

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

MUNICIPIO DE ARECIBO
AUDITORIA 2003-2004
30 DE JUNIO DE 2004

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
SINGLE AUDIT REPORT
YEAR ENDED JUNE 30, 2004

*Call 100-5-0111 (pro)
09 126-5-0111 (pro)*

*04-07-05
Cui*

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

CONTENTS

	Page
<u>BASIC FINANCIAL STATEMENTS</u>	
Independent Auditor's Report	1-2
Required Supplemental Information (Part 1) Management's Discussion and Analysis	3-13
Government-Wide Financial Statements:	
Statement of Net Assets	14
Statement of Activities	15
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	16
Statement of Revenues, Expenditures and Changes in Fund Balances	17
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	18
Notes to basic financial statements	19-46
<u>SUPPLEMENTARY INFORMATION</u>	
Required Supplemental Information (Part II):	
Budgetary Comparison Schedule-General Fund	47
Notes to Budgetary Comparison Schedule-General Fund	48
Schedule of expenditures of federal awards	49-51
Notes to the schedule of expenditures of federal awards	52
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u>	
Independent auditors' report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	53-54

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

CONTENTS - (CONTINUED)

	Page
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)</u>	
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	55-57
<u>FINDINGS AND QUESTIONED COSTS</u>	
Schedule of findings and questioned cost	58-89
Summary schedule of prior year audit findings	90-98



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 Legislature
Municipality of Arecibo
Arecibo, Puerto Rico**

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

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, 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 respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

The financial statements referred to above include only the governmental activities of **Municipality of Arecibo**. The financial statements do not include financial data for the legally separated discrete component unit, "Corporación Desarrollo Cultural Teatro Oliver C.E., which accounting principles generally accepted in the United States of America require to be reported with the financial data of the primary government. As result the primary government financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of the **Municipality of Arecibo**, Puerto Rico, as of June 30, 2004 and the changes in its financial position and its cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 5, to the financial statements, the management has not recorded certain general infrastructure assets in governmental activities and accordingly, has not recorded depreciation expense on those assets. Accounting principles generally accepted in the United States of America require that those general infrastructure assets be capitalized and depreciated, which would increase assets, net assets, and expenses of the governmental activities. The amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonable determinable.

INDEPENDENT AUDITORS' REPORT (Continued)

In our opinion, because of the effect of the matters discussed in the fourth paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the **Municipality of Arecibo**, Puerto Rico as of June 30, 2004 and the changes in financial position thereof for the year then ended.

Further, in our opinion, based on our audit the financial statements referred to above presents fairly, in all material respects, the financial position of each major fund, and the aggregate remaining fund information of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on page 47 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2004 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 basic 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 respective financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 1, 2004

Stamp No. 2019418 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2004

This discussion and analysis of the Municipality of Arecibo (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2004. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2003, first year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements - and Management's Discussion and Analysis-for State and Local Governments.*" This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. asses management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2004 deserve special mention:

1. Total assets of the Municipality amounted to \$99,811,473 which represents an increase of 11% compared to prior fiscal year, as restated.
2. At the end of fiscal year 2004, total liabilities amounted to \$82,911,818. Out of the said amount, \$66,516,917 corresponded to long-term liabilities of which \$44,129,294 represented the outstanding balance of bonds issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues.
3. Total net assets of the Municipality amounted to \$16,899,655 which represents an increase of 41% compared to prior fiscal year, as restated;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$72,783,476, derived from the following sources: \$732,109 charges for services; \$19,545,332 from operating grants and contributions; \$12,501,257 from capital grants and contributions obtained from other sources, and \$40,004,778 from general revenues available.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$65,796,588;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$6,986,888.
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$31,929,938.
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$10,250,131, compared to a fund balance of \$4,778,652 in the prior fiscal year, as restated.
9. The actual General Fund budgetary activities resulted in a favorable balance of \$1,342,339, caused mainly due to favorable variances in collections related to intergovernmental revenues.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2004. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2004, shows total expenses incurred to afford the cost of all functions and programs amounted to \$32,778,698. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$72,783,476 was derived from the following sources: \$732,109 charges for services; \$19,545,332 from operating grants and contributions; and \$12,501,257 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$40,004,778. When such figure is added to the \$32,778,698 previously mentioned, total revenues available for the financing of activities amounted to \$72,783,476. There was an excess of expenses over revenues in the amount of \$6,986,888 which contributed with an increase to the figure of net assets attained at the end of the fiscal year.

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

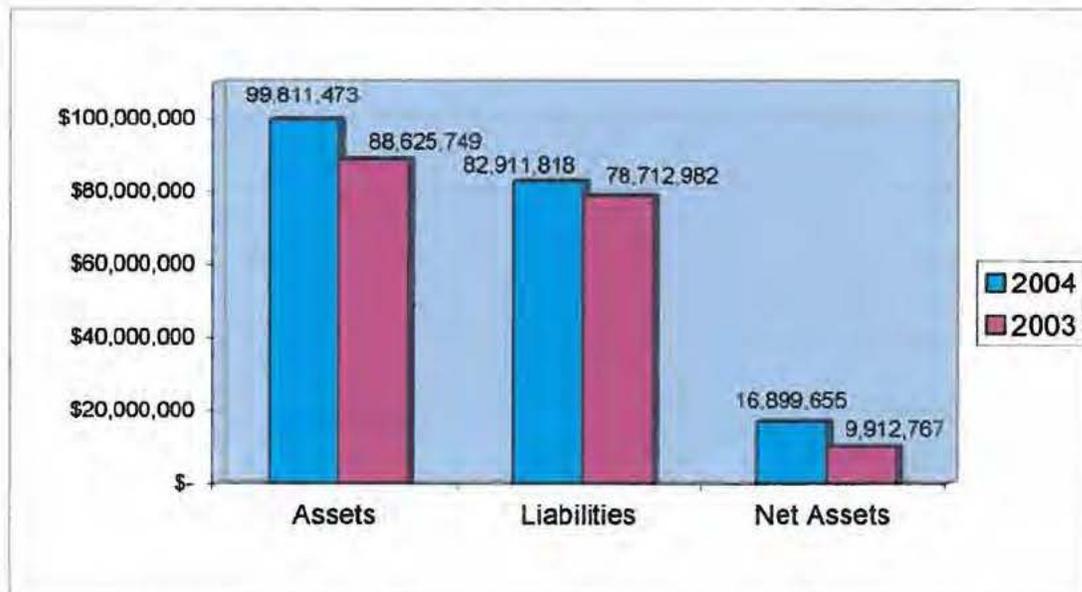
YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Arecibo, primary government total assets exceeded total liabilities by \$16,899,655 at the end of 2004, compared to \$9,912,767 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

Condensed Statement of Net Assets				
	2004	2003	Change	%
Assets				
Current assets	\$48,037,515	\$36,851,791	\$11,185,724	30%
Capital assets	51,773,958	51,773,958	-	-
Other assets				
Total assets	99,811,473	88,625,749	11,185,724	13%
Liabilities				
Current liabilities	16,394,901	13,729,212	2,665,689	19%
Noncurrent liabilities	66,516,917	64,983,770	1,533,147	2%
Total liabilities	82,911,818	78,712,982	4,198,836	5%
Invested in capital assets, net of related debt				
	24,482,958	21,939,958	2,543,000	12%
Restricted	20,897,811	17,980,088	2,917,723	16%
Unrestricted	(28,481,114)	(30,007,279)	1,526,165	(5%)
Total net assets	\$16,899,655	\$9,912,767	\$6,986,888	70%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2004, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$6,986,888 increase in the Municipality's net assets. Approximately 44 percent of the Municipality's total revenue came from taxes, while 54 percent resulted from grants and contributions, including federal aid. Charges for Services provided 1 percent and Interest revenue and miscellaneous 1 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general health and welfare services, general government and public works. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

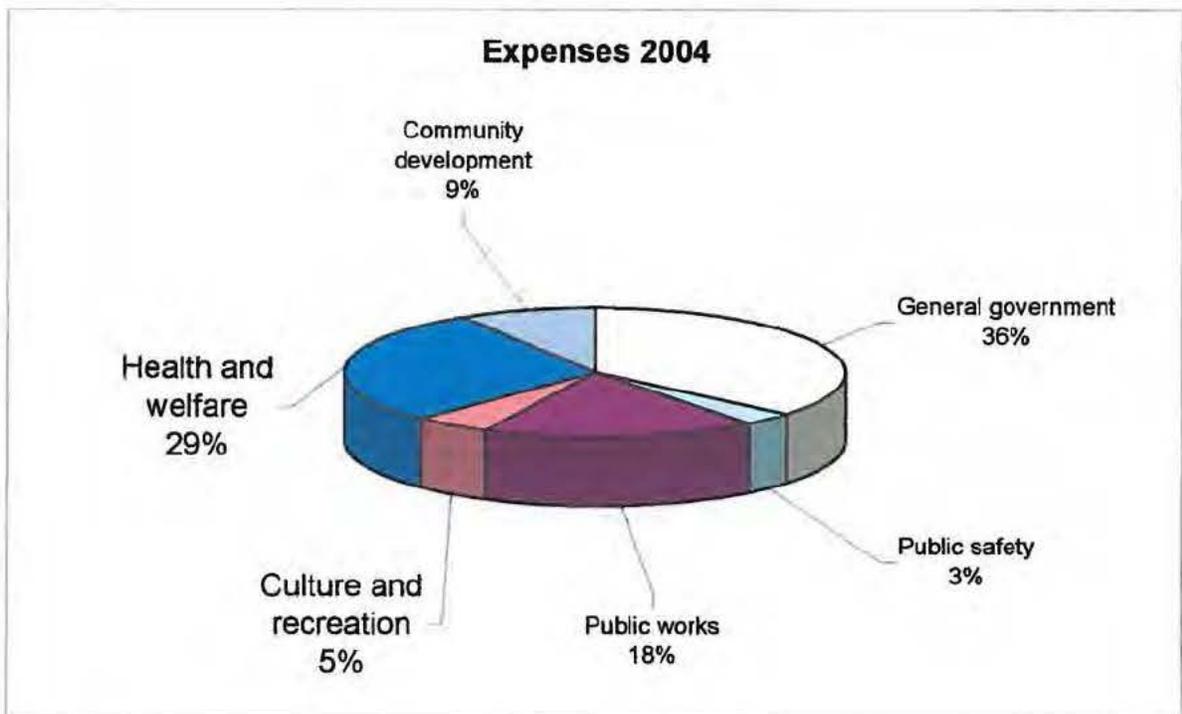
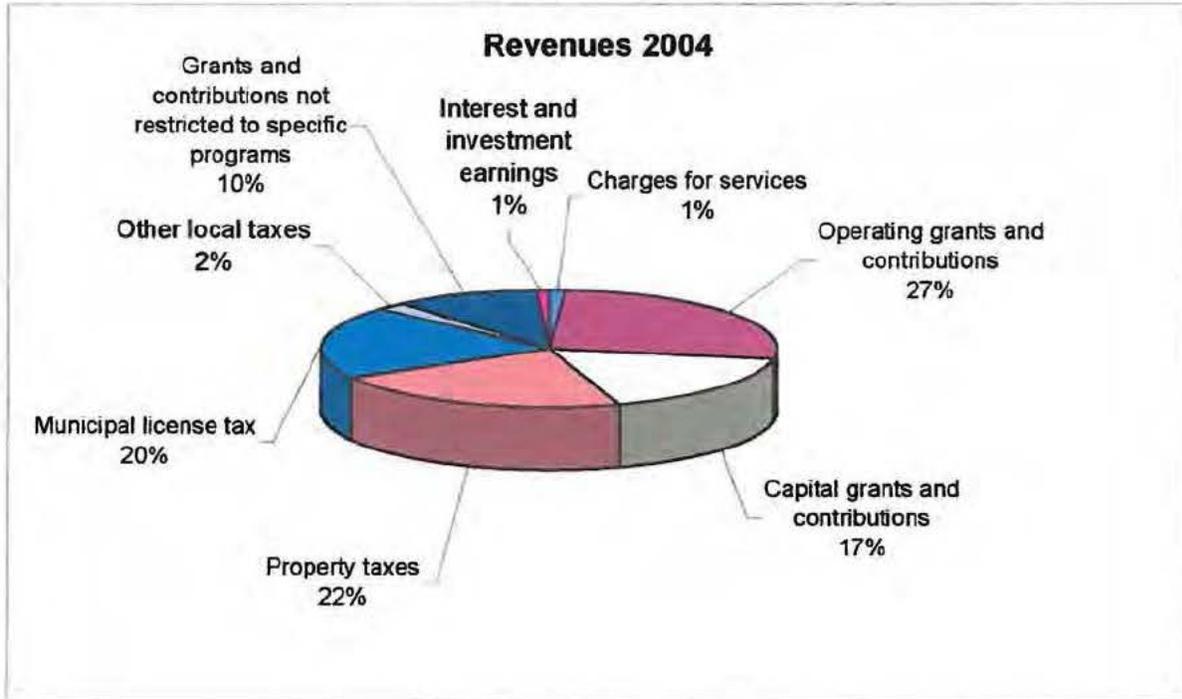
Condensed Statement of Activities	2004	2003	Change	%
Program revenues:				
Charges for services	\$732,109	\$721,294	\$10,815	1%
Operating grants and contributions	19,545,332	17,639,203	1,906,129	11%
Capital grants and contributions	12,501,257	10,734,806	1,766,451	16%
General revenues:				
Property taxes	15,702,592	15,591,962	110,630	1%
Municipal license tax	14,615,737	12,604,874	2,010,863	16%
Other local taxes	1,620,849	603,652	1,017,197	169%
Grants and contributions not restricted to specific programs	7,476,114	4,725,482	2,750,632	58%
Interest and investment earnings	491,017	521,116	(30,099)	(6%)
Gain (loss) on retirement of capital assets			-	-
Miscellaneous	98,469	223,236	(124,767)	(56%)
Total revenues	72,783,476	63,365,625	9,417,851	15%
Expenses:				
General government	22,767,935	11,522,920	11,245,015	98%
Public safety	2,207,193	1,873,237	333,956	18%
Public works	11,242,698	9,140,009	2,102,689	23%
Culture and recreation	3,064,862	345,010	2,719,852	788%
Health and welfare	18,221,885	18,422,562	(200,677)	(1%)
Community development	5,668,151	3,597,905	2,070,246	58%
Urban development	31,000		31,000	100%
Education	5,176	4,335	841	19%
Interest on long-term debt	2,587,688	3,822,079	(1,234,391)	(32%)
Total expenses	65,796,588	48,728,057	17,068,531	35%
Change in net assets	6,986,888	14,637,568	(7,650,680)	(52%)
Net assets, beginning of year	9,912,767	(4,724,801)	14,637,568	(310%)
Net assets, end of year	\$16,899,655	\$9,912,767	\$6,986,888	70%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (continued)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$31,929,938, an increase of \$8,007,966 in comparison with the prior year. There are reservations of fund balance amounting to \$29,097,511. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$7,416,428), 2) to pay debt service (\$6,665,156), 3) to pay for capital projects (\$13,900,500) and 4) for other purposes (\$1,115,427).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2004, the general fund has an undesignated fund balance of \$2,832,427.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The actual General Fund budgetary activities resulted in a favorable balance of \$1,342,339, caused mainly due to favorable variances in collections related to intergovernmental revenues.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality did not include in its capital assets subsidiary the depreciation expense of the total assets capitalized at June 30, 2003. In addition, the Municipality did not include in its subsidiary the current year additions of capital assets as construction in progress and infrastructure assets and the depreciation expense applicable to infrastructure assets. For acquisitions of other assets as vehicles, building, equipment, etc, the depreciation expense was not calculated and included in the capital assets subsidiary at June 30, 2004, but the Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets, and then, comply with such requirement. The Municipal Administration expects to develop a broad and comprehensive

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

identification and assessments project of all fixed assets owned by the local government in order to capitalize them in its Statement of Net Assets, and then, reflects the correct net assets figure of the Municipality as a whole.

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$63,424,449 net of accumulated depreciation of \$11,650,491, leaving a net book value of \$51,773,958. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2004, the Municipality has \$994,693 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities. In addition, the Municipality maintain an available balance of \$1,025,009 Line of Credit in the Government Development Bank approved by the legislature of the Commonwealth of Puerto Rico by Resolution 1726 in November 7, 2002.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a Municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a Municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2004-2005.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

The Municipality has raised funds from long term borrowing expedited thru the Government Development Bank for Puerto Rico acting as its Fiscal Agency.

On May 27, 2004 the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$1,610,000, for the construction of facilities. Repayment of the bond is scheduled from July 2005 through July 2029.

On June 29, 2004 the Municipality of Arecibo authorized the issuance of a rent bond for the amount \$618,100, for the construction of Social Interest Housing Projects.. Repayment of the bond is scheduled from the disbursement date, due on eighteen (18) months or until the end of the housing project construction or the sale of housing units.

On June 8, 2004 the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$410,000, for the construction completion of the Coliseum. Repayment of the bond is scheduled from July 2005 through July, 2019.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINAL COMMENTS (CONTINUED)

On September 7, 2004, Public Law 255 was enacted amending Public Law 83 of May 2, 1941, as amended. In addition to the new formula established for the calculation of the contribution in lieu of taxes as described in Note 1 (E) (2), applicable on fiscal year 2002-2003 and each subsequent fiscal year, the Law provides for quarterly revisions to be prepared by PREPA of its estimates corresponding to the contribution in lieu of taxes for the current fiscal year.

On January, 2005 the Municipality settled with the employees dismissed in year 2001. The litigation settlement amount is \$6,500,000. The first payment of \$4,000,000 is due on July 1, 2005. The remaining balance of \$2,500,000 will be paid on July 1, 2006.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2004. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 1086, Arecibo, Puerto Rico 00613, or call (787) 878-5612.

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Net Assets
June 30, 2004

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 36,806,762
Cash with fiscal agent	7,834,735
Accounts receivable:	
Municipal license tax	451,740
Intergovernmental	1,487,876
Federal Grants	1,344,399
Inventories	
Others	112,003
Capital assets:	
Land, improvements, and construction in progress	38,530,827
Other capital assets, net of depreciation	13,243,131
Total capital assets	51,773,958
 Total assets	 99,811,473
 Liabilities	
Accounts payable and accrued liabilities	2,821,628
Interest payable	783,272
Due to other governmental entities	599,629
Deferred revenues:	
Municipal license tax	11,586,030
Federal grant revenues	604,342
Noncurrent liabilities:	
Due within one year	8,434,047
Due in more than one year	58,082,870
 Total liabilities	 82,911,818
 Net Assets	
Invested in capital assets, net of related debt	24,482,958
Restricted for:	
Capital projects	13,900,500
Debt service	5,881,884
Other purposes	1,115,427
Unrestricted (deficit)	(28,481,114)
 Total net assets	 \$ 16,899,655

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

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Activities
For the Year Ended June 30, 2004

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Primary Government:					
Governmental Activities:					
General government	\$ 22,767,935	\$ 321,948	\$ 1,462,543	\$ 6,771	\$ (20,976,673)
Public safety	2,207,193	4,390	26,792	24,841	(2,151,170)
Public works	11,242,698	393,771	7,264	2,418,203	(8,423,460)
Health and welfare	18,221,885		18,018,993		(202,892)
Culture and recreation	3,064,862	12,000	8,250	2,743,166	(301,446)
Community development	5,668,151			7,308,276	1,640,125
Urban development	31,000				(31,000)
Education	5,176		21,490		16,314
Interest on long-term debt	2,587,688				(2,587,688)
Total governmental activities	\$ 65,796,588	\$ 732,109	\$ 19,545,332	\$ 12,501,257	\$ (33,017,890)
General revenues:					
Property taxes					15,702,592
Municipal license tax					14,615,737
Other local taxes					1,620,849
Grants and contributions not restricted to specific programs					7,476,114
Interest and investment earnings					491,017
Miscellaneous					98,469
Total general revenues					40,004,778
Change in net assets					6,986,888
Net assets - beginning, as restated					9,912,767
Net assets - ending					\$ 16,899,655

Commonwealth of Puerto Rico
Municipality of Arecibo
Balance Sheet
Governmental Funds
June 30, 2004

	General Fund	Special Revenue Fund Head Start	Special Revenue Fund Other Federal Grants	Capital Projects Fund Local and State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets							
Cash and cash equivalents	\$ 22,004,521	\$ 168,504	\$ 377,671	\$ 12,962,445	\$ -	\$ 1,293,621	\$ 38,806,762
Cash with fiscal agent	292,476			994,693	6,547,566		7,834,735
Accounts receivable:							
Municipal license tax	28,505						28,505
Intergovernmental	939,265			412,837	125,339	10,435	1,487,876
Federal Grants		99,845	1,244,554				1,344,399
Due from other funds	798,282						798,282
Other	35,094				4,196		39,290
Total assets	\$ 24,098,143	\$ 268,349	\$ 1,622,225	\$ 14,369,975	\$ 6,677,101	\$ 1,304,056	\$ 48,339,849
Liabilities and Fund Balances							
Liabilities :							
Accounts payable and accrued liabilities	\$ 1,662,353	\$ 37,883	\$ 643,799	\$ 469,475	\$ -	\$ 8,118	\$ 2,821,628
Due to other governmental entities	599,629						599,629
Due to other funds		65,000	690,337		11,945	31,000	798,282
Deferred revenues							
Municipal license tax	11,586,030						11,586,030
Federal grant revenues		165,466	195,583			243,293	604,342
Total liabilities	13,848,012	268,349	1,529,719	469,475	11,945	282,411	\$ 16,409,911
Fund balances:							
Reserved for:							
Encumbrances	7,416,428						\$ 7,416,428
Capital projects				13,900,500			13,900,500
Other purposes			92,506			1,021,645	1,114,151
Debt service fund					6,665,156		6,665,156
Unreserved:							
Designated for specific fund purposes	1,276						1,276
Undesignated	2,832,427						2,832,427
Total fund balances	10,250,131	-	92,506	13,900,500	6,665,156	1,021,645	31,929,938
Total liabilities and fund balances	\$ 24,098,143	\$ 268,349	\$ 1,622,225	\$ 14,369,975	\$ 6,677,101	\$ 1,304,056	

Amounts reported for governmental activities in the statement of net assets are different because

Accrual basis of accounting account receivables recognized in government-wide financial statement:	495,948
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the fund	51,773,958
Long-term liabilities and accrue interest are not due and payable in the current period, and therefore, are not reported in the funds	<u>(67,300,189)</u>
Net assets of governmental activities	\$ 16,899,655

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2004

	General Fund	Special Revenue Fund Head Start	Special Revenue Fund Other Federal Grants	Capital Projects-Fund Local and State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues							
Property taxes	\$ 12,179,579	\$ -	\$ -	\$ -	\$ 3,523,013	\$ -	\$ 15,702,592
Municipal license taxes	14,192,502						14,192,502
Licenses, permits and other local taxes	1,548,136						1,548,136
Charges for services	320,055						320,055
Intergovernmental	8,938,658		8,306	5,007,405		448,283	14,402,652
Rent of property	308,553			87,110		12,000	407,663
Fines and forfeitures	4,390						4,390
Interest	479,446						479,446
Federal grants		10,554,443	10,800,085			3,744,134	25,098,662
Miscellaneous	95,494		32,961			2,975	131,430
Total revenues	38,066,813	10,554,443	10,841,352	5,094,515	3,523,013	4,207,392	72,287,528.00
Expenditures							
Current:							
General government	20,021,021		6,771				20,027,792
Public safety	2,010,751		189,047	7,395			2,207,193
Public works	9,819,500		26,956	535,631		4,783	10,386,870
Health and welfare		10,637,988	3,445,795	4,000		4,134,102	18,221,885
Culture and recreation	363,810			2,701,052			3,064,862
Community development			5,668,151				5,668,151
Urban development						31,000	31,000
Education						5,176	5,176
Debt service:							
Principal			1,575,000		1,746,824		3,321,824
Interest			65,126		2,538,683		2,603,809
Total expenditures	32,215,082	10,637,988	10,976,846	3,248,078	4,285,507	4,175,081	65,538,562
Excess (deficiency) of revenues over (under) expenditures	5,851,731	(83,545)	(135,494)	1,846,437	(762,494)	32,331	6,748,966
Other financing sources (uses)							
Transfers in		83,545	228,000		1,310,707	20,000	1,642,252
Transfers out	(1,639,252)					(3,000)	(1,642,252)
Long-term debt issued	1,259,000						1,259,000
Total other financing sources (uses)	(380,252)	83,545	228,000	-	1,310,707	17,000	1,259,000
Excess (deficiency) of revenues over expenditures and other financing sources (uses)	5,471,479	-	92,506	1,846,437	548,213	49,331	8,007,966
Fund balance, beginning, as restated	4,778,652	-	-	12,054,063	6,116,943	972,314	23,921,972
Fund balance, ending	\$ 10,250,131	\$ -	\$ 92,506	\$ 13,900,500	\$ 6,665,156	\$ 1,021,645	\$ 31,929,938

Commonwealth of Puerto Rico
Municipality of Arecibo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2004

Net Change in Fund Balances - Total Governmental Funds	\$ 8,007,966
Amounts reported for governmental activities in the Statement of Activities are different because:	
Account Receivables reported in Government-Wide Statement of Net Assets collected after year end, but not available soon enough to pay current liabilities, and therefore are not reported in the Governmental Funds.	495,948
Interest Expense change is reported in the Government-Wide Statement of Activities and Change in Net Assets, but not require the use of current financial resources. Therefore, Interest expense change is not reported as expenditures in Governmental Funds Financial Statements.	16,121
Long Term Debt issuances are reported in the Government-Wide Statement of Net Assets, but not require the use of current financial resources. Therefore Long Term debt issuances are not reported as expenditures in Governmental Funds Financial Statements.	(6,518,959)
Long Term Debts payments are reported as expenditures in the Governmental Funds Financial Statements which require the use of current financial resources. Therefore Long Term debts payments are not reported as expenditures in the Government-Wide Statement of Activities and Change in Net Assets.	3,778,816
Change in Landfill Accrual	(855,828)
Bonds proceeds provides current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bond principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments.	<u>2,062,824</u>
Change in Net Assets of Governmental Activities	<u>\$ 6,986,888</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2004

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Arecibo** (the Municipality) was founded on the year 1515. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a sixteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

"Corporación Desarrollo Cultural Teatro Oliver C.E." is a non-profit organization 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.

The Municipality management determined 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 Theater funds comes from private and municipal donations and the rent of the facilities.

The "Corporación Desarrollo Cultural Teatro Oliver C.E." 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. Government-wide and fund financial statements

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

- 1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers of applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

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

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

Special Revenue Fund - Head Start- Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

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

Capital Projects Fund - Local and State Grants- is the accounting entity in which revenues derived from local funds, state or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

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

General Fund - Operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

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

Special Revenue Fund - Section 8 - Special Revenue Fund used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Head Start - Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

Special Revenue Fund – Other Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

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

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

D. Measurement focus, basis of accounting and financial presentation

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

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

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

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

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

E. Assets, liabilities and net assets

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the general fund represent mostly contributions from the Puerto Rico Electric Power Authority (PREPA), which contribute As payment in lieu of taxes a twenty percent of its revenues after deductions of subsidies granted, or an amount equal to the cost of electric power consumed by each Municipality, or an average of the contribution in lieu of taxes paid to each Municipality in the last five fiscal years whichever is greater. The contribution in lieu of tax revenue and related receivable recorded in the General Fund for the current fiscal year was determined based on revenue estimates made by the PREPA and actual transactions during the current fiscal year, because the final contribution amount from the PREPA was not available at the date of release of the basic financial statements. Intergovernmental receivable in the special revenue fund represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
- 4. Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

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

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

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

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

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

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

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

- 7. Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

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

9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:

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

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

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2004 amounted to approximately \$1,190,432. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$807,380 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets - Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 51,773,958	
Deduct:		
Bonds Payable related to Capital Assets	(26,476,000)	
Notes Payable related to Capital assets	<u>(815,0000)</u>	
		\$ 24,482,958
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		13,900,500
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service	6,665,156	
Deduct:		
Interest Payable	<u>\$ (783,272)</u>	\$ 5,881,884
<u>Net assets restricted for other purposes</u>		
Other governmental funds - Fund balance restricted for other purposes		1,115,427
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 10,248,855	
Add:		
Accrual basis account receivables	495,948	
Deduct:		
Bonds Payable related to operational debts	(17,653,294)	
Compensated absences debt	(3,941,635)	
Landfill Obligation	(5,064,621)	
Property tax debt - Law 42	(1,186,326)	
Property tax debt - Law 146	(2,227,714)	
Disallowed Costs reimbursement to HUD	(2,608,562)	
Claims and judgments debt	<u>(6,543,765)</u>	<u>(28,481,114)</u>
Total net assets - governmental activities		<u>\$ 16,899,655</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

2. DEPOSITS

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

The Municipality's bank balances in commercial banks of approximately \$22,004,521, \$168,504, \$377,671, and \$12,962,445 in the general fund, Special Revenue Fund-Head Start, Special Revenue Fund-Other Federal Grants, and Capital Projects Fund-Local and State Grant, respectively, were fully collateralized at June 30, 2004. In the other governmental funds, there were deposits with commercial banks of approximately \$1,293,621, that were fully collateralized.

The deposits at GDB of approximately \$292,476, that is restricted for operational expenditures in the general fund, the \$994,693, that is restricted principally for capital projects in the capital project fund - local and state grant, and the \$6,547,566 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2004, the tax rates were as follows:

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

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 24. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2004, net of allowance for uncollectibles.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

3. RECEIVABLES (CONTINUED)

B. Intergovernmental Receivables- Intergovernmental receivables in the general fund principally consist of the amounts due from the Puerto Rico Electric Power Authority ("PREPA") resulting from the estimated revenues the Municipality is entitled to receive in lieu of payment of taxes, the amounts due from the Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico resulting from property tax collections related to the amnesty granted through the Public Law 74, enacted on March 1, 2004, and the amount due from "Consortio Norte Central" (CONOCE) for training of cadets for the Municipal Police. The amounts receivable from governmental entities are as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Puerto Rico Electric Power Authority ("PREPA")	\$ 31,050
Municipal Revenue Collection Center ("CRIM")	196,343
Consortio Norte Central (CONOCE)	9,641
Department of Labor (Law 52)	<u>702,231</u>
Total	<u>\$939,265</u>

The contribution in lieu of tax receivable from the Puerto Rico Electric Power Authority reported above represent an estimated amount as described in the Note 1 (E) (2), because the final contribution amount from the PREPA for the fiscal year 2003-2004 was not available. Also, as described in Note 15, there is a formula to determine the contribution on lieu of taxes to be distributed to the municipalities.

Intergovernmental receivable in the capital project fund – state and local grants represent contributions from local government for capital outlays. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Government Development Bank of Puerto Rico - \$4,600,000 Line of Credit	\$ 370,583
Department of Treasury	<u>42,254</u>
Total	<u>\$ 412,837</u>

Intergovernmental receivable in the debt service fund represent property tax receivable from local government. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	<u>\$ 125,339</u>
Total	<u>\$ 125,339</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in the other governmental funds represent expenditures incurred not yet reimbursed by the state government. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Housing Choice Voucher Program- Portabilities Department of Treasury	\$ 2,185 <u>8,250</u>
Total	<u>\$ 10,435</u>

Intergovernmental receivable in the special revenue fund – Head Start represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Head Start Program	<u>\$ 99,845</u>
Total	<u>\$ 99,845</u>

Intergovernmental receivable in the special revenue fund – other federal grants represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant/Entitlement Grants	\$ 530,670
Public Assistance Grant	234,094
Community Service Block Grant	22,033
Special Program for Aging – Title III	103,408
Child Care Development Block Grant Program	344,537
Rural Domestic Violence and Child Victimization Enforcement Grant Program	<u>9,812</u>
Total	<u>\$ 1,244,554</u>

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2004, and interfund transfers during the fiscal year ended at June 30, 2004, are summarized as follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

4. INTERFUND TRANSACTIONS (CONTINUED)

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund – Head Start	Payroll and related accruals paid and not reimbursed	\$ 65,000
General Fund	Special Revenue Fund – Other Federal Grants	Payroll and related accruals paid and not reimbursed	690,337
General Fund	Debt Service Fund	Interest Revenue	11,945
General Fund	Other Governmental Funds	Payroll & Related Reimbursable Expenditures	<u>31,000</u>
Total			<u>\$ 798,282</u>

The balance of \$690,337 of General Fund due from the Special Revenue Fund – Federal Grants includes \$ 229,074 pending to be reimbursed by Public Assistance Grant Program. This amount will not expect to be repaid within a year of the Municipality's year end.

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund – Head Start	Matching Contributions	83,545
General Fund	Special Revenue Fund – Other Federal Grants	Matching Contributions	228,000
Other Governmental Funds	Special Revenue Fund – Other Federal Grants	Matching Contributions	3,000
General Fund	Debt Service Fund	Debt Retirement	1,310,707
Other Governmental funds	Special Revenue Fund – Federal Grants	Creation of new fund	<u>17,000</u>
Total			<u>\$ 1,642,252</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans.

As follows we presented the beginning balance of Capital Assets as of June 30, 2003, which comply with the GASB Statement No. 34 implementation requirements. In change, during the fiscal year 2003-2004, the Municipality did not include in its Capital Assets subsidiary the depreciation expense of the total assets capitalized at June 30, 2003. In addition, the Municipality did not include in its subsidiary the current year additions of capital assets as construction in progress and infrastructure assets and the depreciation expense applicable to infrastructure assets. For acquisitions of other assets as vehicles, building, equipment etc, the depreciation expense was not calculated and included in the capital assets subsidiary at June 30, 2004.

As discussed in the preceding paragraph, the management has not recorded certain capital assets in governmental activities and, accordingly, has not recorded depreciation expense on those assets. Therefore, such condition would affect the amount of assets, net assets, and expenses of the governmental activities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. CAPITAL ASSETS (CONTINUED)

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2004</u>
Capital asset, not being depreciated:				
Land	\$ 9,633,722	\$ -	\$ -	\$ 9,633,722
Construction in progress	<u>28,897,105</u>	<u>-</u>	<u>-</u>	<u>28,897,105</u>
Total capital assets not being depreciated	<u>\$ 38,530,827</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 38,530,827</u>
Capital assets, being depreciated:				
Buildings	\$ 13,812,588			\$ 13,812,588
Buildings improvements	1,288,643			1,288,643
Infrastructure	616,066			616,066
Infrastructure improvements				
Equipment	2,371,222			2,371,222
Furnishing	1,374,346			1,374,346
Computers	308,578			308,578
Works of Art	206,519			206,519
Vehicles	<u>4,915,660</u>	<u>-</u>	<u>-</u>	<u>4,915,660</u>
Total capital assets being depreciated	<u>\$ 24,893,622</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,893,622</u>
Less accumulated depreciation for:				
Buildings	\$ (5,466,734)			\$ (5,466,734)
Buildings improvements	(23,327)			(23,327)
Infrastructure	(9,668)			(9,668)
Infrastructure improvements				
Equipment	(1,730,520)			(1,730,520)
Furnishing	(683,487)			(683,487)
Computers	(161,300)			(161,300)
Work of Art	(136,503)			(136,503)
Vehicles	<u>(3,438,952)</u>	<u>-</u>	<u>-</u>	<u>(3,438,952)</u>
Total accumulated depreciation	<u>\$(11,650,491)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$(11,650,491)</u>
Total capital assets being depreciated, net	<u>\$ 13,243,131</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,243,131</u>
Governmental activities capital assets, net	<u>\$ 51,773,958</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 51,773,958</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

6. PROPERTY TAXES

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

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

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26, 1997, Public Law 21 was enacted which authorized the CRIM to sell property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. The property tax receivables were purchased by Public Financing Corporation, a subsidiary of the Government Development Bank (GDB), with proceeds of a bonds issuance. This Law imposes to the CRIM the obligation to replace any uncollectible property tax receivable with any valid property tax receivables or equivalent in money.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

6. PROPERTY TAXES (CONTINUED)

A high percentage of receivables were determined to be uncollectible receivables, and therefore, on October 11, 2001, Public Law 146 was enacted which authorized the CRIM to obtain a loan to pay in advance the bonds issued by the Public Financing Corporation (a GDB subsidiary), and any costs related to the transaction. Also, a term not to exceeding 30 years was authorized to the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from the sale of property tax receivables to the Public Financing Corporation (a GDB Subsidiary).

The government-wide statement of net assets includes an outstanding balance of \$1,186,326 and \$2,227,714 related to Law 42 and Law 146 respectively.

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

The annual tax rate is 8.58% for real property and 6.58% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.75% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

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

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM) – Fiscal Year 2003-2004 Liquidation	\$ 312,031
General Services Administration	16,154
Retirement System Administration	144,818
Workmen's Compensation (Corp. Fondo del Seguro del Estado)	101,742
Puerto Rico Aqueduct and Sewer Authority	<u>24,884</u>
Total	<u>\$ 599,629</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. DEFERRED REVENUES

A. **Municipal License Tax-** The deferred revenues of approximately \$11,586,030 in the general fund relates to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

B. **Federal Government-** The deferred revenues presented in special revenue fund - head start represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Head Start Program	\$ 165,466
Total	\$ 165,466

The deferred revenues presented in special revenue - other federal grants represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Child and Adult Care Food Program	\$ 2,487
Emergency Management Performance Grant	62,544
Federal Transit Authority	1,446
Community Development Block Grant/Entitlement Grants	10,272
Urban Development Action Grant	4,636
Home Investment Partnership Program	7,604
Enforcement Grant Program	3,377
Local Law and Enforcement Block Grants	20,337
Public Assistance Grant	75,607
Child Care Block Grant	6,230
Others	1,043
Total	\$ 195,583

C. The deferred revenues presented in other governmental funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Voucher Program	\$ 243,293
Total	\$ 243,293

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2004, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$ 44,512,117	\$ 1,259,000	\$ (1,641,823)	\$ 44,129,294	\$ 1,786,000
Notes Payable	2,495,000		(1,680,000)	815,000	115,000
Property Tax Debt - 2001- 2002 Final Liquidation	905,283		(905,283)		
Property Tax Debt - Law 42	1,284,410		(98,084)	1,186,326	98,084
Property Tax Debt - Law 146	2,227,714			2,227,714	
Compensated Absences	4,081,110		(139,475)	3,941,635	923,881
Landfill Obligation	8,032,476	855,828	(3,823,683)	5,064,621	
Disallowed Cost HUD	4,809,536		(2,200,975)	2,608,561	1,467,316
Claims and judgments	<u>459,807</u>	<u>6,518,959</u>	<u>(435,000)</u>	<u>6,543,766</u>	<u>4,043,766</u>
Total	<u>\$ 68,807,453</u>	<u>\$ 8,633,787</u>	<u>\$(10,924,323)</u>	<u>\$ 66,516,917</u>	<u>\$ 8,434,047</u>

- 1. Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. LONG-TERM LIABILITIES (CONTINUED)

2. Bonds payable- The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities and for the liquidation of operational debts. During the current year, the Municipality issued bonds for approximately \$1,259,000. Bonds payable outstanding at June 30, 2004 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2004</u>
1984-Series	1-1-2009	\$675,000	5.00%	\$208,000
1987-Series	1-1-2012	875,000	5.00%	429,000
1989-Series	1-1-2014	500,000	5.00%	285,000
1989-Series	7-1-2008	3,000,000	8.00%	635,294
1990-Series	7-1-2005	3,395,000	6.375% to 7.60%	765,000
1991-Series	7-1-2006	2,060,000	4.37% to 6.36%	665,000
1994-Series	1-1-2019	400,000	4.88%	324,000
1995-Series	7-1-2020	14,975,000	4.70% to 6.63%	12,800,000
1998-Series	1-1-2023	900,000	4.75%	781,000
1999-Series	7-1-2024	7,365,000	2.80% to 5.60%	6,885,000
2001-Series	7-1-2026	10,545,000	5.00% to 8.00%	10,075,000
2002-Series	7-1-2026	5,030,000	2.70% to 5.60%	4,880,000
2003-Series	7-1-2028	4,235,000	6.00%	4,160,000
2004-Series	7-1-2013	360,000	5.00% to 6.00%	360,000
2004-Series	7-1-2028	605,000	5.00% to 6.00%	605,000
2004-Series	7-1-2013	294,000	6.00%	272,000
Total general obligation bonds				<u>\$44,129,294</u>

These bonds, except the 1989-Series amounting to \$3,000,000, 2001-Series amounting to 10,545,000, 2003-Series amounting to 4,235,000, and 2004-Series amounting \$294,000, are payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 1,786,000	\$ 2,274,736
2006	1,922,000	2,612,961
2007	1,627,000	2,507,955
2008	1,483,000	2,419,082
2009	1,465,294	2,333,595
2010-2014	8,429,000	10,305,748
2015-2019	11,174,000	7,377,784
2020-2024	11,338,000	3,562,830
2025-2029	<u>4,905,000</u>	<u>611,300</u>
Total	<u>\$ 44,129,294</u>	<u>\$ 34,005,991</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. LONG-TERM LIABILITIES (CONTINUED)

3. **Notes Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2004</u>
2003-Series	7-1-2009	\$920,000	2.70% to 4.10%	<u>\$ 815,000</u>
Total notes payable				<u>\$ 815,000</u>

These note is payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 115,000	\$ 26,587
2006	120,000	23,243
2007	130,000	19,423
2008	140,000	14,858
2009	150,000	9,470
2010-2014	<u>160,000</u>	<u>3,280</u>
Total	<u>\$ 815,000</u>	<u>\$ 96,861</u>

4. **Property Tax Debt-** These amounts represent the balance owed to the Municipal Revenue Collection Center (CRIM) at June 30, 2004, as described in Note 6.
5. **Compensated absences-** The government-wide statement of net assets includes \$2,037,710 of accrued sick leave benefits, and \$1,903,925 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
6. **Landfill obligation-** State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on the future closure and post-closure care cost that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and post-closure care

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. LONG-TERM LIABILITIES (CONTINUED)

costs is based on the amount of landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$5,064,621 as of June 30, 2004 reported in the Government - Wide Financial Statements, which is based on 35% usage (filled) of the landfill. It is estimated that an additional \$9,091,779 will be recognized as closure and post-closure care expenses between the date of the balance sheet and the date the landfill is expected to be filled to capacity (2013). The estimated total current cost of the landfill closure and post-closure care (\$14,156,400) is based on the amount that would be paid if all equipment, facilities and services required to close, monitor, and maintain the landfill were acquired as of June 30, 2004. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. The Municipality of Arecibo maintains a certificate of deposits of \$203,394 held for landfill improvements.

7. **Disallowed costs HUD** - These amounts represent the balance to Housing Urban Development (HUD) at June 30, 2004, as described in Note 13.

8. **Claims and Judgements**- - These amounts represent the balance related to legal claims at June 30, 2004, as described in Note 13.

9. 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, 2004:

<u>Year Ending</u> <u>June 30,</u>	<u>Total</u>
2005	\$ 46,014
2006	46,014
2007	20,925
2008	20,925
2009	17,529
Total minimum payments required	<u>\$151,407</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

10. COMPONENT UNIT:

“Corporación Desarrollo Cultural Teatro Oliver, C.E.

Nature and Organization

“Corporación Desarrollo Cultural Teatro Oliver C.E.” (non-profit organization) 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 operated as Municipal Theater.

Component unit financial statements of “Corporación Desarrollo Cultural Teatro Oliver C.E.” were not available. As result, were not included as part of the Government-Wide Financial Statements.

11. PENSION PLAN

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

11. PENSION PLAN (CONTINUED)

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2004 amounted to approximately \$631,376 and \$707,675, respectively.

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

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

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2004, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

12. RISK MANAGEMENT

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

13. 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. As of June 30, 2004, the Municipality reimbursed \$4,238,915.

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, 2004, are as follows:

<u>Year Ending</u>	<u>Total</u>
<u>June 30,</u>	
September 15, 2004	\$ 733,658
February 15, 2005	733,658
September 15, 2005	<u>1,141,245</u>
Totals	<u>\$2,608,561</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

13. COMMITMENTS AND CONTINGENCIES (CONTINUED)

B. Claims and lawsuits:

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other 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 approximately \$6,543,766 for awarded and anticipated unfavorable judgments. During January, 2005 the Municipality settled with the employees dismissed in year 2001. The settlement amount is \$6,500,000. The first payment of \$4,000,000 is due on July 1, 2005. The remaining balance of \$2,500,000 will be paid on July 1, 2006.

This amount was reported in the government-wide financial statements and not in the funds financial statements. That is because the Municipality will require future available financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

14. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balance for General Fund has been restated by approximately \$282,742 to properly presents the previously reported fund balance at June 30, 2003. The restatement is mainly due to the condoned Treasury Department interest and penalties debt recognized in prior year, and a prior year due from Debt Service Fund.

The beginning Fund Balances for Debt Service Fund has been restated by approximately \$1,150,143 to properly present the previously reported fund balances at June 30, 2003. The restatement is mainly due to the recognition of the amount due from CRIM related to Final Liquidation 2002-2003.

The beginning Fund Balance for Other Governmental Funds has been restated by approximately \$13,089 to properly presents the previously reported fund balance at June 30, 2003. The restatement is mainly due to the elimination of a due to general fund.

The beginning Net Assets for Governmental Activities has been restated by approximately \$3,024,290 to properly present the previously reported Net Assets at June 30, 2003. The restatement is mainly due to the proper liability recognition related to landfill closing and post closing obligation and to recognize interest payable of long term debts.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

15. SUBSEQUENT EVENTS

On May 27 2004, the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$1,610,000, for the construction of facilities. Repayment of the bond is scheduled from July 2005 through July 2029.

On June 29 2004, the Municipality of Arecibo authorized the issuance of a rent bond for the amount \$618,100, for the construction of Social Interest Housing Projects. Repayment of the bond is scheduled from the disbursement date, due on eighteen (18) months or until the end of the housing project construction or the sale of housing units.

On June 8 2004, the Municipality of Arecibo authorized the issuance of a general obligation bond for the amount of \$410,000, for the construction completion of the Coliseum. Repayment of the bond is scheduled from July 2005 through July, 2019.

On September 7 2004, Public Law 255 was enacted amending Public Law 83 of May 2, 1941, as amended. In addition to the new formula established for the calculation of the contribution in lieu of taxes as described in Note 1 (E) (2), applicable on fiscal year 2002-2003 and each subsequent fiscal year, the Law provides for quarterly revisions to be prepared by PREPA of its estimates corresponding to the contribution in lieu of taxes for the current fiscal year.

On January 2005, the Municipality settled with the employees dismissed in year 2001. The litigation settlement amount is \$6,500,000. The first payment of \$4,000,000 is due on July 1, 2005. The remaining balance of \$2,500,000 will be paid on July 1, 2006.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)**

YEAR ENDED JUNE 30, 2004

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES AND BUDGET CARRYOVER:				
Property taxes	\$ 9,522,977	\$ 10,561,102	\$ 11,983,236	\$ 1,422,134
Municipal license tax	12,025,000	13,252,630	14,269,426	1,016,796
Licenses, permits and other local taxes	1,370,000	1,262,151	1,545,628	283,477
Charges for service	111,000	318,717	320,056	1,339
Intergovernmental	6,938,955	6,938,955	6,450,077	(488,878)
Rent of property	260,000	544,529	308,553	(235,976)
Fines and forfeitures	25,000	46,400	4,390	(42,010)
Interest	150,000	296,555	269,379	(27,176)
Miscellaneous	246,433	3,094,610	2,584,076	(510,534)
Budget Carryover	<u> </u>	<u>2,019,626</u>	<u>2,019,626</u>	<u> </u>
Total revenues , and budget carryover	<u>\$ 30,649,365</u>	<u>\$ 38,335,275</u>	<u>\$ 39,754,447</u>	<u>\$ 1,419,172</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	\$ 17,593,460	\$ 19,541,495	\$ 19,787,111	\$ (245,616)
Public safety	2,436,834	1,994,411	2,012,598	(18,187)
Public works	7,882,130	14,610,566	14,543,534	67,032
Culture and recreation	361,630	429,551	429,613	(62)
Operating transfer to other fund	<u>2,375,311</u>	<u>1,759,252</u>	<u>1,639,252</u>	<u>120,000</u>
Total expenditures, encumbrances and other financing uses	<u>\$ 30,649,365</u>	<u>\$ 38,335,275</u>	<u>\$ 38,412,108</u>	<u>\$ (76,833)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u> </u>	<u> </u>	<u>\$ 1,342,339</u>	<u>\$ 1,342,339</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)*available for appropriation* from the budgetary comparison schedule				\$39,754,447
Differences-budget to GAAP:				
Interest Receivable recognized as 2004-2005 revenues				210,066
Change in excise Tax Receivable recognized as 2004-2005 revenues				2,507
Change in Municipal License Tax receivable recognized as 2004-2005 revenues				(76,924)
Current year CRIM receivables collected during year 2004-2005 and readjusted per 2004-2005 budget				196,343
Budget Carryover				<u>(2,019,626)</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 38,066,813</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)*total charges to appropriations* from the budgetary comparison schedule				\$ 38,412,108
Differences-budget to GAAP:				
Adjustment to Expenditures-Operational Loan				655,929
Prior year encumbrances recorded as current year expenditures				1,555,583
Current year Encumbrances recorded as expenditures				(6,769,286)
Operating transfer to other fund				<u>(1,639,252)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 32,215,082</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BUDGETARY COMPARISON SCHEDULE-GENERAL FUND

YEAR ENDED JUNE 30, 2004

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

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

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2004 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2004.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

<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	\$ 779,859
Pass-through the Commonwealth of Puerto Rico Governor Office for the Elderly Food Distribution:			
Nutrition Program for the Elderly	10.570	Not Available	<u>73,282</u>
Total U.S. Department of Agriculture			<u>853,141</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Community Development Block Grants/Entitlement Grants	14.218		7,315,049
Direct Program:			
Emergency Shelter Grants Program	14.231		387,423
Direct Program:			
HOME Investment Partnerships Program	14.239		614,202
Direct Program:			
Section 8 Housing Choice Voucher Program	14.871		<u>3,744,135</u>
Total U.S. Department of Housing and Urban Development			<u>12,060,809</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
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	174,653
Pass-through the Commonwealth of Puerto Rico - Local Department of Justice			
Local Law and Enforcement Block Grants	16.592	2001-IB-PMA-01	<u>14,368</u>
Total U.S. Department of Justice			<u>189,021</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Pass-through the Commonwealth of Puerto Rico Department of Transportation:			
Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grant	20.601	Not Applicable	<u>12,424</u>
Total U.S. Department of Transportation			<u>12,424</u>
U.S. DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico Emergency Management Agency:			
Emergency Management Performance Grant	83.552	Not Available	10,406

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
Pass-through the Commonwealth of Puerto Rico Governor Authorized Representative (GAR):			
Public Assistance Grants	83.544	Not Available	147,498
Hazard Mitigation Grant	83.548	Not Available	23,000
Total U.S. Department of Homeland Security			180,904
U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
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	272,617
Special Programs for Aging - Title III, Part C - Nutrition Services	93.045	Not Available	170,134
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ADFAN):			
Community Services Block Grant	93.569	Not Available 02-CH-0483-22-37	112,005
Head Start	93.600	02-CH-0483-22-38	9,813,110
Child Care and Development Block Grant	93.575	Not Available	1,434,499
Total U.S. Department of Health and Human Services			11,802,365
TOTAL EXPENDITURES OF FEDERAL AWARDS			\$ 25,098,664

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, 2004

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 fund 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 Head Start, Special Revenue Fund Federal Grants and Other Governmental Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Description	Special Revenue Fund Head Start	Special Revenue Fund -Other Federal Grants	Other Governmental Funds	Total
Per Schedule of Expenditures of Federal Awards	\$10,554,443	\$10,800,085	\$3,744,134	\$25,098,662
Non federal programs Expenditures	<u>83,545</u>	<u>176,761</u>	<u>430,927</u>	<u>691,233</u>
Total expenditures in the fund financial statements	<u>\$10,637,988</u>	<u>\$10,976,846</u>	<u>\$4,175,061</u>	<u>\$25,789,895</u>



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 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 basic financial statements of the **Municipality of Arecibo** as of and for the year ended June 30, 2004, and have issued our report thereon dated December 1, 2004, which was unqualified at the fund financial statements level, but qualified at the government-wide financial statements level because the management has not recorded certain general infrastructure assets in governmental activities and accordingly, has not recorded depreciation expense on those assets. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the **Municipality of Arecibo's** basic 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 basic 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 basic 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 basic financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items **04-01** through **04-04**.

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 basic 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 item 04-02 of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs is a material weakness. 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 1, 2004.

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 1, 2004

Stamp No. 2019419 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, 2004. 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.

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.

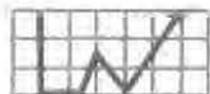
**INDEPENDENT AUDITORS' REPORT
ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB-CIRCULAR A-
133(CONTINUED)**

In our opinion, 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, 2004. 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, 04-06 through 04-16.

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 04-05 through 04-16.



**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 04-06, 04-09, 04-12, 04-13 through 04-15 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 March 3, 2005.

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
March 3, 2005

Stamp No. 2019420 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, 2004

Section I – Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued: Unqualified, except for adverse for government-wide financial statements

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

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>
10.558	Child and Adult Care Food Program
14.218	Community Development Block Grant
14.871	Section 8 Housing Choice Voucher
93.575	Child Care & Development Block Grant
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B programs \$752,960

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, 2004

Section II - Financial Statements Findings

Finding Reference 04-01

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).

The Municipality did not include in the basic financial statements, audited financial information related to the "Corporación de Desarrollo Cultural Teatro Oliver".

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.

GASB Statement No. 14 requires that the financial information of component units not be blended with similar financial information of the primary government. Rather, such information should be presented in the basic financial statements of the financial reporting entity.

Cause of Condition The Municipality did not maintain 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.

The Municipality was unable to obtain audited financial statements of the "Corporación de Desarrollo Cultural Teatro Oliver", a Discrete Component Unit.

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.

The Municipality is not in compliance with the *GASB Statement No. 14* requirements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

Finding Reference 04-01 (Continued)

Recommendation We recommend that the Municipality should establish 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.

We recommend to the Municipality Management to require annual audited financial statements of the "Corporación de Desarrollo Cultural Teatro Oliver", to the Component Unit management, to include them in the financial reporting entity basic financial statements.

Questioned Costs None

Management Response
And Corrective Action

The Municipality concur with the finding. The Finance Director will require annual audited financial statements to the "Corporación de Desarrollo Cultural Teatro Oliver".

Responsible Person: Mr. Guillermo Gabriel Alamo- Finance Director

Implementation date: June, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference 04-02

Requirement Fixed\ Capital Assets and Expenditures – Subsidiary Ledger

Statement of Condition During the fiscal year 2003-2004, the Municipality did not include in its Capital Assets subsidiary the depreciation expense of the total assets capitalized at June 30, 2003. In addition, the Municipality did not include in its subsidiary the current year additions of capital assets as construction in progress and infrastructure assets and the depreciation expense applicable to infrastructure assets. For acquisitions of other assets as vehicles, building, equipment etc, the depreciation expense was not calculated and included in the capital assets subsidiary at June 30, 2004.

As discussed in the preceding paragraph, the management has not recorded certain capital assets in governmental activities and, accordingly, has not recorded depreciation expense on those assets. Therefore, such condition would affect the amount of assets, net assets, and expenses of the governmental activities.

Criteria Chapter IX, Article 9.002 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain updated property accounting records. Also, the GASB Statement No. 34 requires that all capital assets, including infrastructure, must be presented in the Statement of Net Assets and that these assets must be depreciated during its useful life.

Cause of Condition Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.

Effect of Condition The Municipality's Government Wide Financial Statements do not present fairly, the financial position of the governmental activities, and the change in financial position of the Municipality.

Recommendation We recommend the Municipality management to actualize capital assets additions and retirements and the related depreciation expenses from July, 2003 to the present in order to comply with the requirements of the GASB Statement No. 34.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

Finding Reference 04-02 (Continued)

Questioned Costs None

**Management Response
and Corrective Action** The Municipality concurs with the finding. The Municipality contracted
a Company to continue the process of updating capital assets records
and comply with the requirements of the GASB Statement No. 34.

Responsible Person: Mr. Guillermo Gabriel Alamo - Finance Director

Implementation Date: June, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference	04-03
Requirement	Cash Receipts – Revenue, Receivable - Collections
Statement of Condition	<p>We performed a cash receipt test and examined a sample of twenty-five (25) collections. The following summarize the exceptions found:</p> <ul style="list-style-type: none">a. Three (3) collections corresponding to Municipal Landfill account were deposited in the Municipal checking account and accounted in the general fund instead the Special Revenue Fund.b. In one (1) collection the deposit was issued four (4) days after its collection.c. The Treasurers did not include adequate evidential documentation (customer's remittance data as excise tax determination documents, and customer notification letters, etc.) which support the collections receipts CRO1 and CRO2.d. In eleven (11) cases the Daily Receipts Validation Report was not available for examination and we could not trace the amounts collected to the deposit slip and bank statements.
Criteria	<p>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 credited in bank to assure that the revenues has been duly accounted and processed in the period of collection and in the correct fund.</p>
Cause of Condition	<p>Internal control procedures failed to assure that daily collections are duly accounted for and duly recorded in the correct fund.</p>
Effect of Condition	<p>In these cases the Municipality did not comply 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.</p>
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

Finding Reference 04-03 (continued)

Recommendation The Municipality should establish adequate monitoring procedures to assure that collections are deposited in the correct bank account and accounted in the correct fund and revenue account.

Management Response
And Corrective Action The Municipality concurs with the finding. The Municipality will transfer the funds to the correct account and will establish monitoring procedures over the Treasury Department so that every fund collected is deposited in the correct bank account.

Responsible Person: Mr. Guillermo Gabriel Alamo - Finance Director

Implementation Date: March, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference 04-04

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

Statement of Condition We performed a cash disbursement test and examined ninety three (93) disbursement vouchers which belonged to Housing Voucher Program, forty one (41) disbursements which belonged to CDBG Program, one hundred and nine (109) which belonged to Head Start Program, one hundred and twenty nine (129) which belonged to Child Care Development Grant and twelve (12) which belonged to Child Care Food Program. The following will summarize the internal control exceptions noted:

- a. Twenty (20) cancelled checks from Child Care Development Block Grant and two (2) cancelled checks from Child Care Food Program were not available for examination.
- b. Also, three (3) disbursement vouchers from “Resoluciones Conjuntas” for the total amount of \$1,070,957 were not available for examination.
- c. One hundred and eight (108) documents along the disbursement vouchers were not marked as paid.
- d. Forty two (42) disbursement vouchers did not include all required approvals before funds were disbursed.

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. Also, the Finance Director will be responsible for the proper filling of disbursement vouchers, cancelled checks and other supporting evidence about the disbursement of funds.

Cause of Condition The Municipality internal control failed to assure that all documents supporting disbursement of funds are available for examination.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference 04-04 (Continued)

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, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.

Questioned Costs None

Management Response
And Corrective Action

The Municipality concurs with the finding. The Municipality will give specific instructions to each department and to the pre-interventor office that no disbursement will be made unless it complies with minimal documentation and supporting evidence, including all approvals. The Municipality will limit C.O.D disbursement to a minimum and strengthen procedures to locate promptly disbursement vouchers, cancelled checks and other supporting documents related to disbursement of funds.

Responsible Person: Mr. Guillermo Gabriel Alamo – Finance Director

Implementation date: March, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-05

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

Requirement Standards for Financial Management Systems

Statement of Condition We observed that the program determined in the preliminary closing report an underpayment due of \$300,925. The program reports in the closing report \$3,560,298 as annual contribution due for year, exceeding the total partial payments approved by HUD of \$3,259,373. In addition, we noted that the program maintained an average leasing rate of 85% instead a 95% as required, that means that the program did not use all vouchers approved to the Municipality, however the HAP payments per closing reports amounting to 3,314,626 exceed the budget approved by HUD of \$3,049,576. Revised HUD Closing Report was not available for our examination.

At June 30, 2004, the cash balance in books was \$438,777.05; the program preliminary closing reports detail an operation reserve of \$516,063.03, exceeding the total cash in books by \$77,285.98.

Criteria OMB Common Rules, Subpart C, Section 85.20 (b) (1) and (b) (4) requires accurate, current, and complete disclosures of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant. Actual expenditures or outlays must be compared with budgeted amounts for each grant. Financial information must be related to performance or productivity data, including the development of unit cost information whenever appropriate or specifically required in the grant agreement.

Housing Choice Voucher Program Guidebook, Chapter 24, Section, 24.6 stated that a PHA must lease 95 percent of its units. A PHA with a utilization rate below 95 percent will not be identified as a high performer regardless of its overall score and will not be eligible to receive new unit's allocations.

Cause of Condition The payment of Hap's using the 110% Fair Market Rent for all vouchers during the current year caused that the program exceeded the approved HUD budget.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-05 (Continued)

Effect of Condition The Municipality did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (1) and (b) (4). The program did not maintain a leasing rate of 95%. In addition, the excess of funds used during the year of \$300,925 will affect directly the operating reserve balance.

Recommendation The management must perform an exhaustive analysis of the Fair Market Rent used for HAP calculation in order to prevent exceeding the HUD approved budget and to assure the 95% leasing rate. In addition, the management must monitor the operating reserve movement in order to avoid an overdraft in a future.

The management must perform an analysis of the operating reserve balance with the cash maintained in books in order to determine the reasonability of both accounts.

Questioned Costs None

**Management Response
And corrective action**

In order to meet the 95% leasing rate the Department will decrease the FMR levels the Rent used for HAP calculation to the lower, in order to prevent exceeding the HUD approved budget and to assure the required leasing rate. The SEMAP Coordinator would monitor the operating reserve movement in order to avoid an overdraft in a future.

Responsible Person: Juan H. Cruz, Program Accountant

Implementation date: September 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-06

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 twenty five (25) participant files we noted the following exceptions related to the Housing Assistance Payment Calculation:

- a. In eighteen (18) participant files the program did not use the actualized HUD fair market rent tables at the time of Housing Assistance Payment Calculation. As result, the program paid an incorrect HAP to the owner or an incorrect utility allowance to the participant.

Criteria Code of Federal Regulations 24 CFR, Section 982.503 established how the PHA must determine and use 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 HAP's calculation.

Cause of Condition The Municipality's internal control and procedures failed 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.

Recommendation We recommend management to give instructions to program staff to assure all participants HAP are calculated using actualized fair market rent tables to establish the payment standard.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-06 (Continued)

Questioned Costs none

Management Response

And corrective action The participant files will be reviewed in full in order to correct the exemptions noted.

Responsible Person: Elisabeth Ramírez, Program Supervisor

Implementation date: June 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-07

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 twenty five (25) participant files. The following summarize the exceptions noted:

- a. In three (3) participant files the Privacy Act Notice was not signed by participants with eighteen (18) years or older.
- b. In four (4) participant's files we did not find evidence of the Birth Certificate.
- c. In one (1) participant's files we did not find evidence of Social Security card copy.
- d. In twelve (12) participant's files, the Municipality did not document why third party verification of the value of assets was not obtained during the eligibility determination.
- e. In one (1) participant file the dependents detailed in the contract were not the same dependents detailed in the Family Report (HUD-50058 form).
- f. In two (2) cases the application form was not filled completely by the PHA staff during the interview with the tenant during the eligibility determination. Also the application is not signed by the participant.
- g. In one (1) case, the annual reexamination was made thirty (30) days later than established (thirteen (13) months between examinations).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-07 (Continued)

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

Requirement Eligibility of individuals

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 PHA's 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 internal control and procedures failed to assure that the participant 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's Management to give instructions to the program staff to assure that the release form to allow information from third parties, employment information, 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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-07 (Continued)

Management Response

And corrective action The Program consultant will provide technical assistance to the program staff to assure that the release form to allow information from third parties, employment information, 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.

Responsible Person: Elisabeth Ramírez, Program Supervisor

Implementation date: June 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-08
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Reporting
Statement of Condition	During our reporting test, we noted the following exceptions: <ul style="list-style-type: none">a. There is no documental evidence that the SEMAP Certification was executed by a responsible employee. The item Exec. Director approval in the SEMAP Certification is not marked, nor dated. Also, form HUD-52648, was not completed; only the mechanized form was submitted.b. The Municipality did not maintained accurate and complete documentation regarding the information about quality control samples of applicants reaching the top of the waiting list (Indicator 1b.) and Expanding Housing Opportunities (Indicator 7)
Criteria	24 CFR 985.101 (a) (1), requires that the certification must be approved by PHA Board Resolution and signed by the PHA Executive Director. Also, 24 CFR 985.101 (a) (3), states that the grantee may include in its SEMAP Certification any information bearing on the accuracy or completeness of the information used by the PHA in providing its certifications.
Cause of Condition	The Municipality did not maintain adequate monitoring procedures to assure that performance report was properly prepared and certified.
Effect of Condition	The Municipality is not in compliance with 24 CFR 985.101 (a) (1) and 985.101 (a) (3).
Recommendation	The Municipality should strengthen its monitoring system in order to document information regarding performance indicators and preparation of form HUD-52648 properly signed by the responsible employee.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-08 (Continued)

Management Response

And corrective action

The personnel listed bellow will take the corrective actions on the exemptions noted.

Responsible Person for
closing reports :

Juan H. Cruz, Program Accountant

Implementation date: June 30, 2005

Responsible Person
for SEMAP Certification:

Cybelle J. Arce Rodríguez, Housing Director

Implementation date: June 30, 2005

Responsible Person

for SEMAP quality control: Raymond Guzman, SEMAP Coordinator

Implementation date: June 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-09
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: a. During our tests we could not determine how the participants were selected from the top of the waiting list.
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 an adequate waiting list as required by Federal Regulation. In addition, the program did not maintain proper documentation which let us determine how 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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-09 (Continued)

Management Response

And corrective action

In order to respond to the auditor's recommendation, the Housing Director revised Circular 02-05 approved in November 26, 2002 with a new Circular Coded 05-02 Waiting List, as a revised standard operating procedure establishing quality control measures to assure that all new voucher holders will come from the top of the waiting list.

In addition, the new circular established monitoring control measures to comply with SEMAP Indicator Num. 1.

Responsible Person: Ms. Elisabeth Ramírez, Program Supervisor

Implementation date: June 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-10
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	<p>During our Reasonable Rent test we found the following exceptions:</p> <ul style="list-style-type: none">a. The determination of reasonable rent (Reasonable Rent Certification) was not duly documented in eight (8) participant files examined. The certification did not include adequate information of comparable units (unit address, contact person, etc.).b. In one (1) case the Reasonable Rent approved is at a level, lower than comparable units in the private market. The reasonable rent determination made by the PHA, approved a \$407 rent for a three (3) bedroom house, although the Fair Market Rent is \$483. The three (3) comparable units obtained by the PHA fluctuate between \$500 and \$525.
Criteria	<p>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. Also, the Housing Voucher Guidebook in its Chapter 9 “ Rent Reasonableness“ establishes that if rents are approved at levels lower than comparable units in the private market , the better owners do not participate in the program, or they participate only with their lowest –cost and lower quality units. In addition, families may be inappropriately restricted in where they can live.</p>
Cause of Condition	<p>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.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04 10 (Continued)

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 the Municipality to improve it's internal control and procedures to assure that appropriate documentation is duly completed and the determination of reasonable rent is maintained in participant's files.

Questioned Costs None

Management Response
And corrective action

The participant files will be reviewed in full, in order to correct the exemptions noted.

Responsible Person: Ms. Elisabeth Ramírez, Program Supervisor

Implementation date: June 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-11

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 twenty five (25) participant files we noted the following deficiencies:

- a. Section 6 (Building Exterior), Section 7 (Heating and Plumbing) and Section 8 (General Health and Safety) was not evaluated by the inspector in the initial inspection of one (1) participant's file.
- b. We found four (4) inspections in noncompliance for electrical and kitchen repairs. The correction was not realized within 30 calendar days or thereafter. The Municipality did not stop (abate) the Housing Assistance Payment. Also, in one (1) case there is no documental evidence of PHA action taken to enforce the family obligation.
- c. We found that in one (1) participant file an inspection was not performed following up the repairs to be done.

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, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-11 (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 internal control and procedures failed to assure that all inspections are properly documented in participant files.

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 improve it's internal control procedures in order to assure that annual inspections are properly documented. 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.

Management Response
And corrective action The participant files will be reviewed in full in order to correct the exemptions noted.

Responsible Person: Ms. Elisabeth Ramírez, Program Supervisor

Implementation date: June 30, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	04-12
Program	Child Care and Development Block Grant (CFDA. No. 93.575); 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 approximately \$61,800.c. During five (5) month the cash as per bank reconciliation was in overdraft.
Criteria	CFR 45, 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 ACUDEN in the delegation of funds agreement 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 ACUDEN alternate methods to request cash in order to comply with this requirement.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference 04-12 (Continued)

Management Response

And corrective action

The Municipality management agrees with the finding. The Program Coordinator will make a written request to “ACUDEN” for advice regarding this finding.

Responsible Person: Mrs. Ixa Olivieri – Program Coordinator

Implementation date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	04-13
Program	Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico - Administration for Children and Families
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 Property Subsidiary Ledger does not specify the last inventory date.b. The Property Subsidiary Ledger did not contain property tag number, title, and percentage of federal participation in cost.
Criteria	Subpart C, 45 CFR 92.32 (d) (1) and (d) (2) states that property records must 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.
Cause of Condition	There is no adequate internal control procedures to assure that the program maintained accurate property records.
Effect of Condition	The Municipality is not in compliance with Subpart C, 24 CFR, 85.32 (d) (1) and (d) (2).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Program Award Findings and Questioned Costs

Finding Reference 04-13 (continued)

Recommendation We recommend that the Municipality should establish procedures in order to assure the proper valuation and timeliness of recognition of property and equipment in the Property Subsidiary Ledger in a manner that it provides updated and complete financial information.

Questioned Costs None

Management Response
And corrective action

The Municipality management agrees with the finding. Full corrective actions were implemented during October 2004 and program staff was instructed to coordinate an annual inventory as soon as possible.

Responsible Person: Mr. Sigfredo Torres – Fiscal Auxiliary

Implementation date: June, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-14
Program	Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico - Administration for Children and Families
Requirement	Reporting
Statement of Condition	During our reporting test we could not trace the amounts presented in Financial Reports (Monthly Reports and Annual Closing Report) to the accounting records.
Criteria	Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1) states that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.
Cause of Condition	The Municipality internal control failed to assure that the financial and programmatic reports were prepared according to Federal and State Regulations.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1), provisions regarding financial reporting.
Recommendation	We recommend that the Municipality should establish internal controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports.
Questioned Cost	None
Management Response And Corrective Action	The Municipality concurs with the finding. The Municipality will verify that the accounting records are prepared accurately and submitted on time to the agencies. If an amended report is necessary, the Municipality will notify the proper agencies.

Responsible Person: Mrs. Ivette Nazario

Implementation date: June, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	04-15
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: 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 \$75,191. c. During five (5) months the cash as per bank reconciliation was in overdraft.
Criteria	CFR 45, 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 ACUDEN 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 ACUDEN alternate methods to request cash in order to comply with this requirement.
Questioned Costs	None
Management Response And Corrective Action	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

Responsible Person: Mrs. Maria Torres – Program Accountant

Implementation date : June, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	04-16
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 by the Head Start Program financial activities did not provide for the classification of financial transactions between administration and programmatic costs. Alternate procedures were used by the Program staff to compute compliance with the fifteen (15%) administrative costs limit.
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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference 04-16 (Continued)

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

Responsible Person: Mr. Luis Valencia – Program Director

Implementation date: June, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-06	10.558	<p><u>Management should include all contract provisions required by federal regulations before each contract execution</u></p> <p>Corrective action was taken.</p>
03-07	10.558	<p><u>Management should establish adequate controls and procedures in order to assure that accounting records are maintained and accurate reports are submitted to the Federal and State programs. This situation, if unattended, could result in future questioned costs for the Municipality.</u></p> <p>Corrective action was taken.</p>
03-08	14.218	<p><u>Management should 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.</u></p> <p>Corrective action was taken.</p>
03-09	14.218	<p><u>Management should establish the following procedures to ascertain that the deficiencies to be corrected and approved amounts are incorporated into the rehabilitation contract. In addition, the management must assign a staff to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contract specifications. Also, the management must assure that all participant files include all required documentation duly approved and certified.</u></p> <p>Corrective action was taken.</p>
03-10	14.871	<p><u>We recommend management to give instructions to program staff in order to assure that all participants HAP were calculated using the evidence of income obtained form third parties and the actualized fair market rent tables to establish the payment standard.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-06.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-11	14.871	<p><u>Management should give instructions to the program staff to assure that the release form to allow information from third parties, employment information, 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-07.</p>
03-12	14.871	<p><u>Management should 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-09.</p>
03-13	14.871	<p><u>Management should improve it's internal control and procedures to assure that appropriate documentation is duly completed and the determination of reasonable rent is maintained in participant's files.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-10.</p>
03-14	14.871	<p><u>Management should improve it's internal control procedures in order to assure that annual inspections are properly documented. 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-11.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-15	93.575	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-12.</p>
03-16	93.575	<p><u>Management should 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.</u></p> <p>Corrective action was taken.</p>
03-17	93.575	<p><u>Management should strengthen its procedure in order to assure that the participant files are revised periodically to determine if an annual eligibility examination is required. Also, the Management must assure that the participant's eligibility and the parents contributions are performed using the procedures established by the federal and local agencies.</u></p> <p>Corrective action was taken.</p>
03-18	93.575	<p><u>Management should establish procedures in order to assure the proper valuation and timeliness of recognition of property and equipment in the Property Subsidiary Ledger in a manner that it provides updated and complete financial information.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-13.</p>
03-19	93.575	<p><u>Management should establish internal controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports. Also, Management should establish procedures in order to assure that all financial and programmatic reports are submitted on time to the agencies and are prepared in accordance with the required accounting basis.</u></p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		Partial Corrective Action was Taken. The closing reports were submitted on time to the pass-through agency. The auditors reissued the finding in the current year. See Finding Reference 04-14.
03-20	93.600	<u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u> No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-15.
03-21	93.600	<u>Management should 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.</u> Partial Corrective Action was Taken. Alternate procedures were used by the program staff to document the 15 % administrative costs. The auditors reissued the finding in the current year. See Finding Reference 04-16.
03-22	93.600	<u>Management 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.</u> Corrective action was taken.
03-23	93.600	<u>Management should include all contract provisions required by federal regulations before each contract execution</u> Corrective action was taken.
03-24	93.600	<u>Management should establish internal controls and procedures in order to assure that financial reports are in accordance to the financial information detailed in the accounting records.</u> Corrective action was taken.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-25	93.600	<p><u>Management should follow the following procedures:</u></p> <p><u>Establish better communication between the Municipality Finance Department and the program accounting department related to the issuance of manual checks without notifying the program accountant.</u></p> <p><u>The program should establish controls to trace payments of obligations and identify outstanding checks at end of funding period and, if necessary, request a waiver to the Federal Agency.</u></p> <p>Partial corrective action has been taken. The Municipality will reimburse the Head Start program the questioned cost on or before June 30, 2005.</p>
03-26	93.600	<p><u>The Municipality should improve its internal control and procedures in order to assure that disbursement vouchers includes all the required supporting documents before the payment issuance.</u></p> <p>Corrective action has been taken.</p>
02-07	14.218	<p><u>The Municipality should 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.</u></p> <p>Corrective action has been taken.</p>
02-11	14.218	<p><u>The Municipality should establish the following procedures: ascertain that the deficiencies to be corrected and approved amounts are incorporated into the rehabilitation contract; assign a staff to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contract specifications; assure that all participant files include all required documentation duly approved and certified.</u></p> <p>Corrective action has been taken.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
02-17	14.239	<p><u>The Municipality should develop a monitoring system in order to assure that on site inspections are realized to Homebuyer Assistance participants as required by federal regulation.</u></p> <p>No corrective action has been taken. The Municipality plans to enforce property standards on all HOME assisted units. The standards will be prepared by completion date, for all homebuyer acquisitions. Responsible person Mr. Hector Román.</p>
02-18	14.871	<p><u>The Municipality should establish monitoring procedures to assure that Housing Assistance Payments are duly computed as required by the Federal Regulations.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-06.</p>
02-19	14.871	<p><u>The Municipality should 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-07.</p>
02-21	14.871	<p><u>The Municipality should establish adequate monitoring procedures in order to assure the program compliance with federal regulations.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-08.</p>
02-23	14.871	<p><u>The Municipality should 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.</u></p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-09.
02-24	14.871	<u>The Municipality should establish controls to assure that appropriate documentation of the determination of reasonable rent is maintained in participant's files.</u>
		No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 03-10.
02-26	14.871	<u>The Municipality should 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.</u>
		No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-11.
02-27	93.600	<u>The Municipality should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u>
		No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 04-15.
02-28	93.600	<u>The Municipality should 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.</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		Partial Corrective Action was Taken. Alternate procedures were used by the program staff to document the 15 % administrative costs. The auditors reissued the finding in the current year. See Finding Reference 04-16.
02-29	93.600	<u>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.</u> Corrective action has been taken.
02-30	93.600	<u>The Municipality should include all contract provisions required by federal regulations before each contract execution</u> Corrective action has been taken.
01-13	14.239	<u>Failure to perform on site inspections</u> Audit finding is no longer valid since has passed 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 issued a final decision respect to the finding.
01-22	14.218	<u>Deficiencies in Participants files.</u> Audit finding is no longer valid since has passed 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 issued a final decision respect to the finding.
01-24	93.600	<u>No adequate cash management procedures.</u> Audit finding is no longer valid since has passed 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 issued a final decision

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		respect to the finding.
01-28	93.600	<u>Deficiencies in Participants files.</u> Audit finding is no longer valid since has passed 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 issued a final decision respect to the finding.
01-29	93.600	<u>Deficiencies in contract provisions.</u> Audit finding is no longer valid since has passed 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 issued a final decision respect to the finding.