whole. The Municipality operates under four major funds the General Fund, the CDBG fund, the HUD Sec.-8 fund and the Debt Service fund. Other minor funds such as Capital Projects, Joint Resolutions, Childcare program and other federal funds were presented under the column Other Governmental Funds.

Most of the Municipality basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide detailed short-term view of the Municipality general government operations and the basic services provided. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality programs. We describe the relationship (or differences) between governmental activities and governmental funds in a reconciliation at the bottom of the fund financial statements.

**MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

A comparative analysis of overall fund financial activities is presented below:

	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>Change</u>	<u>%</u>
<b>ASSETS</b>				
Cash, and cash equivalents	\$ 3,375,960	\$3,637,165	\$(261,205)	-7%
Cash with fiscal agent	1,449,449	1,085,268	364,181	34%
Accounts receivable	46,889	55,638	(8,749)	-16%
Due from other funds	1,532,421	210,358	1,322,063	628%
Due from agencies	<u>482,178</u>	<u>275,359</u>	<u>206,819</u>	<u>75%</u>
	<u>\$ 6,886,897</u>	<u>\$5,263,788</u>	<u>\$1,623,109</u>	<u>31%</u>
<b>LIABILITIES</b>				
Accounts payable and accrued expenses	\$1,037,342	\$1,226,166	\$(188,824)	-15%
Due to other agencies	196,989	229,020	(32,031)	-14%
Due to other funds	1,532,421	210,358	1,322,063	628
General obligations bonds payable	275,000	210,000	65,000	31%
Deferred revenues-municipal license taxes and other	447,978	319,907	128,071	40%
Deferred revenues-federal financial assistance	<u>445,170</u>	<u>175,960</u>	<u>269,210</u>	<u>153%</u>
<b>Total liabilities</b>	3,934,900	2,371,411	1,563,489	66%
<b>Fund equity and other credits</b>	<u>2,951,997</u>	<u>2,892,377</u>	<u>59,620</u>	<u>2%</u>
	<u>\$ 6,886,897</u>	<u>\$ 5,263,788</u>	<u>\$1,623,109</u>	<u>31%</u>
<b>For the years ended</b>				
<b>REVENUES</b>	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>Change</u>	<u>%</u>
Property taxes	\$ 1,978,858	\$ 1,427,314	\$ 551,544	39%
Municipal license taxes	445,719	457,867	(12,148)	-3%
Licenses fees and permits	215,496	375,257	(159,761)	-43%
Intergovernmental	10,247,829	8,482,938	1,764,891	20%
Rent of properties	69,282	65,516	3,766	6%
Interest	46,642	55,936	(9,294)	-17%
Other	<u>483,351</u>	<u>528,530</u>	<u>(45,179)</u>	<u>90%</u>
	<u>\$ 13,487,177</u>	<u>\$ 11,393,358</u>	<u>\$ 2,093,819</u>	<u>18%</u>

**MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**EXPENDITURES**

General government	\$ 4,470,739	\$ 4,053,617	\$ 417,122	10%
Public Safety	332,721	191,397	141,324	74%
Public Works	3,236,910	4,309,579	(1,072,669)	25%
Health sanitation and welfare	2,989,488	2,882,664	106,824	4%
Education and recreation	178,782	166,397	12,385	7%
Other	6,349	8,427	(2,078)	-25%
Capital outlays	2,533,099	56,681	2,476,418	4369%
Debt services principal retirement	1,852,441	520,805	1,331,636	256%
Debt services interest	<u>168,475</u>	<u>176,456</u>	<u>(7,981)</u>	<u>-5%</u>
	<u>\$ 15,769,004</u>	<u>\$ 12,366,023</u>	<u>\$ 3,402,981</u>	<u>28%</u>

Variances reported on Capital outlays and debt services principal retirement respectively, are explained in the Capital Assets and Long Term Debt sections of this report and in Notes 5 and 9 to the financial statements.

**THE MUNICIPALITY AS A WHOLE**

For the year ended June 30, 2004, net assets changed as follows:

	<b>Governmental Activities</b>
Beginning net assets	\$10,180,065
Increase in net assets	<u>1,487,461</u>
Ending net assets	<u>\$11,667,526</u>

That reflects an increase of 15% for governmental activities, due principally to the difference between the net capitalization of additions of assets and the net change in general obligations during the year.

Since this is the first year to report all activities on the accrual basis of accounting, a comparison to the prior year is not possible (with the exception of the above comparison). However, in the future years, this section will explain the differences between the current-and prior-year assets, liabilities, and changes in net assets.

**Governmental Activities**

Again, because this is the first year to report governmental activities on the accrual basis of accounting, a comparison to the prior year is not possible. However, in next year's discussion of this section we will show a condensed financial comparison of revenues and expenses and provide explanations for significant differences.

**MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

To aid in the understanding of the Statement of Activities some additional explanation is necessary. Of particular interest is the format that is significantly different than a typical Statement of Revenues, Expenses, and Changes in Fund Balance. You will notice that expenses are listed in the first column with revenues from that particular program reported to the right. The result is a Net (Expense)/Revenue. The reason for this kind of format is to highlight the relative financial burden of each of the function on the Municipality taxpayers. It also identifies how much each function draws from the general revenues or if it is self-financing through fees and grants.

**CAPITAL ASSETS**

At the end of the year June 30, 2004, the Municipality had \$15,787,496, net of depreciation invested in capital assets including land, buildings, park facilities, machinery and equipment, and automobiles. This represents a net increase of 17 % percent, over the last year.

	<b>Balance 2004</b>	<b>Balance 2003</b>	<b>Dollar Change</b>	<b>Total Percentage</b>
Non Depreciable Capital Assets				
Land	\$ 2,062,577	\$ 2,062,577	\$ -	0%
Depreciable Capital Assets				
Infrastructure	508,617	-	508,617	508%
Buildings, Parks and Courts	17,964,113	15,731,175	2,232,938	14%
Machinery and equipment	1,531,944	1,472,156	59,788	4%
Automobiles	<u>1,950,804</u>	<u>1,817,844</u>	<u>132,960</u>	<u>7%</u>
Total Capital Assets	<u>24,018,055</u>	<u>21,083,752</u>	<u>2,934,303</u>	<u>14%</u>
Less Accumulated Depreciation				
Infrastructure	-	-	-	
Buildings, Parks and Courts	6,119,387	5,757,559	361,738	6%
Machinery and equipment	767,992	630,612	137,380	22%
Automobiles	<u>1,343,180</u>	<u>1,226,046</u>	<u>117,134</u>	<u>10%</u>
	<u>8,230,559</u>	<u>7,614,217</u>	<u>616,252</u>	<u>8%</u>
Net Capital Assets	<u>\$ 15,787,496</u>	<u>\$ 13,469,535</u>	<u>\$ 2,318,051</u>	<u>17%</u>

The year major additions include:

<b>Buildings, Parks and Courts</b>	\$2,232,938
<b>Infrastructure</b>	508,617
	<u>\$2,741,555</u>

**MUNICIPALITY OF AGUAS BUENAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**LONG TERM DEBT**

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At year-end, the Municipality had \$3,926,000 in general and special bonds and notes, an increase of 93% with respect to prior year. The main reason for this increase is that, during the current year, a pending legal case against the Municipality was finalized and financed by a long term loan. Plaintiffs had claimed unjust separation of employment and damages and the Supreme Court decided in favor of the plaintiffs and awarded damages of \$1,500,000. The Municipality is required to maintain a legal debt margin of 10% of the total assessment of property located within the Municipality plus the balance of the property taxes in the debt service fund. The Municipality's outstanding debt as of June 30, 2004 is as follows:

General and special obligation bonds and notes	\$3,926,000
Compensated absences	985,796
Landfill closure costs	1,360,000
Other long-term debt	1,075,261
Total	<u>\$7,347,057</u>

More detailed information about the Municipality's long term liabilities is presented in Note 10 to the financial statements.

**CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT**

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The financial report is designed to provide a general overview of the Municipality's finances for all those with an interest in the government's finances. For questions concerning any of the information provided in this report or requests for additional information contact the Municipality's Finance Department at (787) 732-2811.

**BASIC FINANCIAL STATEMENTS**

**MUNICIPALITY OF AGUAS BUENAS**

**STATEMENT OF NET ASSETS  
JUNE 30, 2004**

	<u>Governmental Activities</u>
<b>ASSETS</b>	
Cash and cash equivalents	\$ 3,375,960
Cash with fiscal agent	1,449,449
Accounts receivable:	
Municipal License tax - net	46,889
Due from other agencies	482,178
Capital assets - net	<u>15,787,586</u>
 Total assets	 <u>21,142,062</u>
<b>LIABILITIES</b>	
Accounts payable and accrued expenses	1,037,342
Due to other agencies	196,989
Compensated absences:	
Due within one year	488,072
Due in more than one year	497,724
Deferred revenues	893,148
Bonds payable:	
Due within one year	275,000
Due in more than one year	3,651,000
Landfill postclosure costs	
Due within one year	50,500
Due in more than one year	1,309,500
Other long-term debt	<u>1,075,261</u>
 Total liabilities	 <u>9,474,536</u>
<b>NET ASSETS</b>	
Invested in capital assets-net of related debt	12,136,586
Restricted for:	
Capital projects	904,064
Debt service	211,067
Unrestricted	<u>(1,584,191)</u>
 Total net assets	 <u>\$ 11,667,526</u>

The accompanying notes are an integral part of this statement

**MUNICIPALITY OF AGUAS BUENAS**  
**STATEMENT OF ACTIVITIES**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Functions / Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>		<u>Net (Expense) Revenue</u>
		<u>Charges For Services</u>	<u>Operating Grants and Contributions</u>	
<b>Governmental Activities</b>				
General government	\$ 4,598,636	\$ 69,282	\$ 1,149,253	\$ (3,380,101)
Public safety	333,110	-	-	(333,110)
Public works	3,634,956	-	-	(1,133,228)
Health, sanitation and welfare	2,994,526	-	1,899,260	(1,095,266)
Education and recreation	263,661	-	-	(263,661)
Interest on long-term debt	168,475	-	-	(168,475)
Other	6,349	-	-	(6,349)
<b>Totals</b>	<u>\$ 11,999,713</u>	<u>\$ 69,282</u>	<u>\$ 3,048,513</u>	<u>\$ 2,501,728</u>
<b>General Revenues</b>				
Taxes:				
Property taxes				1,978,858
Municipal license tax				445,719
License fees and permits				215,496
Intergovernmental				4,811,128
Interest				46,642
Other				369,808
Total general revenues				<u>7,867,651</u>
<b>Change in net assets</b>				1,487,461
<b>Net assets at beginning of year</b>				<u>10,180,065</u>
<b>Net assets at end of year</b>				<u>\$ 11,667,526</u>

The accompanying notes are an integral part of this statement

**MUNICIPALITY OF AGUAS BUENAS**  
**BALANCE SHEET - GOVERNMENTAL FUNDS**  
**JUNE 30, 2004**

<u>Assets</u>	<u>Governmental Fund Types</u>					<u>Totals</u>
	<u>General</u>	<u>HUD</u>		<u>Debt Service</u>	<u>Other Governmental Funds</u>	
		<u>Section 8</u>	<u>CDBG</u>			
Cash and cash equivalents	\$ 272,195	\$ 450,623	\$ 7,598	\$ -	\$ 2,645,544	\$ 3,375,960
Cash with fiscal agent	370,780	-	-	531,316	547,353	1,449,449
Accounts receivable:						
Municipal license tax (net of an allowance for bad debt of \$109,409)	46,889	-	-	-	-	46,889
Due from agencies	119,315	-	118,184	270	244,409	482,178
Due from other funds	1,532,421	-	-	-	-	1,532,421
Total assets and other debits	<u>\$ 2,341,600</u>	<u>\$ 450,623</u>	<u>\$ 125,782</u>	<u>\$ 531,586</u>	<u>\$ 3,437,306</u>	<u>\$ 6,886,897</u>

Continues

The accompanying notes are an integral part of this statement

**MUNICIPALITY OF AGUAS BUENAS**  
**BALANCE SHEET - GOVERNMENTAL FUNDS**  
(Continued)  
**JUNE 30, 2004**

<b>Liabilities and Fund Equity</b>	<b>Governmental Fund Types</b>					<b>Totals</b>
	<b>General</b>	<b>HUD</b>		<b>Debt Service</b>	<b>Other Governmental Funds</b>	
		<b>Section 8</b>	<b>CDBG</b>			
<b>Liabilities</b>						
Accounts payable and accrued expenses	\$ 843,010	\$ -	\$ 88,697	\$ 45,519	\$ 60,116	\$ 1,037,342
Due to other agencies	196,989	-	-	-	-	196,989
Due to other funds	-	5,453	37,085	-	1,489,883	1,532,421
General obligation bonds payable	-	-	-	275,000	-	275,000
Deferred revenues:						
Municipal license tax	328,664	-	-	-	-	328,664
Federal financial assistance	-	445,170	-	-	-	445,170
Other	119,314	-	-	-	-	119,314
<b>Total liabilities</b>	<b>1,487,977</b>	<b>450,623</b>	<b>125,782</b>	<b>320,519</b>	<b>1,549,999</b>	<b>3,934,900</b>
<b>Fund equity</b>						
Fund balances:						
Designated for debt service	-	-	-	211,067	-	211,067
Reserved for restricted purposes	-	-	-	-	1,887,307	1,887,307
Encumbrances	38,288	-	-	-	-	38,288
Unreserved	815,335	-	-	-	-	815,335
<b>Total fund equity</b>	<b>853,623</b>	<b>-</b>	<b>-</b>	<b>211,067</b>	<b>1,887,307</b>	<b>2,951,997</b>
<b>Total liabilities, and fund equity</b>	<b>\$ 2,341,600</b>	<b>\$ 450,623</b>	<b>\$ 125,782</b>	<b>\$ 531,586</b>	<b>\$ 3,437,306</b>	<b>\$ 6,886,897</b>

Continues

The accompanying notes are an integral part of this statement

**MUNICIPALITY OF AGUAS BUENAS**  
**BALANCE SHEET - GOVERNMENTAL FUNDS**  
**(CONTINUED)**  
**JUNE 30,2004**

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF NET ASSETS**

**Total Fund Balance - Governmental Funds..... \$ 2,951,997**

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 fund. In the current period, these amounts are:

**Total Capital Assets (net)..... 15,787,586**

Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

General Bonds and Special Bonds..... 3,651,000

Compensated Absences..... 985,796

Landfill..... 1,360,000

Other long-term debt..... 1,075,261

Total Long - Term Liabilities..... (7,072,057)

**Total Net Assets of Governmental Activities..... \$ 11,667,526**

MUNICIPALITY OF AGUAS BUENAS

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES  
 GOVERNMENTAL FUND  
 FOR THE YEAR ENDED JUNE 30, 2004

	Governmental Fund Types					Totals
	General	HUD		Debt Service	Other Governmental Funds	
		Section 8	CDBG			
<b>Revenues</b>						
Property taxes	\$ 1,547,311	\$ -	\$ -	\$ 431,547	\$ -	\$ 1,978,858
Municipal license tax	445,719	-	-	-	-	445,719
Licenses, fees and permits	215,496	-	-	-	-	215,496
Intergovernmental	4,811,128	1,255,006	1,546,305	-	2,635,390	10,247,829
Rent of properties	69,282	-	-	-	-	69,282
Interest	46,642	-	-	-	-	46,642
Other	369,808	-	-	-	113,543	483,351
<b>Total revenues</b>	<b>7,505,386</b>	<b>1,255,006</b>	<b>1,546,305</b>	<b>431,547</b>	<b>2,748,933</b>	<b>13,487,177</b>
<b>Expenditures</b>						
General government	4,087,159	223,220	159,521	-	839	4,470,739
Public safety	281,791	-	-	-	50,930	332,721
Public works	3,236,910	-	-	-	-	3,236,910
Health, sanitation and welfare	325,316	999,970	205,355	-	1,458,847	2,989,488
Education and recreation	178,782	-	-	-	-	178,782
Other	6,349	-	-	-	-	6,349
Capital outlays	-	31,816	1,181,429	-	1,319,854	2,533,099
Debt service:						
Principal retirement	-	-	-	1,852,441	-	1,852,441
Interest	-	-	-	168,475	-	168,475
<b>Total expenditures</b>	<b>8,116,307</b>	<b>1,255,006</b>	<b>1,546,305</b>	<b>2,020,916</b>	<b>2,830,470</b>	<b>15,769,004</b>
Excess of revenues over (under) expenditures	\$ (610,921)	\$ -	\$ -	\$ (1,589,369)	\$ (81,537)	\$ (2,281,827)

Continues

MUNICIPALITY OF AGUAS BUENAS

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES  
 GOVERNMENTAL FUND  
 (CONTINUED)  
 FOR THE YEAR ENDED JUNE 30, 2004

	Governmental Fund Types					Totals
	General	HUD		Debt Service	Other Governmental Funds	
		Section 8	CDBG			
Other financing sources (uses)						
Transfers in	\$ -	\$ -	\$ -	\$ 1,572,457	\$ -	\$1,572,457
Transfers out	(1,572,457)	-	-	-	-	(1,572,457)
Proceeds from issuance of long-term debt	1,940,000	-	-	-	-	1,940,000
Other	306,924	-	-	-	-	306,924
Total financing sources (uses)	674,467	-	-	1,572,457	-	2,246,924
Excess of revenues over (under) expenditures and other sources	63,546	-	-	(16,912)	(81,537)	(34,903)
Fund balances at beginning of year, as restated	790,077	-	-	227,979	1,968,844	2,986,900
Fund balances at end of year	\$ 853,623	\$ -	\$ -	\$ 211,067	\$ 1,887,307	\$2,951,997

Continues

The accompanying notes are an integral part of this statement

**MUNICIPALITY OF AGUAS BUENAS**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE  
GOVERNMENTAL FUNDS**

**(CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

**Net Change in Fund Balances - Total Governmental Funds** ..... \$ (34,903)  
Amounts reported for Governmental Activities in the Statement of Activities

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:

Capital Outlays .....	2,533,099	
Depreciation Expense .....	(616,252)	
Excess of Capital Outlays over Depreciation Expense .....		1,916,847

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds and vice versa:

Other financing sources ..... (2,246,924)

Some expenses not reported in the Statement of Activities require the use of current financial resources and therefore are reported as expenditures in governmental funds. These activities consist of:

Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduces Long - Term Liabilities in the Statement of Net Assets. In the current year the repayments were .....		1,852,441
--	--	-----------

<b>Change in Net Assets of Governmental Activities</b> .....		<b>\$ 1,487,461</b>
--	--	---------------------

The accompanying notes are an integral part of this statement

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**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 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.

There are two methods of presentation of the component unit in the financial statement:

1. Blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances.
2. Discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions:

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

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

3. Or presenting condensed financial statements in the notes to the reporting entity's financial statements.

Refer to Note 17 for a description of the component unit based on this criteria.

New accounting pronouncement

In June 1999, the Governmental Accounting Standards Board (GASB) unanimously approved Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Government". This statement establishes new financial reporting requirements for state and local governments. The Municipality adopted the provisions of GASB No. 34 as of July 1, 2003. They require new information restructures much of the information that government entities have presented in the past.

Basis of presentation, measurement focus and basis of accounting

The financial report of the Municipality consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus.

Management Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

Government-wide statements

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**

**NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2004**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The Statement of Net Assets incorporates all capital (long-lived) assets and receivables as well as long-term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focuses on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

Private-sector standards of accounting and financial reporting issued 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.

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed.

The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion (percentage of the assets, liabilities, revenues or expenditures) or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The following are the Municipality's governmental fund types:

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

HUD-Section 8 Housing Choice Program: The Housing Choice Voucher Program provides rental assistance to help very low income families afford a decent, safe and sanitary rental housing.

Community Development Block Grant Program Fund (CDBG): CDBG fund is used to account for revenues sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

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 and interest.

Governmental funds are accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet in the funds statements. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of these funds present increase (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets. The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method 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 Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when the related liability is incurred.

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.

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.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

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

Notes to financial statements

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

Required Supplementary Information

Required supplementary information consists of the Budgetary Comparison Schedule - General Fund as required by GASB.

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.

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 Municipality purchases office and printing supplies, gasoline, oil and other items. The cost of inventories is recorded as an expenditure when incurred in the appropriate fund and the inventory at the year-end is not recorded in the financial statements as management believe is not significant.

Cash equivalents

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

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

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

Capital Assets

Property, plant, and equipment purchased or acquired is carried at historical cost. Where cost can not be determined from the available records, estimated historical cost was used to record the estimated value of the assets. Assets acquired by gift or bequest are recorded at their market value at the date of transfer. Depreciation has been provided over the estimated useful lives using the straight-line method of depreciation. The estimated useful lives for each major class of depreciable fixed are as follows:

Infrastructure	50 years
Buildings	40 years
Improvements to land	25 years
Vehicles	7 years
Machinery and equipment	10 years
Computers and printers	3 years
Furniture	15 years

Upon disposal of property, the related cost and accumulated depreciation are removed from the accounts with gains or losses on disposal reported currently. Expenditures for maintenance, repairs, and minor renewals and betterments are charged against income. Renewals and betterments of a major character are capitalized.

Pursuant to GASB Statement 34, an extended period of deferral is available before the requirement to record and depreciate infrastructure assets become effective. This category is likely to be the largest asset class of the government and has historically not been reflected nor a measure of its consumption charged. Infrastructure assets include roads, bridges, underground pipe (other than related to utilities), traffic signals, etc.

GASB Statement 34 requires the reporting and depreciation of new infrastructure expenditures effective with the beginning of the implementation year.

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.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

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

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.

Interfund 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 from/to 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 from/to other funds".

**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.

**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, 2004, cash retained by the Municipal Revenues Collection Center amounted to \$531,316.

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**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. Municipal licence tax 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 \$328,664 corresponding to the next fiscal year municipal license tax receivable representing uncollected tax as June 30, 2004 on filed tax returns follows:

Receivable as of June 30, 2004	\$156 298
Less: Allowance for Uncollectible	<u>109 409</u>
	<u><u>\$ 46 889</u></u>

**NOTE 5 DUE FROM OTHER AGENCIES**

The composition of the due from other agencies is as follows:

Municipal Revenue Collection Center	\$ 68 350
Puerto Rico Electric Power Authority	51 235
Office of the Commissioner for Municipal Affairs	118 184
FEMA	141 900
Department of Education (Child Care Program)	<u>102 509</u>
	<u><u>\$482 178</u></u>

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 6 CAPITAL ASSETS**

Capital assets of the Governmental Activities for the year ended June 30, 2004, are summarized as follows:

	Balance July 1, 2003	Additions	Adjustments and Retirements	Balance June 30, 2004
<b>Non Depreciable Capital Assets:</b>				
Land	\$ 2 062 577	\$ -	\$ -	\$ 2 062 577
	<u>2 062 577</u>	<u>-</u>	<u>-</u>	<u>2 062 577</u>
<b>Depreciable Capital Assets:</b>				
Infrastructure	-	508 617	-	508 617
Buildings, Parks and Courts	15 731 175	2 232 938	-	17 964 113
Machinery and equipment	1 472,156	59 788	-	1 531 944
Automobiles	1 817 844	132 960	-	1 950 804
	<u>19 021 175</u>	<u>2 934 303</u>	<u>-</u>	<u>21 955 478</u>
<b>Total Capital Assets</b>	<u>21 083 752</u>	<u>2 934 303</u>	<u>-</u>	<u>24 018 055</u>
<b>Less Accumulated Depreciation:</b>				
Buildings, Parks and Courts	5 757 559	361 738	-	6 119 387
Machinery and equipment	630 612	137 380	-	767 992
Automobiles	1 226 046	117 134	-	1 343 180
	<u>7 614 217</u>	<u>616 252</u>	<u>-</u>	<u>8 230 469</u>
<b>Net Capital Assets</b>	<u>\$13 469 535</u>	<u>\$2 318 051</u>	<u>\$ -</u>	<u>\$15 787 586</u>

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 6 CAPITAL ASSETS (CONTINUED)**

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

Governmental activities:	
General government	\$127 897
Public works	398 049
Public safety	389
Education and recreation	84 879
Health and sanitation	5 038
	<u>616 252</u>

**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 amount of \$985,796.

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 31<sup>st</sup> of each year. That excess should be paid to the employee before March 31<sup>st</sup> of the following year.

**NOTE 8 DUE TO OTHER AGENCIES**

The balance of this account at June 30, 2004 consists of the following:

General Fund:

Puerto Rico Water and Sewer Authority	\$ 2 707
General Service Administration	6 730
Department of Labor and Human Resources	20 369
Other municipalities	112 746
Retirement system	<u>54 437</u>
	<u>\$196 989</u>

**MUNICIPALITY OF AGUAS BUENAS**

**NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2004**

**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 SUMMARY OF LONG-TERM DEBT ACTIVITY**

The following summarizes the activity in long-term debt for the fiscal year ended June 30, 2004:

	<u>Balance at July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2004</u>	<u>Due within one year</u>
Bonds payable	\$2 028 000	\$1 940 000	\$ 42 000	\$3 926 000	\$ 275 000
Compensated absences (Note 7)	743 583	590 959	348 746	985 796	488 072
Landfill postclosure costs (Note 18)	350 000	1 010 000	-	1 360 000	50 500
Other long-term debt	<u>2 829 007</u>	<u>-</u>	<u>1 753 746</u>	<u>1 075 261</u>	<u>-</u>
	<u>\$5 950 590</u>	<u>\$3 540 959</u>	<u>\$2 144 492</u>	<u>\$7 347 057</u>	<u>\$ 813 572</u>

A. The following is a summary of general bonds and special obligations as of June 30, 2004:

\$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.	392 000
\$400,000 Bond Anticipation Note due March 1, 2018, with a fixed interest rate of 5.63%.	299 000
\$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%.	<u>85 000</u>
Sub-total	<u>1 566 000</u>

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 10 SUMMARY OF LONG-TERM DEBT ACTIVITY (CONTINUED)**

Sub-total	\$1 566 000
\$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%.	370 000
\$430,000 General Obligation Notes, Serial 2003-04 due in annual installments ranging from \$50,000 to \$75,000 through July 1, 2010; interest rate of 1.25% over libor rate.	430 000
\$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 general obligation bonds	2 416 000
\$1,510,000 Special Obligation Bond, Serial 2003-04 due in annual principal installments of \$150,000; interest rate of 1.25% over libor rate through July 1, 2013.	<u>1 510 000</u>
	<u><u>\$3 926 000</u></u>

The annual requirements to amortize the general obligation bonds outstanding as of June 30, 2004 during the next five years and thereafter are as follows:

<u>Year ending</u> <u>June 30,</u>	<u>Total</u>
2005	\$ 275 000
2006	376 000
2007	341 000
2008	246 000
2009	221 000
Thereafter	<u>2 467 000</u>
	<u><u>\$3 926 000</u></u>

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.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 10 LONG-TERM DEBT (CONTINUED)**

B. Other long-term debt consists of the following balances:

Puerto Rico Health Insurance Administration	\$ 502 529
Municipal Revenue Collection Center	389 705
Property tax advances	<u>183 027</u>
Total	<u>\$1 075 261</u>

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. Resources from the General Fund are used to liquidate these obligations.

**NOTE 11 INTERFUND TRANSACTIONS**

The Municipality reports certain transactions as operating transfers, which are legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

**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.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 12 PENSION PLAN (CONTINUED)**

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.

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.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 12 PENSION PLAN (CONTINUED)**

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.

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, 2004 for the Municipality of Aguas Buenas amounted to approximately \$105,000 and \$115,000, 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, 2004, a copy of which can be obtained from the Administrator at the Retirement System Administration, PO Box 42003, San Juan, Puerto Rico 00940.

**NOTE 13 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.

All of these intergovernmental revenues are accounted for through the general fund except for those directly related to capital improvements and federal grants which are accounted for through other governmental funds.

The federal grants are recorded under the deferred method of accounting; and therefore, revenues are recognized based upon the expenditures recorded.

**NOTE 14 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.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 14 PROPERTY TAXES (CONTINUED)**

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, 2004 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.

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, 2004. The records for such receivables are kept and maintained by the Municipal Revenue Collection Center.

The balance of the excess of property taxes collected by the Municipality amounted to \$96,202 as of June 30, 2004. The terms of the financing of this debt is 30 years with a due date of July 1, 2034 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.

**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 \$86,825 as of June 30, 2004.

**MUNICIPALITY OF AGUAS BUENAS**

**NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2004**

**NOTE 15 FUND EQUITY (RESERVES AND DESIGNATIONS)**

a. Reservation of fund balance

Reservations of fund balance represent portions of the fund balance that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

- Encumbrances: Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.
- Debt Service: Represents net assets available to finance future debt service payments.
- Capital Projects: Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed.

b. Unreserved fund balance designations

Designations of unreserved fund balance represent tentative plans or commitments of governmental resources.

The fund balance of the General Fund as of July 1, 2003 has been adjusted by \$94,524 in order to eliminate accounts payable recorded in prior years. The fund balance was restated as follows:

Fund balance at beginning of year	\$ 695 553
Accounts payable from prior years eliminated	<u>94 524</u>
Fund balance at beginning of year, as restated	<u><u>\$ 790 077</u></u>

**NOTE 16 CLAIMS AND JUDGMENT**

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.

(Continues)

**MUNICIPALITY OF AGUAS BUENAS**

**NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2004**

**NOTE 16 CLAIMS AND JUDGMENT (CONTINUED)**

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 ESPIRITU SANTO HOUSING PROJECT**

On March 1<sup>st</sup>, 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 rental income is received from HUD. Audited financial statements of the project at June 30, 2004 are available from the Municipality. A condensed statement of financial position and statement of activities is as follows:

Statement of Financial Position

<u>Assets</u>	<u>June 30, 2004</u>
Current assets	\$ 89 748
Capital assets (net)	776 840
Other assets	<u>126 415</u>
Total assets	<u>\$993 003</u>
 <u>Liabilities and net assets</u>	
Current liabilities	\$ 30 792
Mortgage payable	<u>729 613</u>
	760 405
Net assets	<u>232 598</u>
Total liabilities and net assets	<u>\$993 003</u>

Statement of Activities

	<u>Year ended June 30, 2004</u>
Revenues	\$277 041
Expenses	<u>(327 524)</u>
Change in net assets	(50 483)
Net assets, beginning of year	<u>283 081</u>
Net assets, ending of year	<u>\$232 598</u>

**MUNICIPALITY OF AGUAS BUENAS**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**NOTE 18 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.

The Municipality operated a solid waste landfill that was closed during 1994. Total closure costs incurred as of June 30, 2004 were approximately \$1,300,000. 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 as of June 30, 2004 amounted to \$1,360,000. Accordingly, a provision for future closure and post closure costs was recognized in the accompanying financial statements.

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

MUNICIPALITY OF AGUAS BUENAS

BUDGETARY COMPARISON SCHEDULE - GENERAL AND DEBT SERVICE FUNDS  
FOR THE YEAR ENDED JUNE 30, 2004

	General Fund				Debt Service Fund			
	Original Budget	Ammended Budget	Actual	Variance	Original Budget	Ammended Budget	Actual	Variance
<b>Revenues</b>								
Property Taxes	\$ 1,265,623	\$ 1,481,375	\$ 1,547,311	\$ 65,936	\$ 409,683	\$ 409,683	\$ 431,547	\$ 21,864
Municipal Licence Tax	394,250	394,250	445,719	51,469				
Licenses, fees and permits	151,000	194,465	215,496	21,031				
Intergovernmental	4,536,252	4,593,524	4,760,618	167,094				
Rent of properties	60,000	60,000	65,925	5,925				
Interest	60,000	60,000	46,642	(13,358)				
Other	173,200	1,223,677	1,278,562	54,885				
<b>Total Revenues</b>	<b>6,640,325</b>	<b>8,007,291</b>	<b>8,360,273</b>	<b>352,982</b>	<b>409,683</b>	<b>409,683</b>	<b>431,547</b>	<b>21,864</b>
<b>Expenditures</b>								
General government	3,353,567	4,242,370	4,140,133	(102,237)				
Public Safety	316,670	282,268	281,791	(477)				
Public Works	2,507,946	2,976,981	3,142,899	165,918				
Health, sanitation and welfare	283,397	325,372	325,316	(56)				
Education and Recreation	178,745	180,300	178,782	(1,518)				
<b>Total Current Expenditures</b>	<b>6,640,325</b>	<b>8,007,291</b>	<b>8,068,921</b>	<b>61,630</b>				
Debt Service								
Principal retirement and interest payment					409,683	409,683	1,745,916	(1,336,233)
<b>Total Expenritures</b>	<b>6,640,325</b>	<b>8,007,291</b>	<b>8,068,921</b>	<b>61,630</b>	<b>409,683</b>	<b>409,683</b>	<b>1,745,916</b>	<b>(1,336,233)</b>
Excess of revenues over (under) expenditures	\$ -	\$ -	\$ 291,352	\$ 291,352	\$ -	\$ -	\$ (1,314,369)	\$ (1,314,369)

The accompanying notes are an integral part of this statement

**MUNICIPALITY OF AGUAS BUENAS**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION  
BUDGETARY COMPARISON SCHEDULE – GENERAL AND DEBT SERVICE FUND  
JUNE 30, 2004**

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

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 Mayor submits to the Municipal Assembly a proposed operating budget for the fiscal year commencing the following July 1<sup>st</sup>. 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.
4. The Mayor 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 presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

**MUNICIPALITY OF AGUAS BUENAS**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION  
BUDGETARY COMPARISON SCHEDULE – GENERAL AND DEBT SERVICE FUND  
JUNE 30, 2004**

**NOTE 2 RECONCILIATION OF GAAP TO BUDGETARY BASIS**

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	\$7 505 386	\$8 116 307	\$ 431 547	\$2 020 916
Plus other financing sources considered revenues in budgetary basis	914 804			
Less current revenues included in GAAP basis but not in budgetary basis	(59 917)			
Less current expenditures included in GAAP basis but not in budgetary basis		(158 131)		
Plus other financing use considered expenditure in budgetary basis		72 457		
Plus year end encumbrances		38 288		
Less current portion of long-term debt not considered in budgetary basis				(275 000)
Budgetary basis	<u>\$8 360 273</u>	<u>\$8 068 921</u>	<u>\$ 431 547</u>	<u>\$1 745 916</u>

**MUNICIPALITY OF AGUAS BUENAS**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2004**

<u>Federal Grantor/Passed-Through Grantor 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	\$1 255 006
Passed-through - Office of the Commissioner of Municipal Affairs Program: State Block Grant	14.228	98-47	1 546 305
U.S. Department of Federal Emergency Management Agency Program: Disaster Assistance	83.516	842-DR-PR	657 711
U.S. Department of Health and Human Services Passed-through - Family and Children Administration: Program: Childcare and Development Block Grant	93.575	N/A	693 935
U.S. Department of Justice Passed through Puerto Rico Department of Justice Police Corp. (COPS)	16.712	N/A	<u>48 781</u>
<b>Total Expenditures of Federal Awards</b>			<b><u><u>\$4 201 738</u></u></b>

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, 2004

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>	
HUD Section 8	\$1 255 006
CDBG	1 546 305
Other federal programs expenditures	<u>1 400 427</u>
Sub-total	4 201 738
State and Municipal expenditures	<u>1 430 043</u>
	<u>\$5 631 781</u>
Financial Statements Fund	
HUD - Section 8	\$1 255 006
CDBG	1 546 305
Other governmental funds	<u>2 830 470</u>
	<u>\$5 631 781</u>

# VALDES, GARCIA & MARIN

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

**PARTNERS:**

ERNESTO VALDÉS  
ARTURO GARCÍA SÁNCHEZ  
RAMÓN MARÍN  
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## REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Mayor and Municipal Legislature  
Municipality of Aguas Buenas  
Aguas Buenas, Puerto Rico

We have audited the financial statements of the Municipality of Aguas Buenas as of and for the year ended June 30, 2004, and have issued our report thereon dated January 12, 2005, in which we have expressed an unqualified opinion. 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 of Aguas Buenas' 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 statements 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 controls over financial reporting**

In planning and performing our audit, we considered the Municipality of Aguas Buenas' 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a 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 noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

This report is intended for the information of the management of the Municipality, the Municipal Legislature and the 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  
January 12, 2005

Stamp 2023337 was affixed  
to the original.

A handwritten signature in blue ink, appearing to read "Vales, Gair + Macis". The signature is written in a cursive style with a large initial 'V'.

# VALDES, GARCIA & MARIN

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

**PARTNERS:**

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

Mayor and Municipal Legislature  
Municipality of Aguas Buenas  
Aguas Buenas, Puerto Rico

### **Compliance**

We have audited the compliance of the Municipality of Aguas Buenas 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, 2004. The Municipality of Aguas Buenas' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality of Aguas Buenas' management. Our responsibility is to express an opinion on the Municipality of Aguas Buenas' compliance based on our audit.

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

In our opinion, the Municipality of Aguas Buenas 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, 2004. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 04-III-01 and 02.

## Internal Control Over Compliance

The management of the Municipality of Aguas Buenas is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality of Aguas Buenas' 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 relative low level the risk that noncompliance with 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 operations that we consider to be material weaknesses.

This report is intended for the information of the management of the Municipality, the Municipal Legislature and the 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  
January 12, 2005

Stamp 2023338 was affixed  
to the original

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

Municipality of Aguas Buenas

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**Section I - Summary of Auditor's Results**

Year ended June 30, 2004

**Part I - Financial Statements**

1. Type of auditor's report issued  Unqualified opinion  Qualified opinion  
 Adverse opinion  Disclaimer of opinion
2. Material weakness(es) identified?  Yes  No
3. Reportable condition(s) identified that are not considered to be material weakness?  Yes  No
4. Noncompliance material to financial statements noted?  Yes  No

**Part II - Federal Awards**

Internal control over major programs:

1. Material weakness(es) identified?  Yes  No
2. Reportable condition(s) identified that are not considered to be material weakness(es)?  Yes  No
3. Type of auditor's report issued on compliance for major programs:  Unqualified opinion  Qualified opinion  
 Adverse opinion  Disclaimer of opinion
4. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?  Yes  No

5. Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
14.228	Community Development Block Grant - State's Program
14.871	Section 8 Rental Voucher Program
83.516	Disaster Assistance

6. Dollar threshold used to distinguish between type A and type B programs:  \$300,000
7. Auditee qualified as low-risk auditee?  Yes  No

**MUNICIPALITY OF AGUAS BUENAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2004**

**PART II - FINDING AND QUESTIONED COSTS - FINANCIAL STATEMENTS**

No findings to be reported.

**MUNICIPALITY OF AGUAS BUENAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2004**

**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, 2004

**FINDING NUMBER 04-III-01 Reportable condition over housing quality inspections**

CONDITION

During our examination of the Municipality's Section 8 internal control procedures we found that in 4 of 13 cases examined the Municipality failed to perform the follow up reinspections 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 to do a 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 Municipality failed to properly follow up on pending inspections.

RECOMMENDATION

The Municipality must implement an effective procedure to follow up on pending inspections and ascertain that these are completed.

QUESTIONED COSTS

None

GRANTEE'S RESPONSE

See grantee's corrective action plan.

**MUNICIPALITY OF AGUAS BUENAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2004**

**B. Community Development Block Grant – CFDA No. 14.228,  
Grant Period – Year ended June 30, 2004**

FINDING NUMBER 04-III-02 Reportable condition over cash management

CONDITION

During our audit we noted that the Municipality disbursed federal funds between 1 (one) to 4 (four) days after the required maximum of three business days.

CRITERIA

The Common Rule – Uniform Administrative Requirements for grants and Cooperative Agreements to State and Local Governments, requires the federal funds recipient to establish a financial management system which includes procedures to minimize the time elapsed between the transfer of funds from the U.S. Treasury Department and the disbursements of funds by the Grantee.

EFFECT

The Municipality is not in compliance with the federal regulation in relation to adequate cash management.

CAUSE

The lack of proper supervision of the cash account balances caused this situation.

RECOMMENDATION

The Municipality should develop the necessary procedures for cash forecasting to minimize the time elapsed between the date of transfer of funds and the disbursement dates.

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 2003 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 2003 report and noted the following:

Finding No. 03-II-01 Inadequate procedures and controls over property and equipment

As part of the implementation of GASBS No. 34 the Municipality performed a comprehensive inventory and reconciliation with the property records and were able to record capital assets as part of the 2004 financial statement. However there is still the need to implement capitalization policies and procedures to continue to properly identify and record capital asset additions and retirements.

Finding No. 03-III-02

Program- U.S. Department of Housing and Urban Development

The Municipality failed to conduct the annual inspection on 2 of 25 cases examined by auditor.

**STATUS**

This finding was repeated during the current year audit.