

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE ARECIBO

AUDITORIA 2001-2002

30 DE JUNIO DE 2002

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARECIBO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2002

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARECIBO

YEAR ENDED JUNE 30, 2002

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARECIBO

YEAR ENDED JUNE 30, 2002

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

INDEPENDENT AUDITORS' REPORT

**To the Honorable Mayor and
the Municipal Legislature
Municipality of Arecibo
Arecibo, Puerto Rico**

We have audited the accompanying general-purpose financial statements of the **Municipality of Arecibo**, as of and for the year ended June 30, 2002, as listed in the table of contents. These general purpose financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of the Office of Management and Budget 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 the general-purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general-purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general-purpose financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

We were unable to obtain audited financial statements of the "Corporación de Desarrollo Cultural Teatro Oliver", a Discrete Component Unit, and that was not included on the accompanying general - purpose financial statements. Accordingly, we do not express an opinion about the reporting entity structure.

As described in **Note 8**, the Municipality has not maintained complete and adequate records of its general fixed assets and, accordingly, we were unable to obtain sufficient competent evidential matter with respect to the reported value of the Municipality's general fixed assets account group at June 30, 2002.

INDEPENDENT AUDITORS' REPORT (Continued)

As disclosed in Note 14, at June 30, 2002, the Municipality had not performed the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated the obligation for landfill closure and post closure care costs. Governmental Accounting Standard Board Statement 18 requires, among other things that the Municipality estimates and recognizes the Municipal Solid Waste Landfill Closure and Post closure Care Costs. Accordingly, no provision for liability has been made in the financial statements.

In our opinion, except for the effect of third, fourth and fifth paragraphs, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the **Municipality of Arecibo** as of June 30, 2002, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements of the **Municipality of Arecibo**, taken as whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the general purpose financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the general purpose financial statements taken as a whole.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 17, 2002

Stamp No. 1854019 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
COMBINED BALANCE SHEET
ALL GOVERNMENTAL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2002**

| | GOVERNMENTAL FUND TYPES | | | | ACCOUNT GROUPS | | TOTAL (MEMORANDUM ONLY) |
|--|-------------------------|--------------------|--------------------|---------------------|-------------------------|---------------------------|----------------------------|
| | General | Special Revenue | Debt Service | Capital Projects | General Fixed Assets | General Long-term Debt | |
| ASSETS AND OTHER DEBITS | | | | | | | |
| Cash and cash equivalents | \$11,862,596 | \$2,714,434 | | \$6,117,263 | | | \$20,694,293 |
| Cash with fiscal agent | | | \$5,699,846 | 9,826,032 | | | 15,525,878 |
| Intergovernmental receivable | 1,056,341 | | | | | | 1,056,341 |
| Municipal License tax receivable | 4,778 | | | | | | 4,778 |
| Federal grants receivable | | 518,318 | | | | | 518,318 |
| Due from other funds | 283,190 | | | | | | 283,190 |
| Other Receivables | 816,283 | | | | | | 816,283 |
| Property and Equipment | | | | | \$58,907,963 | | 58,907,963 |
| Amount available in Debt Service Fund | | | | | | \$5,699,846 | 5,699,846 |
| Amount to be provided for retirement of general long-term debt | | | | | | 55,477,404 | 55,477,404 |
| Total assets and other debits | \$14,023,188 | \$3,232,752 | \$5,699,846 | \$15,943,295 | \$58,907,963 | \$61,177,250 | \$158,984,294 |
| LIABILITIES AND FUND EQUITY | | | | | | | |
| Liabilities: | | | | | | | |
| Accounts payable and accrued liabilities | \$1,406,838 | \$585,918 | | | | | \$1,992,756 |
| Due to other funds | | 274,921 | | \$8,269 | | | 283,190 |
| Due to other governmental entities | 2,422,648 | | | | | \$2,288,871 | 4,711,519 |
| Deferred municipal license tax revenues | 10,238,163 | | | | | | 10,238,163 |
| Deferred federal grant revenues | | 1,512,170 | | | | | 1,512,170 |
| General obligation bonds | | | | | | 30,354,000 | 30,354,000 |
| Notes payable | | | | | | 18,382,940 | 18,382,940 |
| Claims and judgments | | | | | | 973,383 | 973,383 |
| HUD recovery of disallowed costs | | | | | | 5,543,194 | 5,543,194 |
| Accrued compensated absences | | | | | | 3,634,862 | 3,634,862 |
| Total liabilities | 14,067,649 | 2,373,009 | | 8,269 | | 61,177,250 | 77,626,177 |
| Fund equity and other credits | | | | | | | |
| Investment in general fixed assets | | | | | \$58,907,963 | | 58,907,963 |
| Fund balances: | | | | | | | |
| Reserved for encumbrances | 2,249,507 | | | | | | 2,249,507 |
| Reserved for debt service | | | 5,699,846 | | | | 5,699,846 |
| Unreserved: | | | | | | | |
| Designated for specific fund purposes | | 859,743 | | 15,935,026 | | | 16,794,769 |
| Undesignated | (2,293,968) | | | | | | (2,293,968) |
| Total fund equity (deficit) and other credits | (44,461) | 859,743 | 5,699,846 | 15,935,026 | \$58,907,963 | - | 81,358,117 |
| Total liabilities and fund equity | \$14,023,188 | \$3,232,752 | \$5,699,846 | \$15,943,295 | \$58,907,963 | \$61,177,250 | \$158,984,294 |

See accompanying notes to general purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
COMBINED STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
ALL GOVERNMENTAL FUND TYPES
YEAR ENDED JUNE 30,2002**

| | GOVERNMENTAL FUND TYPES | | | | TOTALS (MEMORANDUM ONLY) |
|---|-------------------------|--------------------|--------------------|---------------------|-----------------------------|
| | General | Special Revenue | Debt Service | Capital Projects | |
| REVENUES | | | | | |
| Property taxes | \$10,410,582 | | \$2,663,840 | | \$13,074,422 |
| Municipal license taxes | 12,523,004 | | | | 12,523,004 |
| Licenses and permits | 1,427,994 | | | | 1,427,994 |
| Intergovernmental | 6,835,118 | \$1,029,633 | | \$2,239,468 | 10,104,219 |
| Rent of property | 250,075 | | | | 250,075 |
| Fines and penalties | 27,148 | | | | 27,148 |
| Interest | 318,178 | | | | 318,178 |
| Federal grants | | 17,976,702 | | | 17,976,702 |
| Miscellaneous | 1,320,772 | 53,862 | | | 1,374,634 |
| Total revenues | <u>33,112,871</u> | <u>19,060,197</u> | <u>2,663,840</u> | <u>2,239,468</u> | <u>57,076,376</u> |
| EXPENDITURES | | | | | |
| Current: | | | | | |
| Mayor and Municipal Assembly | 3,026,113 | | | | 3,026,113 |
| General government | 18,197,980 | 1,724,987 | | | 19,922,967 |
| Public safety | 1,478,325 | 140,856 | | | 1,619,181 |
| Public works | 3,799,666 | 64,211 | | | 3,863,877 |
| Public health and sanitation | 5,149,320 | | | | 5,149,320 |
| Welfare | | 14,628,419 | | | 14,628,419 |
| Economic development | 436,006 | | | | 436,006 |
| Culture and Recreation | 399,378 | | | | 399,378 |
| Principal retirement | 418,824 | 1,000,000 | 969,000 | | 2,387,824 |
| Interest | 309,925 | 253,752 | 1,571,196 | | 2,134,873 |
| Capital outlays | 112,812 | 887,475 | | 2,366,461 | 3,366,748 |
| Total expenditures | <u>33,328,349</u> | <u>18,699,700</u> | <u>2,540,196</u> | <u>2,366,461</u> | <u>56,934,706</u> |
| Excess (deficiency) of revenues over (under) expenditures | (215,478) | 360,497 | 123,644 | (126,993) | 141,670 |
| OTHER FINANCES SOURCES (USES): | | | | | |
| Bond Proceeds | 10,545,000 | | | 5,030,000 | 15,575,000 |
| Operating transfer to other funds | (774,427) | | | | (774,427) |
| Operating transfer from other funds | | | 774,427 | | 774,427 |
| Total other financing sources (uses) | <u>9,770,573</u> | <u>-</u> | <u>774,427</u> | <u>5,030,000</u> | <u>15,575,000</u> |
| Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing sources (uses) | 9,555,095 | 360,497 | 898,071 | 4,903,007 | 15,716,670 |
| Fund balances (deficit), beginning as restated | <u>(9,599,556)</u> | <u>499,246</u> | <u>4,801,775</u> | <u>11,032,019</u> | <u>6,733,484</u> |
| Fund balances (deficit), ending | <u>(\$44,461)</u> | <u>\$859,743</u> | <u>\$5,699,846</u> | <u>\$15,935,026</u> | <u>\$22,450,154</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
COMBINED STATEMENT OF REVENUES, EXPENDITURES, ENCUMBRANCES,
AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
GENERAL AND DEBT SERVICE FUNDS
YEAR ENDED JUNE 30, 2002**

| | GENERAL FUND | | | DEBT SERVICE FUND | | |
|---|-------------------|--------------------|--|-------------------|------------------|--|
| | Budget | Actual | Variance Favorable (Unfavorable) | Budget | Actual | Variance Favorable (Unfavorable) |
| REVENUES | | | | | | |
| Property taxes | \$10,410,582 | \$10,410,582 | - | \$2,723,230 | \$2,663,840 | (\$59,390) |
| Municipal license taxes | 11,841,000 | 12,523,004 | \$682,004 | | | |
| Licenses and permits | 762,000 | 1,427,994 | 665,994 | | | |
| Intergovernmental | 6,318,111 | 6,835,118 | 517,007 | | | |
| Rent of property | 108,000 | 250,075 | 142,075 | | | |
| Fines and penalties | 22,095 | 27,148 | 5,053 | | | |
| Interest | 120,000 | 318,178 | 198,178 | | | |
| Miscellaneous | 2,314,536 | 1,320,772 | (993,764) | | | |
| Total revenues | 31,896,324 | 33,112,871 | 1,216,547 | 2,723,230 | 2,663,840 | (59,390) |
| EXPENDITURES AND ENCUMBRANCES: | | | | | | |
| Current. | | | | | | |
| Mayor and Municipal Assembly | 3,259,364 | 3,437,013 | (177,649) | | | |
| General government | 14,366,797 | 11,797,793 | 2,569,004 | | | |
| Public safety | 1,605,272 | 1,532,464 | 72,808 | | | |
| Public works | 5,191,665 | 4,815,878 | 375,787 | | | |
| Public health and sanitation | 5,308,155 | 5,149,320 | 158,835 | | | |
| Economic development | 503,106 | 436,006 | 67,100 | | | |
| Culture and Recreation | 454,957 | 440,259 | 14,698 | | | |
| Principal retirement | 418,824 | 418,824 | 0 | 1,039,000 | 969,000 | 70,000 |
| Interest | 542,576 | 91,638 | 450,938 | 1,684,230 | 1,571,196 | 113,034 |
| Capital outlays | 245,608 | 112,812 | 132,796 | | | |
| Total expenditures and encumbrances | 31,896,324 | 28,232,007 | 3,664,317 | 2,723,230 | 2,540,196 | 183,034 |
| Excess (deficiency) of revenues over (under) expenditures and encumbrances | | 4,880,864 | 4,880,864 | | 123,644 | 123,644 |
| OTHER FINANCING SOURCES (USES): | | | | | | |
| Bond Proceeds | | 10,545,000 | | | | |
| Operating transfer to other funds | | (774,427) | | | | |
| Operating transfer from other funds | | | | | 774,427 | |
| TOTAL OTHER FINANCING SOURCES (USES) | | 9,770,573 | | | 774,427 | |
| Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing sources (uses) | | 14,651,437 | | | 898,071 | |
| Adjustment required under Generally Accepted Accounting Principles: | | | | | | |
| GAAP adjustments to Expenditures - Operational Loan | | (6,876,694) | | | | |
| Current year encumbrances treated as current year expenditures for budgetary basis | | 2,139,983 | | | | |
| Prior year encumbrances paid during the current year | | (359,631) | | | | |
| Fund balances (deficit), beginning as restated | | (9,599,556) | | | 4,801,775 | |
| Fund balance (deficit), ending | | (\$44,461) | | | 5,699,846 | |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2002

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The **Municipality of Arecibo** (the Municipality) was established in 1616. The Municipality's governmental system consists of an executive and a legislative body. It is governed by a Mayor and a sixteen member Municipal Assembly who are elected every four years through the Puerto Rico general elections.

The Municipality provides the following services: public safety, public works, culture and recreation, health, urban development and welfare.

The Municipality's general-purpose financial statements are presented in accordance with generally accepted accounting principles (GAAP), as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. A summary of the Municipality's significant accounting policies follows:

A. 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* of the Governmental Accounting Standards Board. 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 the nature and significance of the relationship between the entity and a primary government is such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria exists a component unit, which was included in the general-purpose financial statements.

"Corporación Desarrollo Cultural Teatro Oliver" is a non-profit corporation duly organized and existent under the laws of the Commonwealth of Puerto Rico. It was established to acquire, restore and operate the Teatro Oliver of Arecibo, Puerto Rico.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

A. Financial reporting entity (continued):

The Municipality's financial statements include as a component unit the operations of Teatro Oliver, because of the financial interdependency, ability to designate management and the ability to significantly influence operations demonstrated by the Municipality.

The Teatro Oliver elected the provision of Section 101 (7) of the Puerto Rico Income Tax Law for non-profit organization and all of their net revenues are exempt from the payment of income taxes.

B. Basis of presentation:

The Municipality records its transactions in the fund types and account groups described below:

Governmental fund types:

Governmental funds are those through which most governmental functions are financed. The acquisition, use and balances of the Municipality's expendable financial resources and the related current liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination. The following are the Municipality's governmental fund types:

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

Special Revenue - is used to account for the proceeds of specific revenue sources that are legally restricted to be expended for specific purposes.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

B. Basis of presentation:

Account groups:

The account groups are used to maintain accounting control and accountability of the Municipality's general fixed assets and long-term debt. The Municipality's account groups are:

General Fixed Assets - is used to account for all fixed assets of the Municipality.

General Long-term Debt -is used to account for all long-term debt obligations of the Municipality.

C. Basis of accounting:

All governmental funds are accounted for using the modified accrual basis of accounting. Revenues are recognized when they become measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the corresponding year. Expenditures are recorded when the liability is incurred, except for (1) interest on general long-term debt obligations which is recorded when due, and (2) accruals for vacation, sick leave, claims and judgments which are recorded in the general long-term debt account group.

In applying the susceptible to accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are essentially two types of such revenues. In one situation, funds must be expended on the specific purpose or project before any amount is reimbursed to the Municipality; therefore, revenues are recognized based upon the expenditures recorded. In the other situation, funds are virtually unrestricted as to purpose of expenditure and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are recognized as revenues at the time of receipt or earlier if they meet the criteria of availability.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

C. Basis of accounting:

Licenses, permits, rent of property, fines, penalties and other miscellaneous revenues (except investment earnings) are recorded as revenues when received because they are generally not measurable until actually received.

The proprietary fund is accounted for using the accrual basis of accounting. Its revenues are recognized when they are earned and their expenses are recognized when they are incurred.

D. Reservations of fund balance:

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

Encumbrances - Represent future expenditures under purchases orders, contracts and other commitments issued for goods and services not received at year-end. Where the appropriations lapse at year-end these will be honored during subsequent year. Encumbrances constitute the equivalent of expenditures for budgetary purposes and, accordingly, are reported with expenditures in all budgetary basis statements.

Debt Service - Represents net assets available to finance future debt service payments.

E. Budgetary data:

In establishing the budgetary data presented in the general purpose financial statements, the Municipality follows these procedures, which are in accordance with the Municipal Law:

- Prior to May 31, the Major submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1. The proposed budget includes estimated expenditures and the means of financing them.
- The budget document is available for public inspection prior to its approval by the Municipal Assembly.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

E. Budgetary data (continued):

- Prior to July 1, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- 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 general-purpose financial statements.

The budget is prepared following the modified accrual basis of accounting, except for the encumbrances that are recorded as expenditures under the budgetary basis and as a reserve of funds balances under GAAP and for the interfund transactions that are not included in the budgetary basis.

The actual result of operations, presented in the Statement of Revenues, Expenditures, Encumbrances, and Changes in Fund Balances-Budget and Actual-General and Debt Service Funds, is in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

The budget prepared for each of the special revenue funds is based on a program period, which is not necessarily the same as the Municipality's fiscal year. Accordingly, it is not practical to present an annual comparison of budget and actual for the special revenue funds.

F. Inventories:

The General Fund purchases office and printing supplies, gasoline, oil and other items. The cost of purchases is recorded as expenditure and, consequently, the inventory is not recorded in the general-purpose financial statements.

G. Property and equipment:

Property and equipment acquired are recorded as expenditures in the governmental funds and are capitalized at cost in the General Fixed Assets Account Group. Donated property and equipment are recorded at their estimated fair market value at the time they are received by the Municipality. No depreciation has been provided on property and equipment. Interest cost during the construction period is capitalized, when significant.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

H. Cash and cash equivalents:

The Municipality's Director of Finance is responsible for investing available resources and is restricted by law to invest only in saving accounts and certificates of deposit with banks qualified as depositories of public funds by the Department of the Treasury of the Commonwealth of Puerto Rico. The Municipality maintains a cash and investment pool that is available for use by all funds. Each fund type's portion of this pool is displayed on the combined balance sheet as "Cash and Cash Equivalents". All cash in banks at June 30, 2002 is insured by the Federal Deposit Insurance Corporation up to \$100,000, and by collateral held by the Treasury Department to its name. Interest earned from certificates of deposit and other short-term investments is recorded as revenue in the General Fund. Cash and Cash Equivalents include investments with original maturities of ninety days or less.

Cash with fiscal agent:

Debt Service Fund: represents property tax collections retained by the Municipal Revenue Collection Center and Government Development Bank of the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service and unused proceeds from bonds and notes issued for the acquisition or construction of permanent improvements.

Capital Project Fund: Funds restricted and held by Governmental Development Bank for the future disbursements of capital projects. This account includes deposits from loans proceeds for capital projects.

I. Interfund transactions:

The Municipality has the following types of transactions among funds:

Operating transfers- Transfers that are reported when incurred as "Operating transfers from other fund" by the recipient fund and as "Operating transfers to other fund" by the disbursing fund.

Transfer of Expenditures (Reimbursements) - Reimbursement of expenditures made by one fund for another that are recorded as expenditures in the reimbursing fund and as reduction of expenditures in the reimbursed fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

J. Compensated absences:

Municipal employees are granted 30 days of vacation and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of an employee resignation, the employee is reimbursed for accumulated vacation days up to the maximum allowed. Separation from employment prior to the use of all or part of the sick leave before 10 years of service terminates all rights for compensation.

The Municipality accrues a liability for compensated absences, which meet the following criteria:

1. The Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by *GASB Number 16*, the Municipality has accrued a liability for compensated absences, which has been earned but not taken by municipal employees. This liability is presented in the general long-term debt account group because they will not be funded with available expendable financial resources at June 30, 2002.

K. Insurance:

The Municipality has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the Municipality's insurance coverage.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

L. Total columns (memorandum only):

The total columns (memorandum only) are presented only to facilitate additional analysis. Consequently, amounts shown in total columns do not represent financial position or result of operations, in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation since interfund eliminations have not been made.

M. Use of estimates in the preparation of general purpose financial statements:

The preparation of general purpose financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures at the date of the general purpose financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

N. Claims and judgments:

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The General Long-term Debt Account Group includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

2. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the General Fund include the following:

| | |
|--|---------------------|
| Puerto Rico Aqueduct and Sewer Authority | \$ 33,124 |
| General Service Administration | 13,904 |
| Internal Revenue Service | 1,960,964 |
| Department of Treasury | 414,656 |
| | <u>\$ 2,422,648</u> |

The Municipality reached agreements with other governmental entities for the payment of debts on a long- term basis. These liabilities are presented in the General Long- term Debt Account Group because they will not be funded with available expendable financial resources at June 30, 2002. The following is the balance of these accounts:

| | |
|-------------------------------------|---------------------|
| Municipal Revenue Collection Center | <u>\$ 2,288,871</u> |
|-------------------------------------|---------------------|

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

3. PROPERTY TAXES:

The Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico is responsible by law to assess, levy and collect real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment, as of January 1 of each year, is made on a return, which must be filed, with the CRIM, together with the payment, by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of the year 1957.

Tax rates are 8.58% for real property and 6.58% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico. The Municipality's share is composed of the basic tax of 5.8% for real property and 3.8% for personal property which is recorded in the General Fund, and the additional tax of 1.75% in both cases which is restricted for debt service and retained by the CRIM for such purposes. To the extent that such taxes are informed and collected by the CRIM, they are recorded as revenue in the General Fund and in the Debt Service Fund.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the CRIM assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the general fund when payments are received from the CRIM.

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.

The CRIM advances to the municipality the estimated property tax collection for each fiscal year. Advances are repaid through actual collections from the taxpayers. The CRIM periodically informs the Municipality of the amounts collected and applied to outstanding advances. The property tax advanced by the CRIM during the year is recorded as property taxes revenues in the Municipality's General Fund. At the date of the release of these financial statements, the CRIM issued the final liquidation noting that the advances were more than collections by \$905,283. Such amount was recognized as Due to Governmental Entities in the General Long Term Debt Account Group because it will not be funded with available expendable financial resources at June 30, 2002. Also, the Municipality has a \$1,383,588 property tax advance debt from prior years; such balance was included a Due to other governmental entities in the General Long Term Debt Account Group because it will not be funded with available expendable financial resources at June 30, 2002.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

4. MUNICIPAL LICENSE TAXES:

The municipal license tax is levied each year 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 Acts of Puerto Rico. All taxpayers are required to file their declaration by April 15, of each year.

The tax rates are as follows:

| | |
|--------------------------------|-------|
| Financial institutions | 1.50% |
| Savings and loans associations | 1.50% |
| Other organizations | 0.50% |

The tax may be paid in two equal semi-annual installments on July 15 and January 15 following the filing date. However, a discount of 5% is allowed for total payment received on or before April 15. Collections made prior to June 30 pertaining to the next fiscal year are recorded as deferred revenues.

5. INTERGOVERNMENTAL:

Intergovernmental revenues consist mainly of payments from the Commonwealth of Puerto Rico and payments in lieu of taxes from certain quasi-public corporations, principally the Puerto Rico Electric Power Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements. Intergovernmental revenues are recorded in the General Fund, except for those related directly to capital improvements, which are recorded in the Capital Projects Fund.

6. CASH AND CASH EQUIVALENTS:

| | |
|---|---------------|
| Cash in bank accounts | \$ 7,881,526 |
| Money Market bank account | 2,212,044 |
| Certificates of deposit (90 days or less) | 10,600,723 |
| | <hr/> |
| | \$ 20,694,293 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

7 DEBT SERVICE FUND:

Revenue for the Debt Service Fund consists mainly of the share of property taxes, which is designated for the debt service requirements of the bonds and notes obligations issued by the Municipality. The Government Development Bank pays principal and interest on these obligations.

8. GENERAL FIXED ASSETS:

The Municipality has not maintained complete and adequate records of its general fixed assets. Also, there are no written procedures to ascertain that all capital expenditures are properly recorded in the property ledger. In addition, the Municipality has not taken a physical inventory of its property and equipment. As a result, no adequate records exist to classify the general fixed assets account group between land, building and equipment.

A summary of changes in the General Fixed Assets Account Group is as follows:

| | <u>Balance</u> <u>July 1, 2001</u> | <u>Additions</u> | <u>Retirements</u> | <u>Balance</u> <u>June 30, 2002</u> |
|----------------------|---------------------------------------|--------------------|--------------------|--|
| Real Estate Property | \$43,762,498 | \$1,000,000 | | \$44,762,498 |
| Vehicles | 3,130,488 | 84,890 | | 3,215,378 |
| Equipment | 10,687,681 | 247,021 | \$4,615 | 10,930,087 |
| Total | <u>\$57,580,667</u> | <u>\$1,331,911</u> | <u>\$4,615</u> | <u>\$58,907,963</u> |

9. GENERAL OBLIGATION BONDS:

The general obligation bonds transactions for the year ended June 30, 2002 were as follows:

| | |
|--------------------------|----------------------|
| Balance at July 1, 2001 | \$ 26,293,000 |
| Debt issued | 5,030,000 |
| Principal retirements | (969,000) |
| Balance at June 30, 2002 | <u>\$ 30,354,000</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

9. GENERAL OBLIGATION BONDS (CONTINUED):

General obligation bonds at June 30, 2002 are as follows:

| Type of bonds | Maturity date | Original Amount | Range of Interest Rates | Balance at June 30, 2002 |
|--------------------------------|---------------|-----------------|-------------------------|--------------------------|
| 1984 Series | 1/1/2009 | \$675,000 | 5.00% | \$ 278,000 |
| 1987 Series | 1/1/2012 | 875,000 | 5.00% | 513,000 |
| 1989 Series | 1/1/2014 | 500,000 | 5.00% | 325,000 |
| 1990 Series | 7/1/2005 | 3,395,000 | 4.37% to 7.81% | 1,395,000 |
| 1991 Series | 7/1/2006 | 2,060,000 | 3.26% to 6.36% | 1,015,000 |
| 1994 Series | 1/1/2019 | 400,000 | 4.88% | 352,000 |
| 1995 Series | 7/1/2020 | 14,975,000 | 4.70% to 8.00% | 13,475,000 |
| 1998 Series | 1/1/2023 | 900,000 | 4.75% | 826,000 |
| 1999 Series | 7/1/2024 | 7,365,000 | 5.88% to 7.81% | 7,145,000 |
| 2002 Series | 7/1/2026 | 5,030,000 | 5.00% to 7.50% | 5,030,000 |
| Total general obligation bonds | | | | <u>\$ 30,354,000</u> |

The future annual requirements for the amortization of general obligations bonds outstanding as of June 30, 2002, are as follows:

| Year ended June 30 | Total |
|-----------------------|----------------------|
| 2003 | \$ 1,106,000 |
| 2004 | 1,206,000 |
| 2005 | 1,307,000 |
| 2006 | 1,417,000 |
| 2007 | 1,100,000 |
| Thereafter | 24,218,000 |
| Total | <u>\$ 30,354,000</u> |

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

10. NOTES PAYABLE:

The notes payable transactions for the year ended June 30, 2002 were as follows:

| | |
|--------------------------|----------------------|
| Balance at July 1, 2001 | \$ 9,256,764 |
| Debt issued | 10,545,000 |
| Principal retirements | <u>(1,418,824)</u> |
| Balance at June 30, 2002 | <u>\$ 18,382,940</u> |

Notes payable at June 30, 2002 are as follows:

| Description | Maturity Date | Original Amount | Range of Interest rates | Balance June 30, 2002 |
|-------------------------|--------------------------|----------------------------|------------------------------------|----------------------------------|
| Special Lottery | 7/1/2008 | 3,000,000 | 8.00% | \$ 952,940 |
| 1994 Series | 7/1/2014 | 5,335,000 | 9.00% | 4,310,000 |
| Section 108 Loan | 8/1/2003 | 9,575,000 | 7.00% | 2,575,000 |
| 2001 Series | 7/1/2026 | 10,545,000 | 5.00% to 8.00% | <u>10,545,000</u> |
| Total notes payable | | | | <u>\$ 18,382,940</u> |

The future annual requirements for the amortization of notes payable outstanding as of June 30, 2002, are as follows:

| Year ended June 30 | Total |
|-------------------------------|----------------------|
| 2003 | \$ 1,490,000 |
| 2004 | 2,095,000 |
| 2005 | 555,000 |
| 2006 | 585,000 |
| 2007 | 625,000 |
| Thereafter | <u>13,032,940</u> |
| Total | <u>\$ 18,382,940</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

11. COMPONENT UNIT:

We were unable to obtain the statement of component unit "Corporación Desarrollo Cultural Teatro Oliver" (non-profit corporation).

The Corporación Desarrollo Cultural Teatro Oliver

Nature and Organization

The "Corporación Desarrollo Cultural Teatro Oliver" (non-profit corporation) was organized under the Laws of the Commonwealth of Puerto Rico. The Corporation was established to acquire "El Teatro Oliver of Arecibo" to be restored and operate as Municipal Theater.

CODEA- The "Corporación de Desarrollo Económico del Atlántico" (CODEA) ceased operations and was dissolved by December 1995.

The Municipality still maintains the agreement entered by the above date with the "Banco Gubernamental de Fomento" in which the Municipality is in charge of the management of all remaining rent income collections of CODEA. These collections are remitted to a special account at the "Banco Gubernamental de Fomento" to amortize an outstanding loan balance of CODEA with the said bank.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN:

Defined Benefit Pension Plan

The Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (the "System") is the administrator of a cost sharing multiple-employer defined benefit public employee retirement system established by the Commonwealth of Puerto Rico. The System was created under the Act 447 approved on May 15, 1951, as amended. All regular employees of the Municipality hired before January 1, 2000 and under 55 years of age at the date of employment became members of the System as a condition to their employment. No benefits are payable if the participant receives a refund of his/her accumulated contributions. The System also provides for death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature.

Under the System, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to contribute 5.775% for the first \$550 of monthly gross salaries plus 8.275% for the excess of this amount, or on the alternative, 8.275% of monthly gross salaries. The Municipality contributes to the System 9.275% of the participating employee's gross salaries.

Pension benefits for employees that joined the system before April 1, 1990 are as follows:

| <u>Years of Service</u> | <u>Participant Age</u> | <u>Pension Benefits</u> |
|-----------------------------|----------------------------|---|
| 30 or more | 54 or less | 65% of the average of the three years of highest salary during the employees' service period. |
| 30 or more | 55 or more | 75% of the average of the three of highest salary during the employees' service period. |

For participants who retire with less than 30 years of service the pension benefits is computed at the rate of 1-1/2% of their average compensation for each year of credited service for the first 20 years and 2% for each of credited service for the remaining years.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN (CONTINUED)

For those employees that joined the system after April 1, 1980 the pension benefits are as follows:

| <u>Years of Service</u> | <u>Participant Age</u> | <u>Pension Benefits</u> |
|-------------------------|------------------------|---|
| 25 or more | Between 55 and 64 | Computed at the rate of 1-1/2% of their average compensation for each year of credited service, with an actuarial reduction based on the actuarial guides adopted by the Board of Trustees. |
| 10 or more | 65 or more | Computed at the rate of 1-1/2% of their average compensation for each year credited service. |

For participants who retire with less than 25 years of service and the participant age are 64 or less the pension benefit is computed at the rate of 1-1/2% of their average compensation for each year of credited service.

Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447 to establish, among other, a defined contribution saving 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 contributions 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 14, 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's account semi-annually.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN (CONTINUED):

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant spouse in case of the participant death. Participants with 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.

Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2002 recorded as pension expenditures were approximately \$ 710,000. This amount represents 100% of the required contribution for the fiscal year ended June 30, 2002.

The amount of the total pension benefit obligation is based on a standardized measurement established by GASB Number 27, *Accounting for Pensions by State and Local Governmental Employers*. The standardized measurement is the actuarial present value of credited projected benefits. This pension valuation method reflects the present value of estimated pension benefits that will be paid in future years as a result of employees services performed to date and is adjusted for the effects of projected salary increases. The significant actuarial assumptions used to determine the standardized measure of the pension benefit obligation are summarized below:

- * The present value of the future pension payments was computed by using a discount rate of 8.5%. The discount rate is equal to the estimated long-term rate of return on current and future investments of the pension plan.
- * Future pension payments reflect an assumption of 5% salary increase.

The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and nonvested is not readily available. Contributions in 2001 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by generally accepted accounting principles.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN (CONTINUED):

An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The ten-year historical trend information is available in the separately issued audited financial statements of the System.

13. INTERFUND TRANSACTIONS:

Due from/to other funds

Interfund receivables and payables represent temporary loans between the funds.

Operating transfers

Operating transfers represent transfers between funds to specific purposes designated by the management.

14. LANDFILL OBLIGATIONS:

State and federal laws and regulations require the Municipality to place a final cover on its landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site after closure. At June 30, 2002, the Municipality has not performed the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated obligation for landfill closure and post closure costs.

15. OPERATING LEASES:

The Municipality is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore the results of the lease agreements are not reflected in the Municipality's account groups.

The following is a schedule by years of future minimum rental payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2002:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

15. OPERATING LEASES (CONTINUED):

| <u>Year ending</u> <u>June 30,</u> | <u>Amounts</u> |
|---------------------------------------|-------------------|
| 2003 | \$ 244,243 |
| 2004 | 214,788 |
| 2005 | 64,800 |
| 2006 | <u>36,000</u> |
| Total minimum payments required | \$ <u>559,831</u> |

16. COMMITMENTS AND CONTINGENCIES:

A. Federal grants:

The Municipality participates in a number of Federal Financial Assistance Programs. According to OIG Audit 99-AT- 241-1001 issued in November 5, 1998 the Municipality has been inefficient and ineffective in the administration of the Community Development Block Grant and Section 108 Loan Guarantee Assistance Programs. As result of that HUD through the Community Planning & Development Division notify to the Municipality to reimburse the amount of \$ 6,847,476 for questioned costs. At audit date the Municipality reimbursed \$1,304,282.

At the present the Municipality participates in a number of Federal Financial Assistance Programs and we have no knowledge of any amount of expenditures, which may be disallowed by the granting agencies, although the Municipality expects such amounts, if any, not to be material.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

16. COMMITMENTS AND CONTINGENCIES (CONTINUED):

During May, 2001 the Municipality entered in an agreement with HUD to repay the outstanding debt that was included in the general long-term debt account group. The future annual requirements for the amortization of the outstanding balance as of June 30, 2002, are as follows:

| <u>Date</u> | <u>Payment Amortization</u> |
|--------------------|---------------------------------|
| September 15 2002 | \$733,658 |
| February 15, 2003 | 733,658 |
| September 15, 2003 | 733,658 |
| February 15, 2004 | 733,658 |
| September 15, 2004 | 733,658 |
| February 15, 2005 | 733,658 |
| September 15, 2005 | <u>1,141,246</u> |
| Totals | <u>\$5,543,194</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

16. COMMITMENTS AND CONTINGENCIES (CONTINUED):

B. Claims and lawsuits:

The Municipality is a defendant in legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigation, the Municipality has reported liabilities of \$973,383 in the general long-term debt account group for anticipated unfavorable judgments. The amount presented in the general long-term debt group of account represents the amount of estimated as probable liability, which will require future available financial resources for its payment. The administration believes that the ultimate liability in excess of amounts provided would not be significant.

In addition, the Municipality is a defendant in several legal proceedings, which are in the discovery stage. Certain of these claims are covered by insurance. The final outcome of these claims cannot be determined by legal counsel 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

17. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balances for Debt Service Fund have been restated by two situations detected during the fiscal year that affect the Fund Equity section of this Governmental fund, as follows:

| Description | Debt Service Fund |
|---|----------------------|
| Beginning Fund Balances at July 1, 2001 | \$3,885,992 |
| Account Receivable from CRIM related to 2000 CAE final liquidation | 1,119,543 |
| Account Payable to CRIM related to 2001 CAE final liquidation | (203,760) |
| Beginning Fund Balances at July 1, 2001, as restated | <u>\$4,801,775</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

18. SIGNIFICANT EFFECTS OF SUBSEQUENT EVENTS:

On August 13, 2002 the Municipality of Arecibo authorized the issuance of a general obligation note in the amount of \$920,000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2002

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u> |
|--|------------------------------------|---|---------------------|
| U.S. DEPARTMENT OF AGRICULTURE: | | | |
| Pass-through the Commonwealth of Puerto Rico Department of Education: Child and Adult Care Food Program | 10.558 | Not Available | \$ 629,733 |
| Total U.S. Department of Agriculture | | | <u>629,733</u> |
| U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT: | | | |
| Direct Program: Community Development Block Grants/Entitlement Grants | 14.218 | | 3,352,575 |
| Direct Program: Urban Development Action Grant | 14.221 | | 2,891 |
| Direct Program: Emergency Shelter Grants Program | 14.231 | | 75,275 |
| Direct Program: HOME Investment Partnerships Program | 14.239 | | 293,365 |
| Direct Program: Section 8 Housing Choice Voucher Program | 14.871 | | <u>3,215,645</u> |
| Total U.S. Department of Housing and Urban Development | | | <u>6,939,751</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u> |
|---|------------------------------------|---|-----------------------|
| U.S DEPARTMENT OF JUSTICE: | | | |
| Pass-through the Commonwealth Office of the Governor (CFWM): Rural Domestic Violence and Child Victimization Enforcement Grant Program | 16.589 | Not Available | 74,469 |
| Pass-through the Commonwealth of Puerto Rico – Local Department of Justice Local Law and Enforcement Block Grants | 16.592 | 2001-IB-PMA-01 | <u>131,980</u> |
| Total U.S. Department of Justice | | | <u>206,449</u> |
| U.S FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA): | | | |
| Pass-through the Commonwealth of Puerto Rico Emergency Management Agency: Emergency Management Performance Grant | 83.552 | Not Available | 8,876 |
| Pass-through the Commonwealth of Puerto Rico Governor Authorized Representative (GAR): Public Assistance Grants | 83.544 | Not Available | <u>57,790</u> |
| Total U.S. FEMA | | | <u>66,666</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

| <u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u> | <u>Federal CFDA Number</u> | <u>Pass-through Entity Identifying Number</u> | <u>Expenditures</u> |
|--|------------------------------------|---|-----------------------------|
| U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES: | | | |
| Direct Program: | | | |
| Community Preventions Coalitions (Partnership) Demonstration Grant | 93.194 | | 1,518 |
| Pass-through the Commonwealth of Puerto Rico Governor's Office (Elderly Office): Special Programs for Aging - Title III, Part B - Grant for Supportive Services and Senior Centers | 93.044 | Not Available | 399,655 |
| Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ADFAN): | | | |
| Community Services Block Grant | 93.569 | Not Available | 5,863 |
| Head Start | 93.600 | 02-CH-0483-36 02-CH-0483-37 | 9,266,471 |
| Child Care and Development Block Grant | 93.575 | Not Available | <u>460,596</u> |
| Total U.S. Department of Health and Human Services | | | <u>10,134,103</u> |
| TOTAL EXPENDITURES OF FEDERAL AWARDS | | | <u>\$ 17,976,702</u> |

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2002

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Arecibo** and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the general-purpose financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund in the Municipality's general-purpose financial statements. The reconciliation between the expenditures in the general-purpose financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

| <u>Description</u> | <u>Special Revenue</u> |
|--|----------------------------|
| Per Schedule of Expenditures of Federal Awards | \$ 17,976,702 |
| Non federal programs Expenditures | <u>722,998</u> |
| Total expenditures in the general purpose financial statements | <u>\$ 18,699,700</u> |



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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

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

**To the Honorable Mayor
and the Municipal Legislature
Municipality of Arecibo
Arecibo, Puerto Rico**

We have audited the general purpose financial statements of the **Municipality of Arecibo** as of and for the year ended June 30, 2002, and have issued our report thereon dated December 17, 2002, which was qualified because we been unable to obtain audited financial statements of the "Corporación de Desarrollo Cultural Teatro Oliver", a Discrete Component Unit, Also, we were unable to audit the fixed assets of the general fixed assets account group. Also, at year end the Municipality's had not performed the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated the obligation for landfill closure and post closure care costs as required by Governmental Accounting Standard Board Statement 18. Except as discussed in the preceding sentences, 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 Arecibo's** general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of general purpose financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Arecibo's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Arecibo's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items 02-01 through 02-06.

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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose reportable conditions that are also considered to be material weaknesses. However, we believe items **02-02** and **02-03** of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs are material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the **Municipality of Arecibo** in a separate letter dated December 17, 2002.

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



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 17, 2002

Stamp No. 1854020 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.





López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

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

**To the Honorable Mayor
and the Municipal Legislature
Municipality of Arecibo
Arecibo, Puerto Rico**

Compliance

We have audited the compliance of the **Municipality of Arecibo** 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, 2002. The **Municipality of Arecibo's** 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 Arecibo's** management. Our responsibility is to express an opinion on the **Municipality of Arecibo's** compliance based on our audit.

Except as discussed in the following paragraph, 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 the *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB 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 Arecibo's** compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the **Municipality of Arecibo's** compliance with those requirements.

We were unable to obtain sufficient documentation supporting the compliance of the **Municipality of Arecibo** with the Head Start Program, regarding the earmarking requirements related to the administrative cost limits (finding 02-28), nor were we able to satisfy ourselves as to the **Municipality of Arecibo's** compliance with those requirements by other auditing procedures.

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

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the **Municipality of Arecibo's** compliance with the requirements of Head Start Program regarding the earmarking requirements related to the administrative cost limits, the **Municipality of Arecibo's** 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 30,2002. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, **02-07** through **02-15** and **02-17** through **02-27**, **02-29** and **02-30**.

Internal Control Over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality of Arecibo's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items **02-07** through **02-30**.



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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of 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 on the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness. However, of the reportable conditions described above, we consider items **02-08, 02-11, 02-14, 02-15, 02-17, and 02-20 through 02-25 and 02-27 through 02-29** to be material weaknesses. We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Arecibo** in a separate letter dated February 13, 2003.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
February 13, 2003

Stamp No. 1854021 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2002

Section I – Summary of Auditors’ Results

Financial Statements

| | | | |
|--|------------------|----------|---------------|
| Type of auditors’ report issued: | Qualified | | |
| Internal control over financial reporting: | | | |
| Material weakness identified? | Yes | X | No |
| Reportable conditions identified not considered to be material weaknesses? | Yes | X | None reported |
| Noncompliance material to financial statements noted? | Yes | | No X |

Federal awards

| | | | |
|---|---|----------|---------------|
| Internal Control over major programs: | | | |
| Material weakness identified? | Yes | X | No |
| Reportable conditions identified not considered to be material weaknesses? | Yes | X | None reported |
| Type of auditors’ report issued on compliance for major programs: | Unqualified except for qualified for Head Start 93.600 | | |
| Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? | Yes | X | No |

Identification of major programs:

| <u>CFDA Number</u> | <u>Name of Federal Program or Cluster</u> |
|--------------------|---|
| 14.218 | Community Development Block Grant |
| 14.239 | HOME Investment Partnership Program |
| 14.871 | Section 8 Housing Choice Voucher |
| 93.600 | Head Start Program |

| | |
|---|-------------------|
| Dollar threshold used to distinguish between Type A and Type B programs | <u>\$ 539,301</u> |
|---|-------------------|

| | | | |
|--|-----|----|----------|
| Auditee qualified as low-risk auditee? | Yes | No | X |
|--|-----|----|----------|

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II - Financial Statements Findings

Finding Reference **02-01**

Requirement **Financial Reporting - Accounting Records**

Statement of Condition During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal Funds) and Account Groups.

Criteria Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.

Cause of Condition The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.

Effect of Condition The Municipality's accounting system did not provide updated and complete financial information that presents the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.

Recommendation We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II - Financial Statements Findings

| | |
|-------------------------------|---|
| Finding Reference | 02-02 |
| Requirement | Equipment and real property management |
| Statement of Condition | During our examination of the Municipality's property records we noted that the procedures followed to record and account for equipment and real estate property are inadequate in order to assure that all assets are properly recorded and accounted for. The property registers are not reliable since the information contained is not updated or completed. |
| Criteria | The federal regulations states that a financial management system shall provide for effective control and accountability for all funds, property and other assets. Also, Article 9.002 of State Act Number 81 of August 30, 1991 states that Municipality should maintain updated property accounting records. |
| Cause of Condition | There is no internal control procedure implemented in order to assure that property register includes all equipment and real estate inventory. |
| Effect of Condition | The Municipality did not maintain an adequate control of the accountability regarding property transactions. |
| Recommendation | The Municipality should implement procedures in order to assure the proper valuation and timeliness of recognition of real property and equipment as well as Construction in progress in the Property Subsidiary Ledger in a manner that it provides updated and complete financial information. The person in charge of the Municipal Property should realize an annual physical inventory of equipment and real property in order to actualize subsidiary ledger and assure that the property that exist is duly recorded in subsidiary ledger. The person in charge of Municipal Property should maintain daily communication with the Purchase Department of the Municipality and with the Federal Programs employee in charge of the property and equipment in order to assure that all property and equipment acquired during the year is properly recorded in the subsidiary ledger. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II - Financial Statements Findings

| | |
|-------------------------------|---|
| Finding Reference | 02-03 |
| Requirement | Financial Reporting |
| Statement of Condition | The Municipality did not include in its general-purpose financial statements, an estimate of the obligation for landfill closure and post closure costs. |
| Criteria | <i>GASB Statements No. 18</i> requires that the Municipality should estimate the closure and post closure cost of its landfill facilities. That estimate should include the current cost of capital assets, final cover, and monitoring and maintenance activities. |
| Cause of Condition | The Municipality did not perform a study of the estimated cost of the closure and post closure cost of its landfill facilities. |
| Effect of Condition | The Municipality is not in compliance with the <i>GASB Statement No. 18</i> requirements. |
| Recommendation | We recommend that the Municipality should contract professional services in order to prepare a formal study of the costs related to the landfill closure. Also, we recommend that the Municipality should include in its general-purpose financial statement the landfill costs necessary to comply with the <i>GASB Statement No. 18</i> . |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II - Financial Statements Findings

Finding Reference **02-04**

Requirement **Cash Receipts\Revenue, Receivable - Collections**

Statement of Condition We performed a cash receipt test and examined a sample of sixty (60) collections. The following summarize the exceptions found:

- a. Four (4) deposit slips were not available for examination.
- b. For three (3) collections, the Model 9 and the Auxiliary Collector's receipt were not available for examination.
- c. In one (1) collection we could not reconcile the amount collected with the deposited amount.
- d. A collection corresponding to Municipal Parking Account was deposited in the Deferred Municipal License Tax account.
- e. In two (2) collections we observed a difference between the amount in the deposit slip and the daily deposit report.
- f. For one (1) collection, cash receipt 26252, no evidence was found for the deposit of the amount corresponding to Municipal parking.

Criteria The Section Four (4) of the Chapter three (3) of the Revised Regulation on Basic Standards for Municipalities of Puerto Rico establishes that the Official Treasurer should realize a daily revision of amount collected and amounts debited in bank to assure that the revenues has been duly accounted and processed in the period of collection.

Cause of Condition No adequate internal control procedures exist to assure that daily collections are duly accounted for.

Effect of Condition The Municipality is not complying with regulations stated in The Section Four (4) of the Chapter three (3) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II - Financial Statements Findings

Finding Reference **02-04 (Continued)**

Recommendation The Municipality should implement the following procedures in order to avoid these situations in a future:

- a. Establish adequate monitoring procedures to assure that collections are deposited in the correct bank account and accounted in the correct fund and revenue account.
- b. Strength the filling procedures in order to assure that collections supporting documents as deposit slips, treasurer receipts and other required documents are duly organized and filled.

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II - Financial Statements Findings

Finding Reference **02-05**

Requirement **Expenditures for Goods and Services and Accounts Payables-
Purchasing and receiving**

Statement of Condition We performed a cash disbursement test and examined twenty four (24) disbursement vouchers related to Housing Voucher Program, fifty (50) disbursements related to HOME Program, seventy five (75) disbursements related to CDBG Program and seventy one (71) related to Head Start Program. The following will summarize the internal control exceptions noted.

- a. Five (5) disbursement vouchers included an invoice copy or the quotations copy instead the original invoice.
- b. Twenty one (21) payroll vouchers were not cancelled as paid.
- c. Thirty six (36) disbursement vouchers to suppliers were not cancelled as paid.
- d. In twenty three (23) disbursement vouchers the Purchase Orders to reserve the necessary credits for the services were prepared subsequently the receiving of good or services.
- e. In three (3) disbursement vouchers the Report of receipt and inspection of goods acquired or services rendered was not available for examination.
- f. Two (2) disbursement vouchers were not available for examination.
- g. Twenty one (21) requisitions were not included in the disbursement voucher.
- h. Two (2) disbursement vouchers did not include all necessary approvals.
- i. In seven (7) disbursement vouchers the invoice was not cancelled as paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II – Financial Statements Findings

Finding Reference **02-05 (continued)**

Statement of Condition

- j. Three (3) disbursement vouchers did not indicate the check number.
- k. Two (2) purchase orders were not cancelled as paid

Criteria

The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico establish in the Chapter Four (4) that the Finance Director will be responsible to account and prepare disbursements through documents duly prepared and certified, including sufficient evidential matter to support the transactions.

Cause of Condition

The Municipality did not establish effective internal control in order to assure that all transactions include all the required documentation.

Effect of Condition

The Municipality is not in compliance with Chapter Four (4) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.

Recommendation

We recommend that the Municipality should improve its internal control and procedures in order to assure that disbursement vouchers contain all the necessary supporting documents before making the payments.

Questioned Costs

None

Management Response

The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II - Financial Statements Findings

Finding Reference 02-06

Requirement Payroll and Related Liabilities - Payroll Preparation and Timekeeping

Statement of Condition We performed a payroll test and examined a sample of 60 personnel files. The following will summarize the exceptions noted:

- a. For one (1) employee there was no evidence of the Notifying of Nomination Form or the Form included in the employee file did not provide evidence of the employee salary.
- b. For three (3) employees we noted differences between the sick and regular vacations as per the time assistance card and the sick and regular vacations discounted in the accumulative vacations card.
- c. The compensated absences report prepared by the Human Resources Department to support the compensated absences long-term debt as of June 30, 2002 did not include the accumulative vacation and sick leave balances of one (1) employee.
- d. One (1) employee file did not include the Immigration Form (I-9).

Criteria The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter IV, Section 18-(1) establish that the Municipality will prepare the payroll based on the employee files.

Cause of Condition There is no internal control procedure implemented to assure the proper preparation and payment of payroll and the correctness of accumulative vacation and sickness balances.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section II – Financial Statements Findings

| | |
|----------------------------|--|
| Finding Reference | 02-06 (continued) |
| Effect of Condition | The Municipality did not maintain an adequate control over the personnel files and the compensated absences cards. |
| Recommendation | We recommend that the Municipality should review all payrolls prepared and the Human Resources Department should verify the accuracy of the compensated absences and assistance records. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-07 |
| Program | Community Development Block Grant-Entitlement Program (CFDA 14.218); U.S. Department of Housing and Urban Development |
| Requirement | Davis-Bacon Act |
| Statement of Condition | During our Davis-Bacon Act test we noted that the Municipality did not apply the monitoring system developed to ensure contractors compliance with payment of prevailing wages rates to employees; contractor's and subcontractor's laborers interviews were not made periodically. |
| Criteria | Davis-Bacon Act, as amended (40 USC 276A-276A-5), Subpart K, 24 CFR 570.603. |
| Cause of Condition | The Municipality did not apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages. |
| Effect of Condition | The Municipality is not in compliance with Davis-Bacon Act, as amended (40 USC 276A-276A-5), Subpart K, 24, CFR 570.603. |
| Recommendation | We recommend management to follow monitoring system procedures developed, including interviewing contractor's and subcontractor's laborers periodically (up to ten percent (10%) of the workers on long term projects) to establish the degree of compliance and the nature and extend of violations, if any. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Mayor Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-08 |
| Program | Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development |
| Requirement | Equipment and Real Property Management |
| Statement of Condition | <p>We realized the Equipment and Real Property Management test and we found the following exceptions:</p> <ul style="list-style-type: none">a. We noted there are no adequate and accurate records to account for additions or disposition of property and equipment.b. The Property Subsidiary Ledger does not detail the source of the property and who holds the title.c. The program did not perform a periodic physical inventory.d. Three (3) of the examined acquisitions during the fiscal year 2001-2002 were not included in the Property Subsidiary Ledger. |
| Criteria | <p>Subpart C, 24 CFR 85.32 (d) (1), states that property records must be maintained to include a description of the property, serial number or other identification number, the source of the property, percentage of Federally participation in the property, the location, use and condition of the property, any ultimate disposition data including the date of the disposal and sale price of the property. Also, a physical inventory of the property must be taken at least once every two years and the result reconciled with the property records.</p> |
| Cause of Condition | <p>There is internal control procedures necessary to maintain accurate property records.</p> |
| Effect of Condition | <p>The Municipality is not in compliance with Subpart C, 24 CFR, 85.32 (d) (1).</p> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Mayor Federal Program Award Findings and Questioned Costs

Finding Reference 02- 08(continued)

Recommendation We recommend management to perform a physical inventory in order to actualize the property subsidiary. In addition, the person in charge of the property should maintain daily communication with the Purchase Department in order to assure that all property acquired with CDBG funds are properly recorded in the subsidiary ledger.

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Mayor Federal Program Award Findings and Questioned Costs

Finding Reference **02-09**

Program **Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development**

Requirement **Financial Reporting**

Statement of Condition **During our examination of reporting requirements we noted the following exceptions:**

- a. Three (3) of the Cash Transaction Reports (SF-272) were not submitted on time to HUD.
- b. On the Cash Transaction Report corresponding to the quarterly of January 1, 2002 to March 31, 2002 the Municipality did not include in the Gross Disbursements, (Item (f) of the report), the disbursements related to program income. In addition, they reported in the Federal share of program income, (Item (g) of the report), the disbursements issued with program income instead the program income received. As a result, the Municipality made an adjustment in the item (i) of the report to reconcile the cash on hand per report with accounting records.

| Federal Cash Transaction Report | As Per Report | Recomputed by us |
|---|---------------|------------------|
| a. Cash on hand beginning of reporting period | \$ 58,542.89 | \$ 58,542.89 |
| b. Letter of credit withdrawals | 446,970.12 | 446,970.12 |
| c. Treasury check payments | | |
| d. Total receipts | 446,970.12 | 446,970.12 |
| e. Total cash available | 505,513.01 | 505,513.01 |
| f. Gross disbursements | 448,500.17 | 452,750.17 |
| g. Federal share of program income | 4,250.00 | 2,771.46 |
| i. Adjustments of prior periods | 5,699.47 | |
| j. Cash on hand end of period | 55,563.37 | 55,534.30 |
| Other information | | |
| a. Interest income | | 29.07 |
| b. Advances to sub grantees or subcontractors | | |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **02-09 (continued)**

Statement of Condition

c. The Municipality's is reporting more than one grant (CDBG, ESG, HOME) in the Federal Cash Transaction Report (Standard Form 272) and did not completed the Standard Form 272A which details the amount corresponding to each grant.

Criteria

OMB Common Rules, Subpart C, Section 85.20 (b) (1), states that the grantee must maintain internal control procedures that permits proper tracing of fund to accounting records. Also, it requires accurate, current and complete disclosure of financial results. According to 24 CFR, Section 85.41 to meet the reporting requirements, the Municipality should submit to HUD the Cash Transaction Reports no later than fifteen (15) working following the end of each quarter.

Cause of Condition

The Municipality has not established adequate internal control procedures to assure the correctness of the reports and the timely submission to HUD.

Effect of Condition

The Municipality did not comply with 24 CFR Section 85.20 (b) (1) and Section 85.20 (4).

Recommendation

We recommend management that the reports be prepared including all the required information and submitted in a timely manner. If the deadline is not achievable, a request for an extension should be obtained from the Federal Agency.

Questioned Costs

None

Management Response

The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **02-10**

Program **Community Development Block Grant/ Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development**

Requirement **Sub-recipient Monitoring**

Statement of Condition During our sub-recipient monitoring test we noted the following exceptions:

- a. The agreement does not include a description of the schedule necessary for completing the work and on budget.
- b. The agreement does not include clauses related to program income requirements set forth in Sec. 570.504 (c).
- c. The agreement does not include a clause that requires to the sub-recipient to comply with applicable uniform administrative requirements, as described in Sec. 570.502.
- d. One (1) file does not have evidence of follow-up visits required to assure the implementation of corrective action plan by the sub-recipient.
- e. Two (2) of the sub-recipients did not submit the required reports in the agreement.
- f. The program has no written monitoring procedures manual necessary to conduct monitoring to sub-recipient.

Criteria 24 CFR Section 570.503 states that before disbursing any CDBG funds to a sub-recipient the Municipality should assure that the agreement between parties include provisions concerning: the statement of work, records and reports, program income and uniform administrative requirements. In addition, the Municipality must perform monitoring activities in order to review the financial information and observes that operations of the sub-recipients are realized in accordance with the agreement. Also, the Municipality shall require to the sub-recipient to take prompt corrective action on any monitoring findings.

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Mayor Federal Award Program Findings and Questioned Costs

| | |
|----------------------------|---|
| Finding Reference | 02-10 (continued) |
| Cause of Condition | The Municipality procurement standard procedures failed to include the requirement contract provisions. There are no adequate internal controls to assure that sub-recipients comply with the clauses established in the contracts. |
| Effect of Condition | Municipality is not in compliance with 24 CFR, Section 570.503. |
| Recommendation | We recommend management to include all contracts provisions required by the federal regulations before each contract execution. Also, the Municipality should strengthen its monitoring procedures to assure that the sub-recipient complied with the requirements established in the contract before issuing any disbursement. In addition, the Municipality should develop specific monitoring guidelines to follow during each monitoring performed. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Mayor Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-11 |
| Program | Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development |
| Requirement | Special Test and Provisions- Housing Rehabilitation |
| Statement of Condition | <p>During our Housing Rehabilitation test we noted the following exceptions:</p> <ul style="list-style-type: none">a. In the twenty-five (25) examined files the contract of participation between the Municipality and the participant did not include the participant housing unit deficiencies to be corrected. Also, two (2) of these contracts did not have the Program Coordinator's signature.b. In the twenty-five (25) examined files the contract of participation between the Municipality and the participant did not include the approved budget amount necessary to perform the residential rehabilitation.c. The twenty-five (25) examined files did not include complete evidence of family composition.d. Seven (7) files did not contain evidence of follow-up visits or inspections realized by the Program personnel in order to verify if the rehabilitation work was carried out in accordance with the specifications.e. Nine (9) files did not contain evidence of the final inspection by program personnel to assure that the materials were used and if the rehabilitation work was completed.f. One (1) file did not include evidence of the income corresponding to Child Support.g. In one (1) file the final determination of the Board for the case eligibility was performed eight (8) months after the settle down of the agreement.h. Thirteen (13) files had no Eligibility Profiles. |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Mayor Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-11 (continued) |
| Statement of Condition | <p>i. Four (4) files did not include complete evidence of follow-up visits, only included the final inspection.</p> <p>j. One (1) file did not include evidence of residence existence (deeds or utilities invoices).</p> <p>k. Two (2) files did not include the final determination of the Board about the eligibility of the case.</p> |
| Criteria | 24 CFR, Section 570.506, states that when CDBG-Entitlement Grants funds are used for rehabilitation, the grantee must assure that the work is properly completed and appropriate documentation is maintained. |
| Cause of Condition | The program has not established adequate internal control procedures to assure that rehabilitations are duly completed as required by regulation and appropriate documentation is maintained |
| Effect of Condition | The Municipality is not in compliance with 24 CFR, Section 570.506. |
| Recommendation | <p>We recommend the Program to establish the following procedures:</p> <p>a. Ascertain that the deficiencies to be corrected and approved amounts are incorporated into the rehabilitation contract.</p> <p>b. Assign a staff to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contract specifications.</p> <p>c. Assure that all participant files include all required documentation duly approved and certified.</p> |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Federal Award Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-12 |
| Program | Home Investment Partnership Program (CFDA. No. 14.239); U.S. Department of Housing and Urban Development |
| Requirement | Eligibility |
| Statement of Condition | <p>During our examination of the participant files of Tenant Based Rental Assistance and Homebuyer Assistance we noted the following exceptions:</p> <p>a. In one (1) file of Tenant Based Rental Assistance and in two (2) files of Homebuyer Assistance the inspections were inconclusive and a re-inspection was not performed by the program inspector.</p> |
| Criteria | <p>The Section 92.209 (I) states that housing occupied by a family receiving tenant based rental assistance or homebuyer assistance should meet the criteria stated in the 24 CFR 982.401. The participant jurisdiction must inspect the housing initially and re-inspect it annually.</p> |
| Cause of Condition | <p>The person in charge of the initial and annual inspection of the housing units did not apply adequate monitoring procedures to assure that the exceptions noted in the inspections were duly corrected.</p> |
| Effect of Condition | <p>Municipality is not in compliance with, 24 CFR, Subpart E, Section 92.209 (I) and 982.401.</p> |
| Recommendation | <p>We recommend management to follow monitoring system procedures developed in order to assure that initial, annual re-inspections and inconclusive inspections be performed as required by regulation.</p> |
| Questioned Costs | <p>None</p> |
| Management Response | <p>The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.</p> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Federal Award Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-13 |
| Program | Home Investment Partnership Program (CFDA. No. 14.239); U.S. Department of Housing and Urban Development |
| Requirement | Cash Management |
| Statement of Condition | We realized the Cash Management Test and found that the program maintains an average cash balance in books of \$38,665. |
| Criteria | Code of Federal Regulations, 24 CFR Subpart I, Section 92.502 states that Home funds must be expended for eligible costs within 15 days. Any interest earned within the 15 days period may be retained by the participant jurisdiction as Home funds. Any funds that are drawn down and not expended for eligible costs within 15 days of the disbursement must be returned to HUD. Interest earned after 15 days belongs to the United States Treasury Department and must be remitted promptly, at least quarterly, to HUD, except that a local participating jurisdiction may retain interest amounts up to \$100 per year for administrative expenses. |
| Cause of Condition | The program did not use the available cash balance in books before requesting additional funds to the federal agency. |
| Effect of Condition | The Municipality is not in compliance with 24 CFR, Subpart I, Section 92.502. |
| Recommendation | We recommend management to use the cash balance in books before the request of additional funds to the federal agency. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Federal Award Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-14 |
| Program | Home Investment Partnership Program (CFDA. No. 14.239); U.S. Department of Housing and Urban Development |
| Requirement | Equipment and Real Property Management |
| Statement of Condition | <p>We realized the Equipment and Real Property Management test and we found the following exceptions:</p> <ul style="list-style-type: none">a) The Municipality did not maintain adequate and accurate records to account for additions or disposition of property and equipment.b) The Property Subsidiary Ledger did not provide the name and address of the supplier who sold the equipment and who holds the title of the property.c) The program did not realize a periodic physical inventory.d) Five (5) equipment units acquired during the current year were not included in the property ledger.e) Five (5) equipment units acquired during the prior years were not included in the property ledger. |
| Criteria | <p>Subpart C, 24 CFR 85.32 (d) (1), states that property records must be maintained that include a description of the property, serial number or other identification number, the source of the property, percentage of federally participation in the property, the location, use and condition of the property, any ultimate disposition data including the date of the disposal, sale price of the property. Also, a physical inventory of the property must be taken and the result reconciled with the property records at least once every two years.</p> |
| Cause of Condition | <p>There are no adequate monitoring procedures to assure that the person in charge of the property register follow the regulation in order to maintain an actualized and accurate property ledger.</p> |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Federal Award Findings and Questioned Costs

| | |
|----------------------------|--|
| Finding Reference | 02-14 (Continued) |
| Effect of Condition | The Municipality is not in compliance with 24 CFR, 85.32 (d) (1). |
| Recommendation | We recommend management to realize a physical inventory in order to actualize the property subsidiary ledger. In addition, the person in charge of the property should maintain daily communication with the Purchase Department in order to assure that all property acquired with Home funds are properly recorded in the subsidiary ledger. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Federal Award Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-15 |
| Program | Home Investment Partnership Program (CFDA. No. 14.239); U.S. Department of Housing and Urban Development |
| Requirement | Earmarking- Investment in Community Housing Development Organizations (CHDO's) |
| Statement of Condition | <p>During our earmarking test we noted the following exceptions:</p> <ul style="list-style-type: none">a. A total of \$280,063 which belongs to CHDO's from 1995 to 1998 was not committed in twenty four (24) months. Those funds were committed by the program on January, 2003.b. A total of \$91,650 which belongs to CHDO from 1999 was recaptured by the Federal Agency since the program did not commit the funds in twenty four (24) months.c. A total of \$85,350 which belongs to CHDO from 1998 appears committed in the IDIS system and no purchase order was recorded in the general ledger to account that the funds were duly committed.d. A total of \$92,100 which belongs to CHDO from 2000 was not committed in the IDIS system as of June 30, 2002. |
| Criteria | <p>24 CFR, Section 92.300 states that each participating jurisdiction must invest at least 15 percent of each year's HOME allocation in projects which are owned, developed or sponsored by a special non-profit organizations called CHDO's. If during the first 24 months of its participation in the HOME Program a participating jurisdiction cannot identify a sufficient number of capable CHDO's, then up to 20 percent of the minimum set-aside but not more than \$150,000 may be available to develop the capacity of CHDO's in the jurisdiction.</p> |
| Cause of Condition | <p>The Municipality did not maintain adequate controls to assure that CHDO's funds were committed and used as required by regulation. Also, the Municipality did not maintain an audit trail between the program books and the IDIS System.</p> |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Federal Award Findings and Questioned Costs

| | |
|----------------------------|--|
| Finding Reference | 02-15 (Continued) |
| Effect of Condition | The Municipality is not in compliance with 24 CFR, Section 92.300 |
| Recommendation | We recommend management to establish procedures in order to assure that CHDO's funds are invested and used in accordance with all program requirements and adequate audit trail exist between the obligations as per books and as per IDIS System. |
| Questioned Costs | None |
| Management Response | The Municipality is in the process of enters in an agreement with a certificated CHDO non for profit organization in order to comply with the program requirements. |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Federal Award Findings and Questioned Costs

Finding Reference **02-16**

Program **Home Investment Partnership Program (CFDA. No. 14.239); U.S. Department of Housing and Urban Development**

Requirement **Period of Availability of Funds**

Statement of Condition a) During our audit we proceeded to examine the Summary of Consolidated Plan Projects for report year 2001 (C04PR06) as of June 30, 2002 obtained from the IDIS System and compare it to the Home program general ledger. After our procedures were performed we noted that in the following activities the balance to commit as per IDIS System did not match with the balance to commit as per general ledger as of June 30, 2002:

| Activity | Program year | Balance to commit as of June 30, 2002 as per IDIS System | Balance to commit as of June 30, 2002 as per General Ledger |
|-----------------------------|--------------|--|---|
| Homebuyer assistance | 2000 | \$28,323 | \$68,678 |
| Homebuyer assistance | 2001 | 8,513 | 272,250 |
| Rental Housing Construction | 2001 | - | 50,000 |
| Homeowner Housing Rehab. | 1995 | 203,500 | - |
| Homeowner Housing Rehab. | 1999 | - | 15,780 |
| Homeowner Housing Rehab. | 2000 | - | 50,000 |
| Homeowner Housing Rehab. | 2001 | - | 100,000 |
| Planning and Administrative | 2001 | - | 28,246 |
| Rental Rehabilitation | 1998 | - | 70,100 |
| Rental Rehabilitation | 1999 | - | 50,000 |

b) We noted that the IDIS System report details the following available balances to draw as follows:

| Activity | Program year | Amount available to draw |
|--------------------------------|--------------|--------------------------|
| Planning and Administrative | 1997 | \$19,818 |
| Tenant Based Rental Assistance | 1997 | 88,775 |
| Rental Rehabilitation | 1999 | 50,000 |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Federal Award Findings and Questioned Costs

| | |
|----------------------------|---|
| Finding Reference | 02-16 (Continued) |
| Criteria | 24 CFR, Section 92.204-2 (a) and (b) states that funds has to be committed within twenty four months after the last day of the month in which HUD notifies the entity of HUD's execution of the HOME agreement. Also, the funds have to be expended within five years after the last day of the month in which HUD notifies the entity of HUD's execution of the agreement. |
| Cause of Condition | The Municipality did not maintain adequate controls to assure that the IDIS System available balance to commit is in line with the available balance to commit in the general ledger. In addition, the Municipality did not maintain adequate controls to assure that the funds are committed and expended at the required period. |
| Effect of Condition | The Municipality is not in compliance with 24 CFR, Section 92.204-2 (a) and (b). |
| Recommendation | The Municipality should establish adequate procedures to assure that accounting records balances to commit are in line with the IDIS System in order to correct the differences and to assure that funds are committed and expended in the required period. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Federal Award Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-17 |
| Program | Home Investment Partnership Program (CFDA. No. 14.239); U.S. Department of Housing and Urban Development |
| Requirement | Special Tests and Provisions - Housing Quality Standards |
| Statement of Condition | We realized procedures to verify the compliance with special test and noted that for Homebuyer Assistance the program has not established adequate procedures to assure that on site inspections are performed to all program participants. |
| Criteria | Code of Federal Regulations, 24 CFR Section 92.251, 92.252 and 92.504 states that during the period of affordability for HOME assisted rental housing, the participating jurisdiction must perform on-site inspections to determine the compliance with property standards and verify the information submitted by the owners no less than: (a) Every three years for projects containing one to four units, (b) Every two years for projects containing 5 to 25 units, and (c) every year for projects containing 26 or more units. |
| Cause of Condition | The program did not establish procedures to assure that inspections are realized to Homebuyer assistance participants. |
| Effect of Condition | The Municipality is not in compliance with 24 CFR, Section 92.251, 92.252 and 92.504. |
| Recommendation | We recommend management to develop a monitoring system in order to assure that on site inspections are realized to Homebuyer Assistance participants as required by federal regulation. |
| Questioned Costs | None |
| Management Response | The program coordinator will realize monitoring activities starting on February, 2003. |

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-18**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Eligibility of Individuals**

Statement of Condition During our verification of thirty-seven (37) participant files we noted the following exceptions related to the Housing Assistance Payment Calculation:

- a. The Municipality did not show consistency in the payment standard used to calculate the Housing Assistance Payments. The Municipality used 100% FMR in various Family Reports calculation and 110% in others.
- b. In four (4) Housing Assistance Payment calculations the Municipality used a payment standard in excess of the 110%.
- c. In one (1) participant file the Housing Assistance Payment as per contract (Form 52641) was not in accordance with the payment calculated as per Family Report (Form 50058).
- d. In one (1) Housing Assistance Payment calculation the Municipality used a payment standard under of the 90%.

Criteria Code of Federal Regulations 24 CFR, Section 982.503 establish how the PHA must determine and used the payment standard. Code of Federal Regulations 24 CFR, Section 982.505 establishes the procedures to follow in order to calculate the Housing Assistance Payment. The Housing Choice Voucher Guidebook, Chapter six (6) establishes procedures for the HAPs calculation.

Cause of Condition The Federal Program Department did not maintain consistency and monitoring procedures in order to assure that the Housing Assistance payment standard used in the Family Report calculation is in accordance with the actualized HUD Fair Market Rent tables.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Sections 982.503 and 982.505.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-18 (Continued)**

Recommendation We recommend management to establish monitoring procedures to assure that Housing Assistance Payments are duly computed as required by the Federal Regulations.

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-19**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Eligibility of individuals**

Statement of Condition We performed an eligibility test and examined a sample of thirty-seven (37) participant files. The following summarize the exceptions noted:

- a. One (1) participant file did not include a release form to allow the PHA to obtain information from third parties.
- b. In four (4) participant files the Release Form to allow the PHA to obtain information from third parties was not duly signed by the participants.
- c. A Federal-prescribed General Release Form for employment information was not obtained from participants that are employed at annual reexamination.
- d. In one (1) participant file the Employer Income Certification was obtained six (6) months after the initial Housing Assistance Payment approval.
- e. The participant files did not include the Privacy Act Notice.
- f. One (1) Birth Certificate and five (5) Social Security Card copies were not available for our examination.
- g. In two (2) cases there was no adequate evidence of family income and the family composition photo was not available for examination.
- h. In three (3) cases the Good Behavior Certificate was not available for examination.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-19 (Continued)**

- i. The Municipality did not document in the tenant file why third party verification of the value of assets was not obtained during the eligibility determination.

Criteria Code of Federal Regulations 24, Sections 5.230, 5.212 and 982.516 states that as a condition of admission or continued occupancy, the PHA must require the tenant and other family members to provide necessary information, documentation and releases necessary for the PHAs verification of the income eligibility. As part of this regulation the participant and other members of the family who are at least 18 years old must sign an application form, one or more releases forms, a federally prescribed General Release Form for employment information and a Privacy Act Notice.

Cause of Condition The Municipality does not maintain adequate monitoring procedures to assure that the participant's files include all required documentation and releases required by federal agencies.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Sections 5.230, 5.212 and 982.516.

Recommendation We recommend the Program to establish adequate monitoring procedures in order to assure that the release form to allow information from third parties, employment information and the Privacy Act Notice and all required participants information are included in the participant files as required by Federal Regulations. In addition, third party verification should be obtained to verify the value of assets or the program must include adequate documentation explaining the reason why third party verification was not obtained.

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-20**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Cash Management**

Statement of Condition We realized Cash Management Test and after our procedures were performed we found that the Municipality requested funds that were not disbursed on a reasonable lapse of time and the programs maintained an excessive cash balance in books of approximately \$213,000. We noted that for nine months the leasing rate was under 95% and a revised requisition (Form 52663) was not submitted to HUD to reduce the monthly advances.

Criteria OMB Common Rules, Subpart C, Section 85.20 (b) (7), requires a cash management system; in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by the grantee.

Cause of Condition The Federal Program Department did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs.

Effect of Condition The Municipality did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).

Recommendation We recommend that management should strengthen it's procedures to minimize the time elapsed between the transfer of funds from the Federal Agency and the disbursements made by the Municipality. The management must submit a revised requisition (Form 52663) to HUD when the leasing rate does not exceeds the 95% in order to avoid and excessive adjusted cash balance in books.

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-21**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Performance Reporting**

Statement of Condition The Municipality answered a (yes) for the items 1(b), 2(b), 3, 4, 5, 6 and 10 of the SEMAP Report, nevertheless, the results of our test shows exceptions related to the compliance with those requirements.

Criteria Code of Federal Regulations 24, CFR, Section 985.3 states that under SEMAP, PHAs must submit an annual certification, Form HUD-52648 (OMB No. 2577-0215), to HUD concerning their compliance with program requirements under 14 indicators of performance. Finally, HUD will realize on site visits and verify the independent auditors' annual audit reports to assure the compliance with this requirement.

Cause of Condition The Municipality did not maintain adequate monitoring procedures to assure the program compliance with the SEMAP Report requirements.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Section 985.3.

Recommendation We recommend to the Municipality to establish adequate monitoring procedures in order to assure the program compliance with federal regulations.

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-22 |
| Program | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development |
| Requirement | Special Reporting |
| Statement of Condition | We noted that HUD 50058, Family Report Form (OMB No. 2577-0083) was not transmitted electronically to HUD as required by Federal Regulation. |
| Criteria | Code of Federal Regulations 24, Part 908 requires to the PHA to submit HUD-50058, Family Report Form electronically to HUD each time the PHA completes an admission, annual reexamination, interim reexamination, portability move-in or other change of unit for a family. The PHA must also submit the Family Report when a family ends participation in the program or moves out of the PHAs jurisdiction under portability. |
| Cause of Condition | The person in charge to submit the form to HUD had transmission problems during the year. The Municipality did not correct the situation until March, 2002. |
| Effect of Condition | The Municipality is in not compliance with Code of Federal Regulations 24, Part 908. |
| Recommendation | We recommend to the Municipality to establish internal control procedures to assure that any transmission problem with the HUD system is corrected in a timely manner. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-23 |
| Program | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development |
| Requirement | Special Test - Selection from the Section 8 Waiting List |
| Statement of Condition | During our waiting list test we found the following: <ul style="list-style-type: none">a. In seventeen (17) cases examined by us we could not determine if the participants were selected from the top of the waiting list.b. During the audited period the Municipality's waiting list was not maintained as required by Program regulations. |
| Criteria | Code of Federal Regulations 24, Sections 982.54 (d) and 982.201 through 982.207 states the waiting list procedures and that the selection from the waiting list generally occurs when the PHA notifies a family whose names reaches the top of the waiting list to come in to verify eligibility for admission. |
| Cause of Condition | The Municipality did not maintain adequate internal control procedures to assure that the waiting list include all information required by Federal Regulation and to assure that the participants were selected from the top of the waiting list. |
| Effect of Condition | The Municipality is not in compliance with 24 CFR sections 982.54 (d) and 982.201 through 982.207. |
| Recommendation | We recommend to the Municipality management to follow admission procedures established in the administrative plan. Also, we recommend the management to establish control procedures to maintain a waiting list with all information required by the Federal Regulation. This control must permit proper tracing of participants selected in the waiting list in order to assure the selection from the top of the waiting list. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-24 |
| Program | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development |
| Requirement | Special Test - Reasonable Rent |
| Statement of Condition | During our Reasonable Rent test we found the following exceptions: <ul style="list-style-type: none">a. The determination of reasonable rent (Reasonable Rent Certification) was not duly documented in thirty two (32) participant files examined. The certification did not include adequate information of comparable units (unit address, contact person etc.).b. The determination of reasonable rent (Reasonable Rent Certification) was not available for examination in five (5) participant files. |
| Criteria | Code of Federal Regulations 24, Sections 982.54 (d) (15), 982.158 (f) (7) and 982.507 states that the PHA must determine reasonable rent at the time of the initial leasing and before any increase in the rent to the owner and all the times during the assisted tenancy, the rent to owner may not exceed the reasonable rent as most recently determined or re-determined by the PHA. In addition, the PHA must maintain records to document the basis for the determination that the rent paid to the owner is reasonable. |
| Cause of Condition | The Federal Program Department did not maintain adequate documentation to support the basis for the determination that the rent paid to the owner was reasonable. |
| Effect of Condition | The Municipality is not in compliance with Code of Federal Regulations 24, Section 982.507, 982.54 (d) (15) and 982.158 (f) (7). |
| Recommendation | We recommend that the Federal Program Department to establish controls to assure that appropriate documentation of the determination of reasonable rent is maintained in participant's files. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-24 (Continued)**

Questioned Costs **None**

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-25 |
| Program | Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development |
| Requirement | Special Test - Utility Allowance Schedule |
| Statement of Condition | The Municipality did not maintain an up-to-date utility schedule for the audit period ending June 30, 2002. The utility allowance used was last updated in 1999. |
| Criteria | Code of Federal Regulations, 24 CFR Section 982.517 states that the Municipality must maintain an up-to-date utility allowance schedule. The Municipality must review the utility rate data for each utility category each year and must adjust its allowance schedule if there has been a rate change of 10 percent or more for a utility category or fuel type since the last time utility allowance was revised. |
| Cause of Condition | The Municipality did not follow the procedures established to review utility rate data each year. |
| Effect of Condition | The Municipality is not in compliance with Code of Federal Regulations, 24 CFR Section 982.517. |
| Recommendation | The Municipality should evaluate utility allowance rate each year as established in the federal regulations. |
| Questioned Costs | None |
| Management Response | The Municipality actualized the Utility Allowance Schedule on January, 2002 and will use it for next fiscal year. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-26**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Special Test – Housing Quality Standards Inspections and HQS Enforcement**

Statement of Condition During our verification of thirty-seven (37) participant files we noted the following deficiencies:

- a. Certain items of the inspections checklist such as smoke detectors, lead-based paint and the water heater were not evaluated by the inspectors in thirteen (13) inspections examined by us.
- b. Quality control re-inspections did not provide feedback on inspectors' work for the purpose of determining if the individual performances or general HQS training issues need to be addressed. In addition, we noted that about five (5) quality control re-inspections detailing various exceptions did not indicate if the corrections were realized as required by federal regulations.
- c. In seven (7) inspections the required corrections reported in the inspection report were corrected within 30 calendar days and we found no evidence on file of the Municipality approved extension.
- d. In four (4) inspections the 30 days correction period had ended and the Municipality did not stopped (abate) the Housing Assistance Payments. The corrections were realized three (3) months after the violation notice.

Criteria Code of Federal Regulations 24, Subpart I, Section 982.158 (d) and 982.405 (b) states that the PHA must inspect the unit leased to a family at least annually to determine if the unit meets Housing Quality Standards (HQS) and the PHA must conduct quality control re-inspections. Also, the PHA must prepare a unit inspection report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-26 (Continued)**

Criteria (continued) 24 CFR, Section 982.404 establishes that for units under contract that fail to meet HQS, the PHA must require the owner to correct any cited life threatening HQS deficiencies within 24 hours of the inspections and all other HQS deficiencies within 30 calendar days or within a specified PHA-approved extension. If the owner does not correct the cited HQS deficiencies within the specified correction period the PHA must stop the Housing Assistance Payment or must terminate the HAP contract.

Cause of Condition The Municipality did not maintain adequate monitoring procedures to assure that inspections and quality control re-inspections are properly documented in participant files. Also, the Municipality did not follow the procedures to assure the compliance with Housing Quality Standards Enforcements.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Section and 982.404, 982.158 (d) ad 982.405 (b).

Recommendation We recommend management to implement internal control procedures to assure that annual inspections and quality control re-inspections are properly documented. The PHA supervisor or other qualified personnel must re-inspect a sample of units under contract during the last PHA fiscal year. HQS inspections included in the sample must be no older than three months at the time of the re-inspection. In addition, the quality control re-inspection should provide feedback on inspectors' work, which can be used to determine if individual performance or general HQS training issues need to be addressed.

For HQS deficiencies that are the owner's responsibility and are not corrected within the prescribed time frames, the PHA must abate housing assistance payments beginning no later than the first of the month following expiration of the PHA violation notice.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **02-26 (Continued)**

Questioned Costs None

Management Response The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Mayor Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-27 |
| Program | Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State - Commonwealth of Puerto Rico Administration for Children and Families |
| Requirement | Cash Management |
| Statement of Condition | We realized Cash Management Test and we found the following exceptions: <ul style="list-style-type: none">a. The program did not maintain the proper documentation (Audit Trail) necessary to reconcile the funds received from the pass-through grantor with the disbursement of checks.b. The programs maintained an average cash balance per month of \$216,912.c. During four (4) months the cash as per bank reconciliation was in overdraft. |
| Criteria | 45 CFR, Subpart C, Section 92.20 (b) (7), requires a cash management system in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursements made by the grantee. |
| Cause of Condition | The procedures established by ADFAN in the agreement of delegation of funds do not provide a clause to comply with this requirement. |
| Effect of Condition | The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b) (7). |
| Recommendation | We recommend management to require ADFAN alternate methods to request cash in order to comply with this requirement. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Mayor Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|--|
| Finding Reference | 02-28 |
| Program | Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families |
| Requirement | Matching, Level of Effort, Earmarking – Administrative Cost Limits |
| Statement of Condition | The Accounting System maintained for Head Start Program financial activities did not provide for the classification of financial transactions between administration and programmatic costs. Therefore we were unable to determine if the Municipality complies with this requirement. |
| Criteria | Code of Federal Regulations 45, Subpart C, Section 92.20 (a) (2) states that the sub grantees must maintain fiscal controls and accounting procedures sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restriction and prohibitions of applicable statutes. |
| Cause of Condition | The Municipality did not maintain adequate internal controls to assure the accountability of all transactions in accordance with Federal regulations. |
| Effect of Condition | Such condition may cause Municipality's non-compliance with certain compliance requirements like: allowable costs, activities allowed and unallowed; and earmarking. |
| Recommendation | We recommend management to modify the Accounting System chart of accounts to create separate accounts for administrative and programmatic expenditures. Also, cost with dual benefits (administrative and programmatic) should be identified and allocated appropriately using a cost-benefit proportion. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Mayor Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-29 |
| Program | Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State - Commonwealth of Puerto Rico Administration for Children and Families |
| Requirement | Matching, Level of Effort, Earmarking-90% |
| Statement of Condition | <p>In our Participants Files Test, whose sample is constituted by the 90 percent of low income participants and which is realized to support our Earmarking Test, we noted the following exceptions:</p> <ul style="list-style-type: none">a. The program has not prepared a procedures manual to establish the official documentation to be requested to the participants.b. Four (4) participants that exceed low-income limits were not included in the over income list submitted to us by the Program personnel.c. The program did not request to the applicants household a copy of the Social Security Card and Birth Certificate of all family members to assure participant family composition.d. Two (2) files did not include evidence of the family income.e. Three (3) participant files were not available for examination. |
| Criteria | 45 CFR, Section 1305.4, establishes that at least 90 percent of the enrollees must come from families whose income is below the Official Federal Poverty Guidelines or who are receiving public assistance. |
| Cause of Condition | The program did not maintain adequate internal controls to assure that the program does not exceed 10 percent requirement of participant above poverty guides. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III - Mayor Federal Award Program Findings and Questioned Costs

| | |
|----------------------------|--|
| Finding Reference | 02-29 (continued) |
| Effect of Condition | The program is in not compliance with 45 CFR Section 1305.4. |
| Recommendation | We recommend that the Municipality should review their procedures for enrollment of the participants according to their income levels and develop policies and procedures to reduce the risk of noncompliance with this requirement. |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2002

Section III – Mayor Federal Award Program Findings and Questioned Costs

| | |
|-------------------------------|---|
| Finding Reference | 02-30 |
| Program | Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families. |
| Requirement | Procurement and Suspension and Debarment |
| Statement of Condition | <p>In our contract provisions test we observed the following exceptions:</p> <ul style="list-style-type: none">a. Six (6) contracts did not include provisions for granting access to GAO or other federal agencies, to books, documents, papers, records of the contractor which are directly pertinent to that specific contract for the purpose of making audits and examinations.b. Six (6) contracts did not include provisions for retention of all required records for a three years period.c. One (1) contract did not include provisions for compliance with Sections 103 and 107 of the Contract Work Hours and Safety Standards Act, provision for compliance with Energy Policy and Conservation Act and provision for compliance with the Copeland “Anti-kickback” Act. |
| Criteria | 45 CFR, Subpart C, Section 92.36 (I) (1-13), states that sub grantee’s contract must contain provisions described in paragraph (I) of this section. |
| Cause of Condition | The Municipality procurement standard procedures failed to include the required contract provisions. |
| Effect of Condition | The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.36 (I) (1-13). |
| Recommendation | We recommend management to include all contract provisions required by federal regulations before each contract execution |
| Questioned Costs | None |
| Management Response | The Municipality Management concurs with the finding. Auditor’s recommendation would be considered as part of corrective action plan development and implementation. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|--|
| 01-07 | 14.239 | <p><u>Deficiencies in tenant's files.</u></p> <p>Partial corrective action has been taken. Actually the program includes all the require participant documentation in the participant files and an employee was assigned to perform inspections as required by regulations.</p> |
| 01-08 | 14.239 | <p><u>No adequate cash management procedures.</u></p> <p>Partial corrective action has been taken. Actually the program maintains a file duly organized of the requisition of funds through IDIS System and exist adequate audit trial to reconcile the funds received from the Federal Agency with the disbursements of checks.</p> |
| 01-09 | 14.239 | <p><u>The Municipality did not maintain adequate property records.</u></p> <p>No corrective action has been taken. The person in charge of the property management will perform an annual inventory.</p> |
| 01-10 | 14.239 | <p><u>Earmarking- Investment in Community Housing Development Organizations (CHDO's)</u></p> <p>Partial Corrective action has been taken. The Municipality is in the process of enters in an agreement with a certificated CHDO non for profit organization in order to comply with the program requirements.</p> |
| 01-11 | 14.239 | <p><u>Procurement Suspension and Debarment</u></p> <p>Full corrective action has been taken.</p> |
| 01-12 | 14.239 | <p><u>Program Income</u></p> <p>Full corrective action has been taking.</p> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|--|
| 01-13 | 14.239 | <u>Failure to perform on site inspections</u> No corrective action has been taken. The program assigned a person to perform on-site inspections starting on February, 2003. |
| 01-14 | 14.239 | <u>Drawdown of HOME funds</u> Full corrective action has been taken. |
| 01-15 | 14.218 | <u>No adequate cash management procedures.</u> Full corrective action has been taken. |
| 01-16 | 14.218 | <u>The Municipality did not maintain adequate property records.</u> No corrective action has been taken. |
| 01-17 | 14.218 | <u>Deficiencies in contract provisions.</u> Full corrective action has been taken. |
| 01-18 | 14.218 | <u>Inactive funds.</u> Full corrective action has been taken. |
| 01-19 | 14.218 | <u>Failure in Relocation Assistance.</u> Full corrective action has been taken. |
| 01-20 | 14.218 | <u>No adequate Sub-Recipient Monitoring.</u> No corrective action has been taken. |
| 01-21 | 14.218 | <u>Deficiencies in Financial Reports</u> No corrective action has been taken. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|--|
| 01-22 | 14.218 | <u>Deficiencies in Participants files.</u> No corrective action has been taken. |
| 01-23 | 93.600 | <u>Deficiencies in disbursement tests.</u> No corrective action has been taken. |
| 01-24 | 93.600 | <u>No adequate cash management procedures.</u> No corrective action has been taken. |
| 01-25 | 93.600 | <u>No adequate property transactions.</u> Full corrective action has been taken. |
| 01-26 | 93.600 | <u>Failure to prepare and submit the administration expenses.</u> Full corrective action has been taken. |
| 01-27 | 93.600 | <u>Matching, Level of Effort, Earmarking</u> Full corrective action has been taken. |
| 01-28 | 93.600 | <u>Deficiencies in Participants files.</u> No corrective action has been taken. |
| 01-29 | 93.600 | <u>Deficiencies in contract provisions.</u> No corrective action has been taken. |
| 01-30 | 93.600 | <u>Reports submitted after deadline.</u> Full corrective action has been taken. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|------------------|--|
| 01-31 | 93.600 | <u>Special Test-Licensing Requirement</u> Full corrective action has been taken. |
| 00-19 | Various programs | <u>Records Retention</u> Partial corrective action has been taken The Municipality assigned an employee to actualize the real property subsidiary ledger. |
| 00-20 | 14.855 | <u>Records Retention</u> Full corrective action has been taken. |
| 00-22 | 83.544 | <u>Procurement procedures and contract provisions</u> Full corrective action has been taken. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|---|
| 00-25 | 14.218 | <u>Cash Management</u> Partial corrective action has been taken. The Municipality established procedures in order to maintain an adequate cash balance in books. |
| 00-26 | 10.558 | <u>Cash Management</u> No corrective action has been taken. As of June 30, 2002 the program maintain a book balance of approximately \$286,000. |
| 00-27 | 93.194 | <u>Cash Management</u> Full corrective action has been taken. The program maintain no cash balance as of June 30, 2002 |
| 00-28 | 14.855 | <u>Cash Management</u> No corrective action has been taken. The program maintains an excessive cash balance as of June 30, 2002. |
| 00-29 | 14.221 | <u>Cash Management</u> Partial corrective action has been taken. The program maintains a cash balance of \$30,222 as of 6/30/02. |
| 00-30 | 14.218 | <u>Cash Management</u> Partial corrective action has been taken. The Municipality established procedures in order to maintain an adequate cash balance in books. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|------------------|--|
| 00-31 | 14.218 | <p><u>Cash Management</u></p> <p>Partial corrective action has been taken. The Municipality established procedures in order to maintain an adequate cash balance in books.</p> |
| 06/30/99 02 | Various programs | <p><u>Records Retentions</u></p> <p>Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding.</p> |
| 06/30/99 05 | 93.600 | <p><u>Records Retention</u></p> <p>Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding.</p> |
| 06/30/99 11 | 14.855 | <p><u>Cash Management</u></p> <p>Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding.</p> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|--|
| 06/30/99 12 | 93.600 | <u>Cash Management</u> Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding. |
| 06/30/99 13 | 10.558 | <u>Cash Management</u> Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding. |
| 06/30/99 14 | 14.857 | <u>Cash Management</u> Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding. |
| 06/30/99 15 | 14.221 | <u>Cash Management</u> Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|-------------------------|----------|--|
| 06/30/99 16 | 14.218 | <u>Cash Management</u> Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding. |
| 06/30/99 17 | 14.218 | <u>Cash Management</u> Audit finding is no longer valid since has pass more than two years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow up to the finding and has not issue a final decision respect to the finding. |

OFIC. DEL COMISIONADO
DE ASUNTOS MUNICIPALES

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RECIBIDO
UNIDAD DE CORREO

11.23.507/112

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
REPORT ON GENERAL PURPOSE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2002

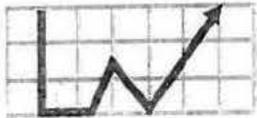
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YEAR ENDED JUNE 30, 2002

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

**To the Honorable Mayor and
the Municipal Assembly
Municipality of Arecibo
Arecibo, Puerto Rico**

We have audited the accompanying general-purpose financial statements of the **Municipality of Arecibo**, as of and for the year ended June 30, 2002, as listed in the table of contents. These general purpose financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit.

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

We were unable to obtain audited financial statements of the "Corporación de Desarrollo Cultural Teatro Oliver", a Discrete Component Unit, and that was not included on the accompanying general - purpose financial statements. Accordingly, we do not express an opinion about the reporting entity structure.

As described in **Note 8**, the Municipality has not maintained complete and adequate records of its general fixed assets and, accordingly, we were unable to obtain sufficient competent evidential matter with respect to the reported value of the Municipality's general fixed assets account group at June 30, 2002.

INDEPENDENT AUDITORS' REPORT (Continued)

As disclosed in Note 14, at June 30, 2002, the Municipality had not performed the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated the obligation for landfill closure and post closure care costs. Governmental Accounting Standard Board Statement 18 requires, among other things that the Municipality estimates and recognizes the Municipal Solid Waste Landfill Closure and Post closure Care Costs. Accordingly, no provision for liability has been made in the financial statements.

In our opinion, except for the effect of third, fourth and fifth paragraphs, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the **Municipality of Arecibo** as of June 30, 2002, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 17, 2002

Stamp No. 1853955 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
COMBINED BALANCE SHEET
ALL GOVERNMENTAL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2002**

| | GOVERNMENTAL FUND TYPES | | | | ACCOUNT GROUPS | | TOTAL (MEMORANDUM ONLY) |
|--|-------------------------|--------------------|--------------------|---------------------|-------------------------|---------------------------|----------------------------|
| | General | Special Revenue | Debt Service | Capital Projects | General Fixed Assets | General Long-term Debt | |
| ASSETS AND OTHER DEBITS | | | | | | | |
| Cash and cash equivalents | \$11,862,596 | \$2,714,434 | | \$6,117,263 | | | \$20,694,293 |
| Cash with fiscal agent | | | \$5,699,846 | 9,826,032 | | | 15,525,878 |
| Intergovernmental receivable | 1,056,341 | | | | | | 1,056,341 |
| Municipal License tax receivable | 4,778 | | | | | | 4,778 |
| Federal grants receivable | | 518,318 | | | | | 518,318 |
| Due from other funds | 283,190 | | | | | | 283,190 |
| Other Receivables | 816,283 | | | | | | 816,283 |
| Property and Equipment | | | | | \$58,907,963 | | 58,907,963 |
| Amount available in Debt Service Fund | | | | | | \$5,699,846 | 5,699,846 |
| Amount to be provided for retirement of general long-term debt | | | | | | 55,477,404 | 55,477,404 |
| Total assets and other debits | \$14,023,188 | \$3,232,752 | \$5,699,846 | \$15,943,295 | \$58,907,963 | \$61,177,250 | \$158,984,294 |
| LIABILITIES AND FUND EQUITY | | | | | | | |
| Liabilities: | | | | | | | |
| Accounts payable and accrued liabilities | \$1,406,838 | \$585,918 | | | | | \$1,992,756 |
| Due to other funds | | 274,921 | | \$8,269 | | | 283,190 |
| Due to other governmental entities | 2,422,648 | | | | | \$2,288,871 | 4,711,519 |
| Deferred municipal license tax revenues | 10,238,163 | | | | | | 10,238,163 |
| Deferred federal grant revenues | | 1,512,170 | | | | | 1,512,170 |
| General obligation bonds | | | | | | 30,354,000 | 30,354,000 |
| Notes payable | | | | | | 18,382,940 | 18,382,940 |
| Claims and judgments | | | | | | 973,383 | 973,383 |
| HUD recovery of disallowed costs | | | | | | 5,543,194 | 5,543,194 |
| Accrued compensated absences | | | | | | 3,634,862 | 3,634,862 |
| Total liabilities | 14,067,649 | 2,373,009 | | 8,269 | | 61,177,250 | 77,626,177 |
| Fund equity and other credits | | | | | | | |
| Investment in general fixed assets | | | | | \$58,907,963 | | 58,907,963 |
| Fund balances: | | | | | | | |
| Reserved for encumbrances | 2,249,507 | | | | | | 2,249,507 |
| Reserved for debt service | | | 5,699,846 | | | | 5,699,846 |
| Unreserved: | | | | | | | |
| Designated for specific fund purposes | | 859,743 | | 15,935,026 | | | 16,794,769 |
| Undesignated | (2,293,968) | | | | | | (2,293,968) |
| Total fund equity (deficit) and other credits | (44,461) | 859,743 | 5,699,846 | 15,935,026 | \$58,907,963 | - | 81,358,117 |
| Total liabilities and fund equity | \$14,023,188 | \$3,232,752 | \$5,699,846 | \$15,943,295 | \$58,907,963 | \$61,177,250 | \$158,984,294 |

See accompanying notes to general purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
COMBINED STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
ALL GOVERNMENTAL FUND TYPES
YEAR ENDED JUNE 30,2002**

| | GOVERNMENTAL FUND TYPES | | | | TOTALS (MEMORANDUM ONLY) |
|---|-------------------------|--------------------|--------------------|---------------------|-----------------------------|
| | General | Special Revenue | Debt Service | Capital Projects | |
| REVENUES | | | | | |
| Property taxes | \$10,410,582 | | \$2,663,840 | | \$13,074,422 |
| Municipal license taxes | 12,523,004 | | | | 12,523,004 |
| Licenses and permits | 1,427,994 | | | | 1,427,994 |
| Intergovernmental | 6,835,118 | \$1,029,633 | | \$2,239,468 | 10,104,219 |
| Rent of property | 250,075 | | | | 250,075 |
| Fines and penalties | 27,148 | | | | 27,148 |
| Interest | 318,178 | | | | 318,178 |
| Federal grants | | 17,976,702 | | | 17,976,702 |
| Miscellaneous | 1,320,772 | 53,862 | | | 1,374,634 |
| Total revenues | <u>33,112,871</u> | <u>19,060,197</u> | <u>2,663,840</u> | <u>2,239,468</u> | <u>57,076,376</u> |
| EXPENDITURES | | | | | |
| Current: | | | | | |
| Mayor and Municipal Assembly | 3,026,113 | | | | 3,026,113 |
| General government | 18,197,980 | 1,724,987 | | | 19,922,967 |
| Public safety | 1,478,325 | 140,856 | | | 1,619,181 |
| Public works | 3,799,666 | 64,211 | | | 3,863,877 |
| Public health and sanitation | 5,149,320 | | | | 5,149,320 |
| Welfare | | 14,628,419 | | | 14,628,419 |
| Economic development | 436,006 | | | | 436,006 |
| Culture and Recreation | 399,378 | | | | 399,378 |
| Principal retirement | 418,824 | 1,000,000 | 969,000 | | 2,387,824 |
| Interest | 309,925 | 253,752 | 1,571,196 | | 2,134,873 |
| Capital outlays | 112,812 | 887,475 | | 2,366,461 | 3,366,748 |
| Total expenditures | <u>33,328,349</u> | <u>18,699,700</u> | <u>2,540,196</u> | <u>2,366,461</u> | <u>56,934,706</u> |
| Excess (deficiency) of revenues over (under) expenditures | (215,478) | 360,497 | 123,644 | (126,993) | 141,670 |
| OTHER FINANCES SOURCES (USES): | | | | | |
| Bond Proceeds | 10,545,000 | | | 5,030,000 | 15,575,000 |
| Operating transfer to other funds | (774,427) | | | | (774,427) |
| Operating transfer from other funds | | | 774,427 | | 774,427 |
| Total other financing sources (uses) | <u>9,770,573</u> | <u>-</u> | <u>774,427</u> | <u>5,030,000</u> | <u>15,575,000</u> |
| Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing sources (uses) | 9,555,095 | 360,497 | 898,071 | 4,903,007 | 15,716,670 |
| Fund balances (deficit), beginning as restated | (9,599,556) | 499,246 | 4,801,775 | 11,032,019 | 6,733,484 |
| Fund balances (deficit), ending | <u>(\$44,461)</u> | <u>\$859,743</u> | <u>\$5,699,846</u> | <u>\$15,935,026</u> | <u>\$22,450,154</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
COMBINED STATEMENT OF REVENUES, EXPENDITURES, ENCUMBRANCES,
AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
GENERAL AND DEBT SERVICE FUNDS
YEAR ENDED JUNE 30, 2002

| | GENERAL FUND | | | DEBT SERVICE FUND | | |
|---|-------------------|--------------------------|--|-------------------|-------------------------|--|
| | Budget | Actual | Variance Favorable (Unfavorable) | Budget | Actual | Variance Favorable (Unfavorable) |
| REVENUES | | | | | | |
| Property taxes | \$10,410,582 | \$10,410,582 | - | \$2,723,230 | \$2,663,840 | (\$59,390) |
| Municipal license taxes | 11,841,000 | 12,523,004 | \$682,004 | | | |
| Licenses and permits | 762,000 | 1,427,994 | 665,994 | | | |
| Intergovernmental | 6,318,111 | 6,835,118 | 517,007 | | | |
| Rent of property | 108,000 | 250,075 | 142,075 | | | |
| Fines and penalties | 22,095 | 27,148 | 5,053 | | | |
| Interest | 120,000 | 318,178 | 198,178 | | | |
| Miscellaneous | 2,314,536 | 1,320,772 | (993,764) | | | |
| Total revenues | <u>31,896,324</u> | <u>33,112,871</u> | <u>1,216,547</u> | <u>2,723,230</u> | <u>2,663,840</u> | <u>(59,390)</u> |
| EXPENDITURES AND ENCUMBRANCES: | | | | | | |
| Current: | | | | | | |
| Mayor and Municipal Assembly | 3,259,364 | 3,437,013 | (177,649) | | | |
| General government | 14,366,797 | 11,797,793 | 2,569,004 | | | |
| Public safety | 1,605,272 | 1,532,464 | 72,808 | | | |
| Public works | 5,191,665 | 4,815,878 | 375,787 | | | |
| Public health and sanitation | 5,308,155 | 5,149,320 | 158,835 | | | |
| Economic development | 503,106 | 436,006 | 67,100 | | | |
| Culture and Recreation | 454,957 | 440,259 | 14,698 | | | |
| Principal retirement | 418,824 | 418,824 | 0 | 1,039,000 | 969,000 | 70,000 |
| Interest | 542,576 | 91,638 | 450,938 | 1,684,230 | 1,571,196 | 113,034 |
| Capital outlays | 245,608 | 112,812 | 132,796 | | | |
| Total expenditures and encumbrances | <u>31,896,324</u> | <u>28,232,007</u> | <u>3,664,317</u> | <u>2,723,230</u> | <u>2,540,196</u> | <u>183,034</u> |
| Excess (deficiency) of revenues over (under) expenditures and encumbrances | | 4,880,864 | 4,880,864 | | 123,644 | 123,644 |
| OTHER FINANCING SOURCES (USES): | | | | | | |
| Bond Proceeds | | 10,545,000 | | | | |
| Operating transfer to other funds | | (774,427) | | | | |
| Operating transfer from other funds | | | | | 774,427 | |
| TOTAL OTHER FINANCING SOURCES (USES) | | <u>9,770,573</u> | | | <u>774,427</u> | |
| Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing sources (uses) | | <u>14,651,437</u> | | | <u>898,071</u> | |
| Adjustment required under Generally Accepted Accounting Principles: | | | | | | |
| GAAP adjustments to Expenditures - Operational Loan | | (6,876,694) | | | | |
| Current year encumbrances treated as current year expenditures for budgetary basis | | 2,139,983 | | | | |
| Prior year encumbrances paid during the current year | | (359,631) | | | | |
| Fund balances (deficit), beginning as restated | | <u>(9,599,556)</u> | | | <u>4,801,775</u> | |
| Fund balance (deficit), ending | | <u><u>(\$44,461)</u></u> | | | <u><u>5,699,846</u></u> | |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2002

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The **Municipality of Arecibo** (the Municipality) was established in 1616. The Municipality's governmental system consists of an executive and a legislative body. It is governed by a Mayor and a sixteen member Municipal Assembly who are elected every four years through the Puerto Rico general elections.

The Municipality provides the following services: public safety, public works, culture and recreation, health, urban development and welfare.

The Municipality's general-purpose financial statements are presented in accordance with generally accepted accounting principles (GAAP), as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. A summary of the Municipality's significant accounting policies follows:

A. 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* of the Governmental Accounting Standards Board. 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 the nature and significance of the relationship between the entity and a primary government is such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria exists a component unit, which was included in the general-purpose financial statements.

"Corporación Desarrollo Cultural Teatro Oliver" is a non-profit corporation duly organized and existent under the laws of the Commonwealth of Puerto Rico. It was established to acquire, restore and operate the Teatro Oliver of Arecibo, Puerto Rico.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

A. Financial reporting entity (continued):

The Municipality's financial statements include as a component unit the operations of Teatro Oliver, because of the financial interdependency, ability to designate management and the ability to significantly influence operations demonstrated by the Municipality.

The Teatro Oliver elected the provision of Section 101 (7) of the Puerto Rico Income Tax Law for non-profit organization and all of their net revenues are exempt from the payment of income taxes.

B. Basis of presentation:

The Municipality records its transactions in the fund types and account groups described below:

Governmental fund types:

Governmental funds are those through which most governmental functions are financed. The acquisition, use and balances of the Municipality's expendable financial resources and the related current liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination. The following are the Municipality's governmental fund types:

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

Special Revenue - is used to account for the proceeds of specific revenue sources that are legally restricted to be expended for specific purposes.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

B. Basis of presentation:

Account groups:

The account groups are used to maintain accounting control and accountability of the Municipality's general fixed assets and long-term debt. The Municipality's account groups are:

General Fixed Assets - is used to account for all fixed assets of the Municipality.

General Long-term Debt -is used to account for all long-term debt obligations of the Municipality.

C. Basis of accounting:

All governmental funds are accounted for using the modified accrual basis of accounting. Revenues are recognized when they become measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the corresponding year. Expenditures are recorded when the liability is incurred, except for (1) interest on general long-term debt obligations which is recorded when due, and (2) accruals for vacation, sick leave, claims and judgments which are recorded in the general long-term debt account group.

In applying the susceptible to accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are essentially two types of such revenues. In one situation, funds must be expended on the specific purpose or project before any amount is reimbursed to the Municipality; therefore, revenues are recognized based upon the expenditures recorded. In the other situation, funds are virtually unrestricted as to purpose of expenditure and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are recognized as revenues at the time of receipt or earlier if they meet the criteria of availability.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

C. Basis of accounting:

Licenses, permits, rent of property, fines, penalties and other miscellaneous revenues (except investment earnings) are recorded as revenues when received because they are generally not measurable until actually received.

The proprietary fund is accounted for using the accrual basis of accounting. Its revenues are recognized when they are earned and their expenses are recognized when they are incurred.

D. Reservations of fund balance:

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

Encumbrances – Represent future expenditures under purchases orders, contracts and other commitments issued for goods and services not received at year-end. Where the appropriations lapse at year-end these will be honored during subsequent year. Encumbrances constitute the equivalent of expenditures for budgetary purposes and, accordingly, are reported with expenditures in all budgetary basis statements.

Debt Service – Represents net assets available to finance future debt service payments.

E. Budgetary data:

In establishing the budgetary data presented in the general purpose financial statements, the Municipality follows these procedures, which are in accordance with the Municipal Law:

- Prior to May 31, the Major submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1. The proposed budget includes estimated expenditures and the means of financing them.
- The budget document is available for public inspection prior to its approval by the Municipal Assembly.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

E. Budgetary data (continued):

- Prior to July 1, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- 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 general-purpose financial statements.

The budget is prepared following the modified accrual basis of accounting, except for the encumbrances that are recorded as expenditures under the budgetary basis and as a reserve of funds balances under GAAP and for the interfund transactions that are not included in the budgetary basis.

The actual result of operations, presented in the Statement of Revenues, Expenditures, Encumbrances, and Changes in Fund Balances-Budget and Actual-General and Debt Service Funds, is in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

The budget prepared for each of the special revenue funds is based on a program period, which is not necessarily the same as the Municipality's fiscal year. Accordingly, it is not practical to present an annual comparison of budget and actual for the special revenue funds.

F. Inventories:

The General Fund purchases office and printing supplies, gasoline, oil and other items. The cost of purchases is recorded as an expenditure and, consequently, the inventory is not recorded in the general-purpose financial statements.

G. Property and equipment:

Property and equipment acquired are recorded as expenditures in the governmental funds and are capitalized at cost in the General Fixed Assets Account Group. Donated property and equipment are recorded at their estimated fair market value at the time they are received by the Municipality. No depreciation has been provided on property and equipment. Interest cost during the construction period is capitalized, when significant.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

H. Cash and cash equivalents:

The Municipality's Director of Finance is responsible for investing available resources and is restricted by law to invest only in saving accounts and certificates of deposit with banks qualified as depositories of public funds by the Department of the Treasury of the Commonwealth of Puerto Rico. The Municipality maintains a cash and investment pool that is available for use by all funds. Each fund type's portion of this pool is displayed on the combined balance sheet as "Cash and Cash Equivalents". All cash in banks at June 30, 2002 is insured by the Federal Deposit Insurance Corporation up to \$100,000, and by collateral held by the Treasury Department to its name. Interest earned from certificates of deposit and other short-term investments is recorded as revenue in the General Fund. Cash and Cash Equivalents include investments with original maturities of ninety days or less.

Cash with fiscal agent:

Debt Service Fund: represents property tax collections retained by the Municipal Revenue Collection Center and Government Development Bank of the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service and unused proceeds from bonds and notes issued for the acquisition or construction of permanent improvements.

Capital Project Fund: Funds restricted and held by Governmental Development Bank for the future disbursements of capital projects. This account includes deposits from loans proceeds for capital projects.

I. Interfund transactions:

The Municipality has the following types of transactions among funds:

Operating transfers- Transfers that are reported when incurred as "Operating transfers from other fund" by the recipient fund and as "Operating transfers to other fund" by the disbursing fund.

Transfer of Expenditures (Reimbursements) – Reimbursement of expenditures made by one fund for another that are recorded as expenditures in the reimbursing fund and as reduction of expenditures in the reimbursed fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

J. Compensated absences:

Municipal employees are granted 30 days of vacation and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of an employee resignation, the employee is reimbursed for accumulated vacation days up to the maximum allowed. Separation from employment prior to the use of all or part of the sick leave before 10 years of service terminates all rights for compensation.

The Municipality accrues a liability for compensated absences, which meet the following criteria:

1. The Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by *GASB Number 16*, the Municipality has accrued a liability for compensated absences, which has been earned but not taken by municipal employees. This liability is presented in the general long-term debt account group because they will not be funded with available expendable financial resources at June 30, 2002.

K. Insurance:

The Municipality has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the Municipality's insurance coverage.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

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

L. Total columns (memorandum only):

The total columns (memorandum only) are presented only to facilitate additional analysis. Consequently, amounts shown in total columns do not represent financial position or result of operations, in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation since interfund eliminations have not been made.

M. Use of estimates in the preparation of general purpose financial statements:

The preparation of general purpose financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures at the date of the general purpose financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

N. Claims and judgments:

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The General Long-term Debt Account Group includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

2. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the General Fund include the following:

| | |
|--|---------------------|
| Puerto Rico Aqueduct and Sewer Authority | \$ 33,124 |
| General Service Administration | 13,904 |
| Internal Revenue Service | 1,960,964 |
| Department of Treasury | 414,656 |
| | <u>\$ 2,422,648</u> |

The Municipality reached agreements with other governmental entities for the payment of debts on a long-term basis. These liabilities are presented in the General Long-term Debt Account Group because they will not be funded with available expendable financial resources at June 30, 2002. The following is the balance of these accounts:

| | |
|-------------------------------------|---------------------|
| Municipal Revenue Collection Center | <u>\$ 2,288,871</u> |
|-------------------------------------|---------------------|

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

3. PROPERTY TAXES:

The Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico is responsible by law to assess, levy and collect real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment, as of January 1 of each year, is made on a return, which must be filed, with the CRIM, together with the payment, by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of the year 1957.

Tax rates are 8.58% for real property and 6.58% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico. The Municipality's share is composed of the basic tax of 5.8% for real property and 3.8% for personal property which is recorded in the General Fund, and the additional tax of 1.75% in both cases which is restricted for debt service and retained by the CRIM for such purposes. To the extent that such taxes are informed and collected by the CRIM, they are recorded as revenue in the General Fund and in the Debt Service Fund.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the CRIM assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the general fund when payments are received from the CRIM.

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.

The CRIM advances to the municipality the estimated property tax collection for each fiscal year. Advances are repaid through actual collections from the taxpayers. The CRIM periodically informs the Municipality of the amounts collected and applied to outstanding advances. The property tax advanced by the CRIM during the year is recorded as property taxes revenues in the Municipality's General Fund. At the date of the release of these financial statements, the CRIM issued the final liquidation noting that the advances were more than collections by \$905,283. Such amount was recognized as Due to Governmental Entities in the General Long Term Debt Account Group because it will not be funded with available expendable financial resources at June 30, 2002. Also, the Municipality has a \$1,383,588 property tax advance debt from prior years; such balance was included a Due to other governmental entities in the General Long Term Debt Account Group because it will not be funded with available expendable financial resources at June 30, 2002.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

4. MUNICIPAL LICENSE TAXES:

The municipal license tax is levied each year 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 Acts of Puerto Rico. All taxpayers are required to file their declaration by April 15, of each year.

The tax rates are as follows:

| | |
|--------------------------------|-------|
| Financial institutions | 1.50% |
| Savings and loans associations | 1.50% |
| Other organizations | 0.50% |

The tax may be paid in two equal semi-annual installments on July 15 and January 15 following the filing date. However, a discount of 5% is allowed for total payment received on or before April 15. Collections made prior to June 30 pertaining to the next fiscal year are recorded as deferred revenues.

5. INTERGOVERNMENTAL:

Intergovernmental revenues consist mainly of payments from the Commonwealth of Puerto Rico and payments in lieu of taxes from certain quasi-public corporations, principally the Puerto Rico Electric Power Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements. Intergovernmental revenues are recorded in the General Fund, except for those related directly to capital improvements, which are recorded in the Capital Projects Fund.

6. CASH AND CASH EQUIVALENTS:

| | |
|---|----------------------|
| Cash in bank accounts | \$ 7,881,526 |
| Money Market bank account | 2,212,044 |
| Certificates of deposit (90 days or less) | 10,600,723 |
| | <u>\$ 20,694,293</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

7 DEBT SERVICE FUND:

Revenue for the Debt Service Fund consists mainly of the share of property taxes, which is designated for the debt service requirements of the bonds and notes obligations issued by the Municipality. The Government Development Bank pays principal and interest on these obligations.

8. GENERAL FIXED ASSETS:

The Municipality has not maintained complete and adequate records of its general fixed assets. Also, there are no written procedures to ascertain that all capital expenditures are properly recorded in the property ledger. In addition, the Municipality has not taken a physical inventory of its property and equipment. As a result, no adequate records exist to classify the general fixed assets account group between land, building and equipment.

A summary of changes in the General Fixed Assets Account Group is as follows:

| | <u>Balance</u> <u>July 1, 2001</u> | <u>Additions</u> | <u>Retirements</u> | <u>Balance</u> <u>June 30, 2002</u> |
|----------------------|---------------------------------------|--------------------|--------------------|--|
| Real Estate Property | \$43,762,498 | \$1,000,000 | | \$44,762,498 |
| Vehicles | 3,130,488 | 84,890 | | 3,215,378 |
| Equipment | <u>10,687,681</u> | <u>247,021</u> | <u>\$4,615</u> | <u>10,930,087</u> |
| Total | <u>\$57,580,667</u> | <u>\$1,331,911</u> | <u>\$4,615</u> | <u>\$58,907,963</u> |

9. GENERAL OBLIGATION BONDS:

The general obligation bonds transactions for the year ended June 30, 2002 were as follows:

| | |
|--------------------------|----------------------|
| Balance at July 1, 2001 | \$ 26,293,000 |
| Debt issued | 5,030,000 |
| Principal retirements | <u>(969,000)</u> |
| Balance at June 30, 2002 | <u>\$ 30,354,000</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

9. GENERAL OBLIGATION BONDS (CONTINUED):

General obligation bonds at June 30, 2002 are as follows:

| Type of bonds | Maturity date | Original Amount | Range of Interest Rates | Balance at June 30, 2002 |
|---------------------------------------|---------------|-----------------|----------------------------|-----------------------------|
| 1984 Series | 1/1/2009 | \$675,000 | 5.00% | \$ 278,000 |
| 1987 Series | 1/1/2012 | 875,000 | 5.00% | 513,000 |
| 1989 Series | 1/1/2014 | 500,000 | 5.00% | 325,000 |
| 1990 Series | 7/1/2005 | 3,395,000 | 4.37% to 7.81% | 1,395,000 |
| 1991 Series | 7/1/2006 | 2,060,000 | 3.26% to 6.36% | 1,015,000 |
| 1994 Series | 1/1/2019 | 400,000 | 4.88% | 352,000 |
| 1995 Series | 7/1/2020 | 14,975,000 | 4.70% to 8.00% | 13,475,000 |
| 1998 Series | 1/1/2023 | 900,000 | 4.75% | 826,000 |
| 1999 Series | 7/1/2024 | 7,365,000 | 5.88% to 7.81% | 7,145,000 |
| 2002 Series | 7/1/2026 | 5,030,000 | 5.00% to 7.50% | 5,030,000 |
| Total general obligation bonds | | | | <u>\$ 30,354,000</u> |

The future annual requirements for the amortization of general obligations bonds outstanding as of June 30, 2002, are as follows:

| Year ended June 30 | Total |
|-----------------------|-----------------------------|
| 2003 | \$ 1,106,000 |
| 2004 | 1,206,000 |
| 2005 | 1,307,000 |
| 2006 | 1,417,000 |
| 2007 | 1,100,000 |
| Thereafter | 24,218,000 |
| Total | <u>\$ 30,354,000</u> |

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

10. NOTES PAYABLE:

The notes payable transactions for the year ended June 30, 2002 were as follows:

| | |
|--------------------------|----------------------|
| Balance at July 1, 2001 | \$ 9,256,764 |
| Debt issued | 10,545,000 |
| Principal retirements | <u>(1,418,824)</u> |
| Balance at June 30, 2002 | <u>\$ 18,382,940</u> |

Notes payable at June 30, 2002 are as follows:

| Description | Maturity Date | Original Amount | Range of Interest rates | Balance June 30, 2002 |
|-------------------------|--------------------------|----------------------------|------------------------------------|----------------------------------|
| Special Lottery | 7/1/2008 | 3,000,000 | 8.00 % | \$ 952,940 |
| 1994 Series | 7/1/2014 | 5,335,000 | 9.00 % | 4,310,000 |
| Section 108 Loan | 8/1/2003 | 9,575,000 | 7.00 % | 2,575,000 |
| 2001 Series | 7/1/2026 | 10,545,000 | 5.00 % to 8.00 % | <u>10,545,000</u> |
| Total notes payable | | | | <u>\$ 18,382,940</u> |

The future annual requirements for the amortization of notes payable outstanding as of June 30, 2002, are as follows:

| <u>Year ended June 30</u> | <u>Total</u> |
|-------------------------------|----------------------|
| 2003 | \$ 1,490,000 |
| 2004 | 2,095,000 |
| 2005 | 555,000 |
| 2006 | 585,000 |
| 2007 | 625,000 |
| Thereafter | <u>13,032,940</u> |
| Total | <u>\$ 18,382,940</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

11. COMPONENT UNIT:

We were unable to obtain the statement of component unit "Corporación Desarrollo Cultural Teatro Oliver" (non-profit corporation).

The Corporación Desarrollo Cultural Teatro Oliver

Nature and Organization

The "Corporación Desarrollo Cultural Teatro Oliver" (non-profit corporation) was organized under the Laws of the Commonwealth of Puerto Rico. The Corporation was established to acquire "El Teatro Oliver of Arecibo" to be restored and operate as Municipal Theater.

CODEA- The "Corporación de Desarrollo Económico del Atlántico" (CODEA) ceased operations and was dissolved by December 1995.

The Municipality still maintains the agreement entered by the above date with the "Banco Gubernamental de Fomento" in which the Municipality is in charge of the management of all remaining rent income collections of CODEA. These collections are remitted to an special account at the "Banco Gubernamental de Fomento" to amortize an outstanding loan balance of CODEA with the said bank.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN:

Defined Benefit Pension Plan

The Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (the "System") is the administrator of a cost sharing multiple-employer defined benefit public employee retirement system established by the Commonwealth of Puerto Rico. The System was created under the Act 447 approved on May 15, 1951, as amended. All regular employees of the Municipality hired before January 1, 2000 and under 55 years of age at the date of employment became members of the System as a condition to their employment. No benefits are payable if the participant receives a refund of his/her accumulated contributions. The System also provides for death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature.

Under the System, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to contribute 5.775% for the first \$550 of monthly gross salaries plus 8.275% for the excess of this amount, or on the alternative, 8.275% of monthly gross salaries. The Municipality contributes to the System 9.275% of the participating employee's gross salaries.

Pension benefits for employees that joined the system before April 1, 1990 are as follows:

| <u>Years of Service</u> | <u>Participant Age</u> | <u>Pension Benefits</u> |
|-----------------------------|----------------------------|---|
| 30 or more | 54 or less | 65% of the average of the three years of highest salary during the employees' service period. |
| 30 or more | 55 or more | 75% of the average of the three of highest salary during the employees' service period. |

For participants who retire with less than 30 years of service the pension benefits is computed at the rate of 1-1/2% of their average compensation for each year of credited service for the first 20 years and 2% for each of credited service for the remaining years.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN (CONTINUED)

For those employees that joined the system after April 1, 1980 the pension benefits are as follows:

| <u>Years of Service</u> | <u>Participant Age</u> | <u>Pension Benefits</u> |
|-------------------------|------------------------|---|
| 25 or more | Between 55 and 64 | Computed at the rate of 1-1/2% of their average compensation for each year of credited service, with an actuarial reduction based on the actuarial guides adopted by the Board of Trustees. |
| 10 or more | 65 or more | Computed at the rate of 1-1/2% of their average compensation for each year credited service. |

For participants who retire with less than 25 years of service and the participant age are 64 or less the pension benefit is computed at the rate of 1-1/2% of their average compensation for each year of credited service.

Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447 to establish, among other, a defined contribution saving 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 contributions 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 14, 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's account semi-annually.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN (CONTINUED):

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant spouse in case of the participant death. Participants with 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.

Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2002 recorded as pension expenditures were approximately \$ 710,000. This amount represents 100% of the required contribution for the fiscal year ended June 30, 2002.

The amount of the total pension benefit obligation is based on a standardized measurement established by GASB Number 27, *Accounting for Pensions by State and Local Governmental Employers*. The standardized measurement is the actuarial present value of credited projected benefits. This pension valuation method reflects the present value of estimated pension benefits that will be paid in future years as a result of employees services performed to date and is adjusted for the effects of projected salary increases. The significant actuarial assumptions used to determine the standardized measure of the pension benefit obligation are summarized below:

- * The present value of the future pension payments was computed by using a discount rate of 8.5%. The discount rate is equal to the estimated long-term rate of return on current and future investments of the pension plan.
- * Future pension payments reflect an assumption of 5% salary increase.

The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and nonvested is not readily available. Contributions in 2001 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by generally accepted accounting principles.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

12. RETIREMENT PLAN (CONTINUED):

An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The ten-year historical trend information is available in the separately issued audited financial statements of the System.

13. INTERFUND TRANSACTIONS:

Due from/to other funds

Interfund receivables and payables represent temporary loans between the funds.

Operating transfers

Operating transfers represent transfers between funds to specific purposes designated by the management.

14. LANDFILL OBLIGATIONS:

State and federal laws and regulations require the Municipality to place a final cover on its landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site after closure. At June 30, 2002, the Municipality has not performed the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated obligation for landfill closure and post closure costs.

15. OPERATING LEASES:

The Municipality is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore the results of the lease agreements are not reflected in the Municipality's account groups.

The following is a schedule by years of future minimum rental payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2002:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

15. OPERATING LEASES (CONTINUED):

| <u>Year ending June 30,</u> | <u>Amounts</u> |
|---------------------------------|-------------------|
| 2003 | \$ 244,243 |
| 2004 | 214,788 |
| 2005 | 64,800 |
| 2006 | <u>36,000</u> |
| Total minimum payments required | \$ <u>559,831</u> |

16. COMMITMENTS AND CONTINGENCIES:

A. Federal grants:

The Municipality participates in a number of Federal Financial Assistance Programs. According to OIG Audit 99-AT- 241-1001 issued in November 5, 1998 the Municipality has been inefficient and ineffective in the administration of the Community Development Block Grant and Section 108 Loan Guarantee Assistance Programs. As result of that HUD through the Community Planning & Development Division notify to the Municipality to reimburse the amount of \$ 6,847,476 for questioned costs. At audit date the Municipality reimbursed \$1,304,282.

At the present the Municipality participates in a number of Federal Financial Assistance Programs and we have no knowledge of any amount of expenditures, which may be disallowed by the granting agencies, although the Municipality expects such amounts, if any, not to be material.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

16. COMMITMENTS AND CONTINGENCIES (CONTINUED):

During May, 2001 the Municipality entered in an agreement with HUD to repay the outstanding debt that was included in the general long-term debt account group. The future annual requirements for the amortization of the outstanding balance as of June 30, 2002, are as follows:

| <u>Date</u> | <u>Payment Amortization</u> |
|--------------------|---------------------------------|
| September 15 2002 | \$733,658 |
| February 15, 2003 | 733,658 |
| September 15, 2003 | 733,658 |
| February 15, 2004 | 733,658 |
| September 15, 2004 | 733,658 |
| February 15, 2005 | 733,658 |
| September 15, 2005 | <u>1,141,246</u> |
| Totals | <u><u>\$5,543,194</u></u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

16. COMMITMENTS AND CONTINGENCIES (CONTINUED):

B. Claims and lawsuits:

The Municipality is a defendant in legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigation, the Municipality has reported liabilities of **\$973,383** in the general long-term debt account group for anticipated unfavorable judgments. The amount presented in the general long-term debt group of account represents the amount of estimated as probable liability, which will require future available financial resources for its payment. The administration believes that the ultimate liability in excess of amounts provided would not be significant.

In addition, the Municipality is a defendant in several legal proceedings, which are in the discovery stage. Certain of these claims are covered by insurance. The final outcome of these claims cannot be determined by legal counsel 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

17. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balances for Debt Service Fund have been restated by two situations detected during the fiscal year that affect the Fund Equity section of this Governmental fund, as follows:

| <u>Description</u> | <u>Debt Service Fund</u> |
|--|------------------------------|
| Beginning Fund Balances at July 1, 2001 | \$3,885,992 |
| Account Receivable from CRIM related to 2000 CAE final liquidation | 1,119,543 |
| Account Payable to CRIM related to 2001 CAE final liquidation | <u>(203,760)</u> |
| Beginning Fund Balances at July 1, 2001, as restated | <u>\$4,801,775</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2002

18. SIGNIFICANT EFFECTS OF SUBSEQUENT EVENTS:

On August 13, 2002 the Municipality of Arecibo authorized the issuance of a general obligation note in the amount of \$920,000.