

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

**MUNICIPIO DE ARECIBO**  
**AUDITORIA 2004-2005**  
**30 DE JUNIO DE 2005**

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FISCAL

*Audit No. 6-142-1*

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF ARECIBO**  
**SINGLE AUDIT REPORT**  
**YEAR ENDED JUNE 30, 2005**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2005

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CONTENTS

	Page
<b><u>BASIC FINANCIAL STATEMENTS</u></b>	
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
<b><u>SUPPLEMENTARY INFORMATION</u></b>	
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
<b><u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u></b>	
Independent auditor's 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, 2005

---

CONTENTS - (CONTINUED)

	Page
<b><u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)</u></b>	
Independent auditor's 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
<b><u>FINDINGS AND QUESTIONED COSTS</u></b>	
Schedule of findings and questioned cost	58-84
Summary schedule of prior year audit findings	85-92



*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 AUDITOR'S 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, 2005, 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.

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 primary government of the **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, 2005 and the changes in its financial position and its cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**INDEPENDENT AUDITOR'S REPORT (CONTINUED)**

In our opinion, based on our audit the financial statements referred to above presents fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the primary government of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2005, 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 19, 2005 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 19, 2005

Stamp No. 2106091 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**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**YEAR ENDED JUNE 30, 2005**

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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, 2005. 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, 2004. 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. assess 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 2005 deserve special mention:

1. Total assets of the Municipality amounted to \$118,878,928 which represents an increase of 13% compared to prior fiscal year, as restated.
2. At the end of fiscal year 2005, total liabilities amounted to \$94,714,708. Out of the said amount, \$71,880,060 corresponded to long-term liabilities of which \$53,343,571 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 \$24,164,220 which represents an increase of 9% 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 \$62,938,223, derived from the following sources: \$1,330,980 charges for services; \$18,476,969 from operating grants and contributions; \$7,404,667 from capital grants and contributions obtained from other sources, and \$35,725,607 from general revenues available.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

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**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 \$61,010,887.
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$1,927,336.
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$30,979,281.
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$8,169,028, compared to a fund balance of \$10,250,132 in the prior fiscal year.
9. The actual General Fund budgetary activities resulted in a favorable balance of \$1,415,717, caused mainly due to favorable variances in various expenditures accounts.

**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 2005. 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, 2005**

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**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, 2005, shows total expenses incurred to afford the cost of all functions and programs amounted to \$61,010,887. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$62,938,223 was derived from the following sources: \$1,330,980 charges for services; \$18,476,969 from operating grants and contributions; and \$7,404,667 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$35,725,607. There was an excess of revenues over expenses in the amount of \$1,927,336 which increase 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, 2005

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**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.

**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 \$24,164,220 at the end of 2005, compared to \$22,236,884 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

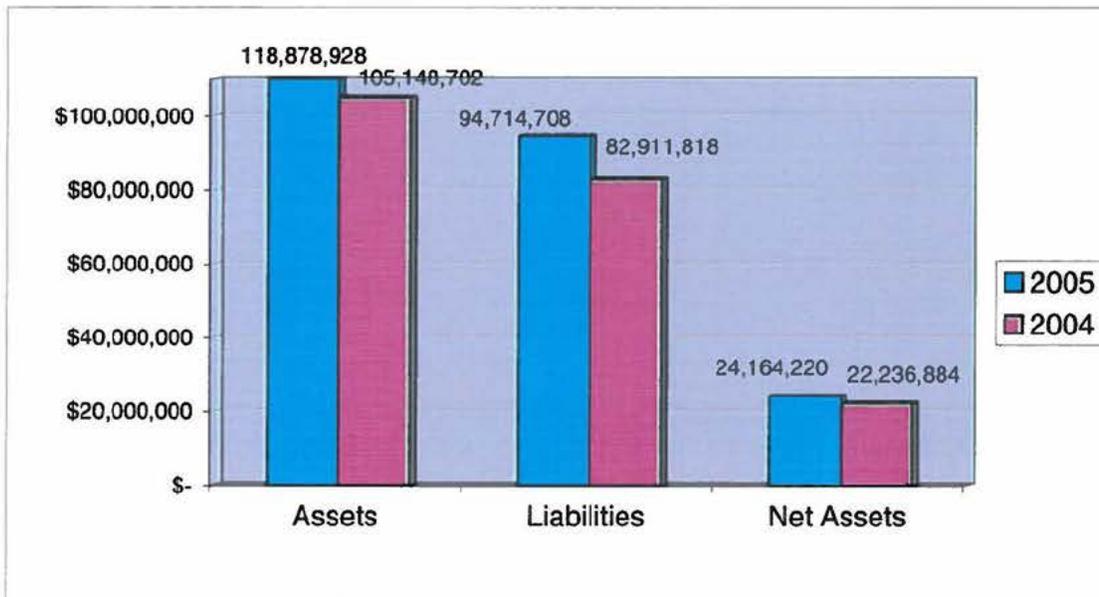
**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

**Condensed Statement of Net**

<b>Assets</b>	<b>2005</b>	<b>2004</b>	<b>Change</b>	<b>%</b>
Current assets	\$52,620,370	\$48,375,398	\$4,244,972	9%
Capital assets	66,258,558	56,773,304	9,485,254	17%
<b>Total assets</b>	<b>118,878,928</b>	<b>105,148,702</b>	<b>13,730,226</b>	<b>13%</b>
Current liabilities	22,834,648	16,394,901	6,439,747	39%
Noncurrent liabilities	71,880,060	66,516,917	5,363,143	8%
<b>Total liabilities</b>	<b>94,714,708</b>	<b>82,911,818</b>	<b>11,802,890</b>	<b>14%</b>
Invested in capital assets, net of related debt	37,990,558	29,482,304	8,508,254	29%
Restricted	22,008,737	20,897,811	1,110,926	5%
Unrestricted	(35,835,075)	(28,143,231)	(7,691,844)	27%
<b>Total net assets</b>	<b>\$24,164,220</b>	<b>\$22,236,884</b>	<b>\$1,927,336</b>	<b>9%</b>



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)**

**Changes in Net Assets**

The Statement of Activities reflects that for fiscal year 2005, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$1,927,336 increase in the Municipality's net assets. Approximately 45 percent of the Municipality's total revenue came from taxes, while 52 percent resulted from grants and contributions, including federal aid. Charges for Services provided 2 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.

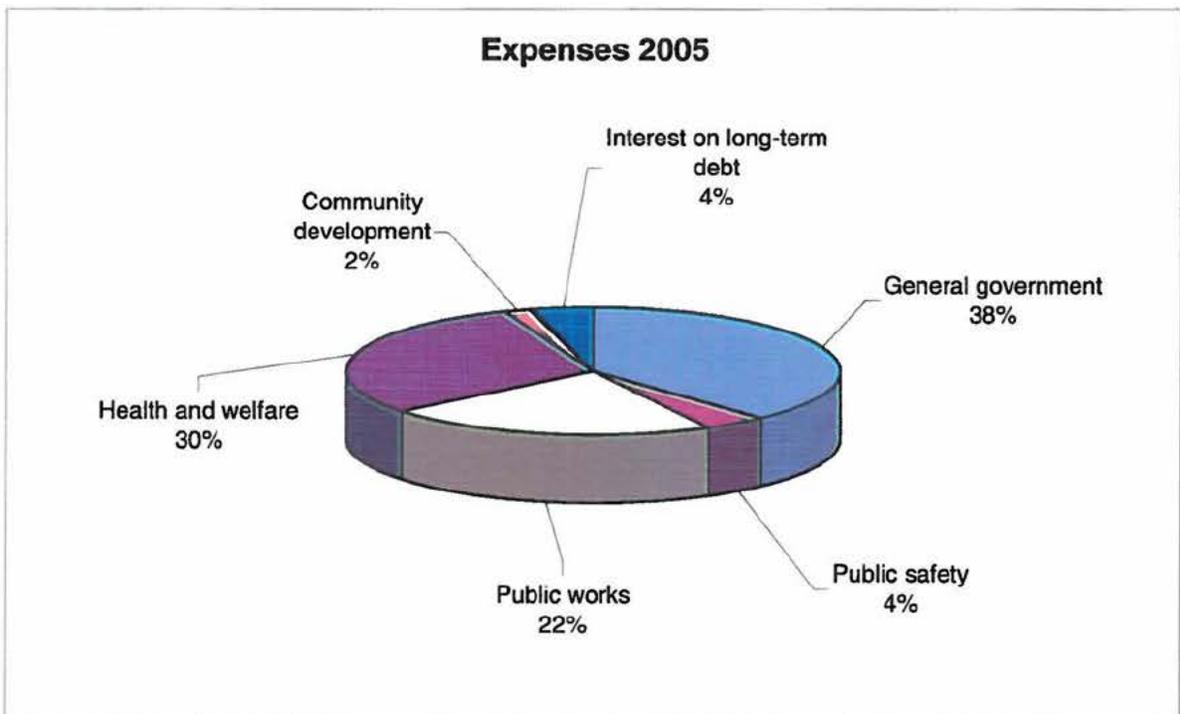
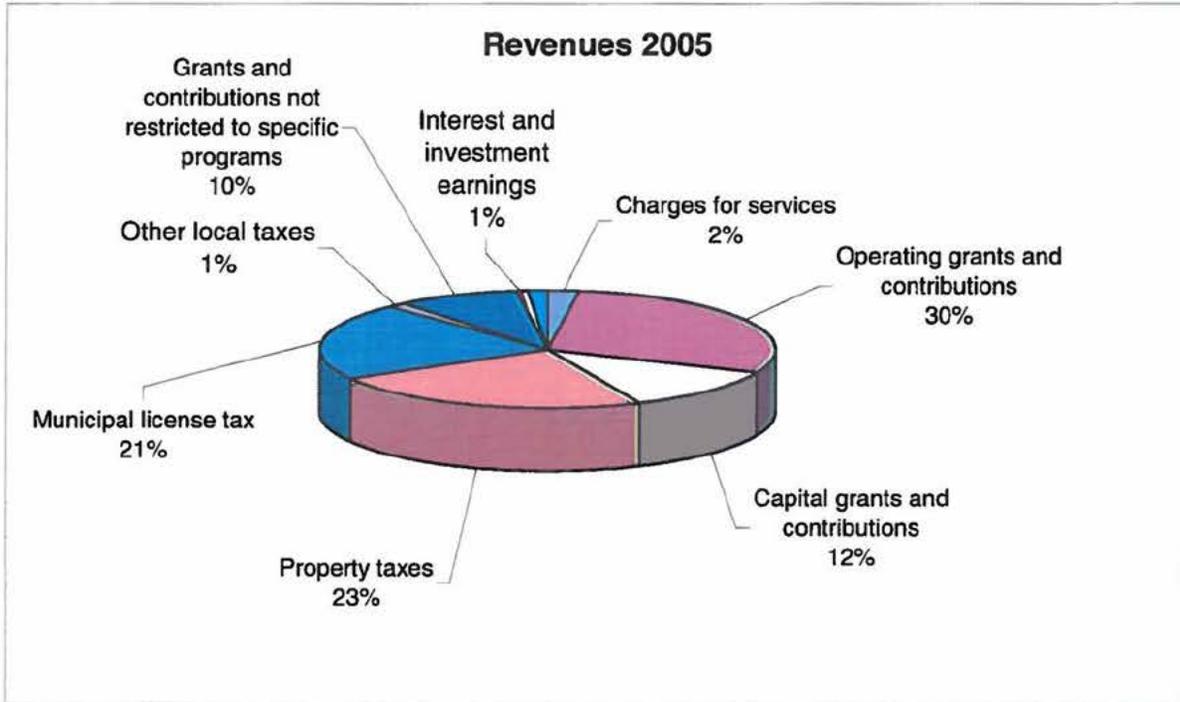
<b>Condensed Statement of Activities</b>	<b>2005</b>	<b>2004</b>	<b>Change</b>	<b>%</b>
<b>Program revenues:</b>				
Charges for services	\$1,330,980	\$732,109	\$598,871	82%
Operating grants and contributions	18,476,969	19,545,332	(1,068,363)	(5%)
Capital grants and contributions	7,404,667	12,501,257	(5,096,590)	(41%)
<b>General revenues:</b>				
Property taxes	14,684,649	16,132,980	(1,448,331)	(9%)
Municipal license tax	13,287,813	14,615,737	(1,327,924)	(9%)
Other local taxes	881,878	1,620,849	(738,971)	(46%)
Grants and contributions not restricted to specific programs	5,494,768	7,383,609	(1,888,841)	(26%)
Interest and investment earnings	449,196	491,017	(41,821)	(9%)
Gain (loss) on retirement of capital assets	-	-	-	-
Miscellaneous	927,303	98,469	828,834	842%
<b>Total revenues</b>	<b>62,938,223</b>	<b>73,121,359</b>	<b>(10,183,136)</b>	<b>(14%)</b>
<b>Expenses:</b>				
General government	23,150,231	22,767,935	382,296	2%
Public safety	2,601,774	2,207,193	394,581	18%
Public works	13,361,501	11,242,698	2,118,803	19%
Culture and recreation	79,609	3,064,862	(2,985,253)	(97%)
Health and welfare	18,218,967	18,221,885	(2,918)	-
Community development	1,089,299	668,805	420,494	63%
Urban development	35,779	31,000	4,779	15%
Education	19,339	5,176	14,163	274%
Interest on long-term debt	2,454,388	2,587,688	(133,300)	(5%)
<b>Total expenses</b>	<b>61,010,887</b>	<b>60,797,242</b>	<b>213,645</b>	<b>-</b>
<b>Change in net assets</b>	<b>1,927,336</b>	<b>12,324,117</b>	<b>(10,396,781)</b>	<b>(84%)</b>
<b>Net assets, beginning of year, as restated</b>	<b>22,236,884</b>	<b>9,912,767</b>	<b>12,324,117</b>	<b>124%</b>
<b>Net assets, end of year</b>	<b>\$24,164,220</b>	<b>\$22,236,884</b>	<b>\$1,927,336</b>	<b>9%</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

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, 2005

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**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 \$30,979,281 a decrease of \$1,288,540 in comparison with the prior year. There are reservations of fund balance amounting to \$28,262,926. 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 (\$4,188,592), 2) to pay debt service (\$7,584,751), 3) to pay for capital projects (\$14,249,787), 4) for other purposes (\$975,715), 5) for assets not available for spending (\$711,872), 6) for advances to other funds (\$550,933), and 7) designated for specific purpose (\$1,276).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2005, the general fund has an undesignated fund balance of \$2,716,355.

**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 \$1,415,717, caused mainly due to favorable variances in collections related to intergovernmental revenues.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The Municipality's investment in capital assets as of June 30, 2005, amounts to \$81,459,254 net of accumulated depreciation of \$15,200,696, leaving a net book value of \$66,258,558. 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

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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, 2005, the Municipality has \$3,515,201 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities. In addition, the Municipality maintains an available balance of approximately \$300,000 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, 2005**

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**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 2005-2006.

**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.

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.

On August 12, 2005, the Municipality of Arecibo authorized the sale of the Puerto Rico Distillers for the amount of \$3,000,000. A non interest bearing Note Receivable for a period of ten (10) years was issued by contract for a total of \$2,850,000. During the month of August, 2005 the Municipality collected \$150,000 corresponding to the down payment.

On August 18, 2005 the Municipality of Arecibo authorized a final transaction in the case of the unavoidable expropriation of land by the Public Building Authority for a total of \$396,000 already collected by the Municipality in July, 2002 instead the estimated amount by the Municipality appraiser of \$645,000.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

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**FINAL COMMENTS (CONTINUED)**

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 2006. 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, 2005

	<b>Governmental Activities</b>
<b>Assets</b>	
Cash and cash equivalents	\$ 30,281,268
Cash with fiscal agent	18,156,202
Accounts receivable:	
Municipal license tax	127,781
Intergovernmental	1,864,121
Federal Grants	1,973,729
Interests	24,197
Others	193,072
Capital assets:	
Land, improvements, and construction in progress	17,500,689
Other capital assets, net of depreciation	48,757,869
Total capital assets	66,258,558
 Total assets	 118,878,928
 <b>Liabilities</b>	
Accounts payable and accrued liabilities	3,113,391
Claims and Judgments	7,641,837
Interest payable	802,792
Due to other governmental entities	392,834
Deferred revenues:	
Municipal license tax	9,992,624
Federal grant revenues	891,170
Noncurrent liabilities:	
Due within one year	4,839,482
Due in more than one year	67,040,578
 Total liabilities	 94,714,708
 <b>Net Assets</b>	
Invested in capital assets, net of related debt	37,990,558
Restricted for:	
Capital projects	14,249,787
Debt service	6,781,959
Other purposes	976,991
Unrestricted (deficit)	(35,835,075)
 Total net assets	 \$ 24,164,220

**Commonwealth of Puerto Rico**  
**Municipality of Arecibo**  
**Statement of Activities**  
**For the Year Ended June 30, 2005**

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
<b>Governmental Activities:</b>					
General government	\$ 23,150,231	\$ 513,051	\$ 1,174,651	\$ -	\$ (21,462,529)
Public safety	2,601,774	198,801	40,908	19,155	(2,342,910)
Public works	13,361,501	619,128	9,546	703,177	(12,029,650)
Health and welfare	18,218,967		17,236,864		(982,103)
Culture and recreation	79,609		15,000	819,647	755,038
Community development	1,089,299			5,862,688	4,773,389
Urban development	35,779				(35,779)
Education	19,339				(19,339)
Interest on long-term debt	2,454,388				(2,454,388)
<b>Total governmental activities</b>	<b>\$ 61,010,887</b>	<b>\$ 1,330,980</b>	<b>\$ 18,476,969</b>	<b>\$ 7,404,667</b>	<b>\$ (33,798,271)</b>
<b>General revenues:</b>					
					14,684,649
Property taxes					13,287,813
Municipal license tax					881,878
Other local taxes					5,494,768
Grants and contributions not restricted to specific programs					449,196
Interest and investment earnings					927,303
Miscellaneous					
<b>Total general revenues</b>					<b>35,725,607</b>
Change in net assets					1,927,336
Net assets - beginning , as restated					22,236,884
Net assets - ending					<b>\$ 24,164,220</b>

**Commonwealth of Puerto Rico**  
**Municipality of Arecibo**  
**Balance Sheet**  
**Governmental Funds**  
**June 30, 2005**

	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
<b>Assets</b>							
Cash and cash equivalents	\$ 16,150,031	\$ 85,173	\$ 550,427	\$ 11,936,949	\$ -	\$ 1,558,688	\$ 30,281,268
Cash with fiscal agent	7,643,113			3,515,201	6,997,888		18,156,202
Accounts receivable:							
Municipal license tax	25,556						25,556
Intergovernmental	1,252,627				611,494		1,864,121
Federal Grants		862,210	1,111,519				1,973,729
Advances from other funds	550,933						550,933
Due from other funds	1,927,935						1,927,935
Other	154,851			49,025	13,393		217,269
<b>Total assets</b>	<b>\$ 27,705,046</b>	<b>\$ 947,383</b>	<b>\$ 1,661,946</b>	<b>\$ 15,501,175</b>	<b>\$ 7,622,775</b>	<b>\$ 1,558,688</b>	<b>\$ 54,997,013</b>
<b>Liabilities and Fund Balances</b>							
<b>Liabilities :</b>							
Accounts payable and accrued liabilities	\$ 1,508,723	\$ 163,773	\$ 486,921	\$ 456,134	\$ -	\$ 4,848	\$ 2,620,399
Claims and judgments	7,641,837						7,641,837
Due to other governmental entities	392,834						392,834
Advances to other funds			519,933			31,000	550,933
Due to other funds		578,376	445,307	795,254	38,024	70,974	1,927,935
Deferred revenues							
Municipal license tax	9,992,624						9,992,624
Federal grant revenues		205,234	209,785			476,151	891,170
<b>Total liabilities</b>	<b>19,536,018</b>	<b>947,383</b>	<b>1,661,946</b>	<b>1,251,388</b>	<b>38,024</b>	<b>582,973</b>	<b>\$ 24,017,732</b>
<b>Fund balances:</b>							
<b>Reserved for:</b>							
Encumbrances	4,188,592						\$ 4,188,592
Capital projects				14,249,787			14,249,787
Assets not available for spending	711,872						711,872
Debt service fund					7,584,751		7,584,751
Advances to other funds	550,933						550,933
<b>Reserved reported in nonmajor funds</b>							
Other purposes						975,715	975,715
Designated for specific fund purpose	1,276						1,276
<b>Unreserved for:</b>							
Undesigned	2,716,355						2,716,355
<b>Total fund balances</b>	<b>8,169,028</b>	<b>-</b>	<b>-</b>	<b>14,249,787</b>	<b>7,584,751</b>	<b>975,715</b>	<b>30,979,281</b>
<b>Total liabilities and fund balances</b>	<b>\$ 27,705,046</b>	<b>\$ 947,383</b>	<b>\$ 1,661,946</b>	<b>\$ 15,501,175</b>	<b>\$ 7,622,775</b>	<b>\$ 1,558,688</b>	

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

Accrual basis of accounting accounts receivable recognized in government-wide financial statements	102,225
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	66,258,558
Long-term liabilities, Construction in progress accounts payable and accrued interest are not due and payable in the Current period, and therefore, are not reported in the funds.	(73,175,844)
<b>Net assets of governmental activities</b>	<b>\$ 24,164,220</b>

**Commonwealth of Puerto Rico**  
**Municipality of Arecibo**  
**Statement of Revenues, Expenditures and Changes in Fund Balances**  
**Governmental Funds**  
**For the Year Ended June 30, 2005**

	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
<b>Revenues</b>							
Property taxes	\$ 11,079,124	\$ -	\$ -	\$ -	\$ 3,605,525	\$ -	\$ 14,684,649
Municipal license taxes	13,608,823						13,608,823
Licenses, permits and other local taxes	954,591						954,591
Charges for services	272,257						272,257
Intergovernmental	6,669,419		9,546	1,465,570		466,990	9,611,525
Rent of property	493,515			366,407			859,922
Fines and forfeitures	198,801						198,801
Interest	443,733						443,733
Federal grants		10,378,350	8,359,880			4,035,688	22,773,918
Miscellaneous	896,342		25,854	1,531			923,727
<b>Total revenues</b>	<b>34,616,605</b>	<b>10,378,350</b>	<b>8,395,280</b>	<b>1,833,508</b>	<b>3,605,525</b>	<b>4,502,678</b>	<b>63,331,946</b>
<b>Expenditures</b>							
<b>Current:</b>							
General government	28,090,117			20,592			28,110,709
Public safety	2,529,404		19,155			34,995	2,583,554
Public works	11,100,808		69,934	3,342,085			14,512,827
Health and welfare		10,900,350	2,843,503	2,499		4,475,452	18,221,804
Culture and recreation	463,012			757,145		15,000	1,235,157
Community development			5,862,688				5,862,688
Urban development						31,000	31,000
Education						27,156	27,156
<b>Debt service:</b>							
Principal					1,908,823		1,908,823
Interest					2,434,868		2,434,868
<b>Total expenditures</b>	<b>42,183,341</b>	<b>10,900,350</b>	<b>8,795,280</b>	<b>4,122,321</b>	<b>4,343,691</b>	<b>4,583,603</b>	<b>74,928,586</b>
Excess (deficiency) of revenues over (under) expenditures	(7,566,736)	(522,000)	(400,000)	(2,288,813)	(738,166)	(80,925)	(11,596,640)
<b>Other financing sources (uses)</b>							
Transfers in		522,000	400,000		1,227,373	34,995	2,184,368
Transfers out	(2,184,368)						(2,184,368)
Long-term debt issued	7,670,000			2,638,100			10,308,100
<b>Total other financing sources (uses)</b>	<b>5,485,632</b>	<b>522,000</b>	<b>400,000</b>	<b>2,638,100</b>	<b>1,227,373</b>	<b>34,995</b>	<b>10,308,100</b>
<b>Net Change in fund balances</b>	<b>(2,081,104)</b>	<b>-</b>	<b>-</b>	<b>349,287</b>	<b>489,207</b>	<b>(45,930)</b>	<b>(1,288,540)</b>
Fund balance, beginning, as restated	10,250,132			13,900,500	7,095,544	1,021,645	32,267,821
Fund balance, ending	<b>\$ 8,169,028</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 14,249,787</b>	<b>\$ 7,584,751</b>	<b>\$ 975,715</b>	<b>\$ 30,979,281</b>

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 [Signature]  
 07/20/06*

**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, 2005**

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Net Change In Fund Balances - Total Governmental Funds	(1,288,540)
Amounts reported for governmental activities in the Statement of Activities are different because:	
Prior Year Accounts Receivable reported in the Governmental Fund Financial Statements as revenues, but reversed in the Government-Wide Statement of Activities and Changes in Net Assets.	(495,948)
Accounts Receivable 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.	102,225
Governmental Funds report capital outlays as expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.	12,009,950
Depreciation Expense on Capital Assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, Depreciation expense is not reported as expenditures in Governmental Funds Financial Statements.	(2,524,696)
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.	(19,520)
Accounts payable reported in the Government-Wide Statement of Activities and Change in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. This is the amount reported in the current period.	(492,992)
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.	(4,591,578)
Long-term debt 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.	9,764,977
Change in Landfill Accrual	(2,137,265)
Bonds proceeds provide 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.	(8,399,277)
<b>Change In Net Assets of Governmental Activities</b>	<u><u>1,927,336</u></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS**

**YEAR ENDED JUNE 30, 2005**

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**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, 2005**

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**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, 2005

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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, 2005

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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, 2005

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**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, 2005**

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**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, 2005**

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**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 receivable in the general fund relates mostly to Law 52 proposal payroll reimbursements from prior years and property taxes owed by the Municipal Revenue Collection Center ("CRIM"). Intergovernmental receivable in the debt service fund represent property taxes owed by the Municipal Revenue Collection Center ("CRIM").

- 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, 2005

**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, 2005

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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.
  - e. **Assets not Available for Spending-** Represents the reservation of intergovernmental receivables that they are not available for appropriation and are not expendable available financial resources.
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, 2005 amounted to approximately \$738,016. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$851,518 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, 2005**

**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	\$ 66,258,558	
Deduct:		
Bonds Payable related to Capital Assets	(27,568,000)	
Notes Payable related to Capital assets	<u>(700,000)</u>	
		\$ 37,990,558
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		14,249,787
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service	7,584,751	
Deduct:		
Interest Payable	<u>\$ (802,792)</u>	\$ 6,781,959
<u>Net assets restricted for other purposes</u>		
Other governmental funds - Fund balance restricted for other purposes		976,991
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 8,169,028	
Deduct:		
Designated for specific fund purpose	(1,276)	
Add:		
Accrual basis accounts receivable	102,225	
Deduct:		
Accrual basis account payables	(492,992)	
Bonds Payable related to operational debts	(25,075,571)	
Compensated absences debt	(4,240,788)	
Landfill Obligation	(7,201,886)	
Property tax debt - Law 42	(1,091,635)	
Property tax debt - Law 146	(2,227,714)	
Internal Revenue Service - Social Security Debt	(3,633,418)	
Claims and judgments debt	<u>(141,048)</u>	<u>(35,835,075)</u>
Total net assets - governmental activities		<u>\$ 24,164,220</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

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**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 \$16,150,031, \$85,173, \$550,427 and \$11,936,949 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, 2005. In the other governmental funds, there were deposits with commercial banks of approximately \$1,558,688 that were fully collateralized.

The deposits at GDB of approximately \$7,643,113, that is restricted for operational expenditures in the general fund, the \$3,515,201, that is restricted principally for capital projects in the capital project fund - local and state grant, and the \$6,997,888 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, 2005, 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, 2005, 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, 2005**

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**3. RECEIVABLES (CONTINUED)**

**B. Intergovernmental Receivables-** Intergovernmental receivables in the general fund principally consist of the amounts due from the Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico resulting from the excess of current year property tax collections over current year advances as determined in the CRIM final liquidation for the fiscal year ended on June 30, 2005. The amounts due from the Government Development Bank of Puerto Rico relates to a claim settlement liquidated by the general fund, the amounts due from the "Consortio Norte Central" (CONOCE) relates to the training of cadets for the Municipal Police, and the amounts due from the Department of Labor and Human Resources relates to Law 52 prior year proposals financed by the general fund, but not reimbursed at June 30, 2005. The amounts receivable from governmental entities are as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ 249,555
Government Development Bank for Puerto Rico	291,200
Consortio Norte Central (CONOCE)	9,641
Department of Labor and Human Resources(Law 52)	<u>702,231</u>
<b>Total</b>	<b><u>\$ 1,252,627</u></b>

Intergovernmental receivable in the debt service fund represents the amounts due from the CRIM resulting from the excess of the current year property tax collections over current year advances. Following is a detail of the Intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	<u>\$ 611,494</u>
<b>Total</b>	<b><u>\$ 611,494</u></b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

3. RECEIVABLES (CONTINUED)

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>862,210</u>
<b>Total</b>	<b>\$ <u>862,210</u></b>

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	\$ 401,448
Public Assistance Grant	273,218
Community Service Block Grant	28,666
Special Program for Aging - Title III	86,476
Child Care Food Program	1,653
Child Care Development Block Grant Program	190,583
Emergency Management Performance Grant	20,268
Even Start Family Literacy Program	98,887
Rural Domestic Violence and Child Victimization Enforcement Grant Program	<u>10,320</u>
<b>Total</b>	<b>\$ <u>1,111,519</u></b>

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2005, and interfund transfers during the fiscal year ended at June 30, 2005, are summarized as follows:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

**4. INTERFUND TRANSACTIONS (CONTINUED)**

**a. Due from/to other fund and Advances to/from other funds:**

**b.**

<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	\$ 578,376
General Fund	Special Revenue Fund – Other Federal Grants	Payroll and related accruals paid and not reimbursed	965,240
General Fund	Debt Service Fund	Interest Revenue	38,024
General Fund	Capital Project Fund	Reimbursable Expenditures	795,254
General Fund	Other Governmental Funds	Payroll & Related Reimbursable Expenditures	<u>101,974</u>
<b>Total</b>			<b><u>\$ 2,478,868</u></b>

**c. 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, and Medical and Christmas Bonus Contributions	\$ 522,000
General Fund	Special Revenue Fund – Other Federal Grants	Matching Contributions	400,000
General Fund	Debt Service Fund	Debt Retirement	1,227,373
General Fund	Other Governmental Funds	Creation of new fund and Matching Contribution	<u>34,995</u>
<b>Total</b>			<b><u>\$2,184,368</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

**5. CAPITAL ASSETS**

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2005, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance July 1, 2004 as restated</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2005</u>
<b>Capital asset, not being depreciated:</b>				
Construction in progress	\$ 3,098,841	\$ 5,506,981	\$ (468,454)	\$ 8,137,368
Land	<u>9,252,501</u>	<u>110,820</u>	<u>-</u>	<u>9,363,321</u>
<b>Total capital assets not being depreciated</b>	<b><u>\$ 12,351,342</u></b>	<b><u>\$ 5,617,801</u></b>	<b><u>\$ (468,454)</u></b>	<b><u>\$ 17,500,689</u></b>
<b>Capital assets, being depreciated:</b>				
Buildings	\$ 41,990,725	1,113,705	-	\$ 43,104,430
Buildings improvements	3,044,203	3,836,190	-	6,880,393
Infrastructure	1,307,450	434,211	-	1,741,661
Infrastructure improvements	216,066	40,000	-	256,066
Equipment	2,750,132	400,766	-	3,150,898
Furnishing	1,469,107	76,609	-	1,545,716
Computers	420,124	67,002	-	487,126
Works of Art	206,519	3,500	-	210,019
Vehicles	<u>5,693,636</u>	<u>888,620</u>	<u>-</u>	<u>6,582,256</u>
<b>Total capital assets being depreciated</b>	<b><u>\$ 57,097,962</u></b>	<b><u>\$ 6,860,603</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 63,958,565</u></b>
<b>Less accumulated depreciation for:</b>				
Buildings	\$ (5,402,611)	\$ (1,063,500)	-	\$ (6,466,111)
Buildings improvements	(75,384)	(123,820)	-	(199,204)
Infrastructure	(42,271)	(39,924)	-	(82,195)
Infrastructure improvements	(12,004)	(15,960)	-	(27,964)
Equipment	(1,956,604)	(283,805)	-	(2,240,409)
Furnishing	(900,412)	(229,932)	-	(1,130,344)
Computers	(246,738)	(107,540)	-	(354,278)
Work of Art	(149,735)	(13,177)	-	(162,912)
Vehicles	<u>(3,890,241)</u>	<u>(647,038)</u>	<u>-</u>	<u>(4,537,279)</u>
<b>Total accumulated depreciation</b>	<b><u>\$(12,676,000)</u></b>	<b><u>\$ (2,524,696)</u></b>	<b><u>\$ -</u></b>	<b><u>\$(15,200,696)</u></b>
<b>Total capital assets being depreciated, net</b>	<b><u>\$ 44,421,962</u></b>	<b><u>\$ 4,335,907</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 48,757,869</u></b>
<b>Governmental activities capital assets, net</b>	<b><u>\$ 56,773,304</u></b>	<b><u>\$ 9,953,708</u></b>	<b><u>\$ (468,454)</u></b>	<b><u>\$ 66,258,558</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

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**5. CAPITAL ASSETS (CONTINUED)**

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

**Governmental activities:**

General Government	\$ 605,927
Public Safety	67,719
Public Works	796,861
Health and Welfare	15,733
Culture and Recreation	925,383
Community Development	104,978
Urban Development	4,779
Education	<u>3,316</u>

**Total depreciation expense-governmental activities** \$2,524,696

**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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

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**6. PROPERTY TAXES (CONTINUED)**

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.

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 \$1,091,635 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

6. PROPERTY TAXES (CONTINUED)

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")	312,031
General Services Administration	16,834
Department of Labor and Human Resources	12,654
Internal Revenue Service	2,600
Puerto Rico Aqueduct and Sewer Authority	<u>48,715</u>
Total	<u>\$ 392,834</u>

8. DEFERRED REVENUES

A. **Municipal License Tax**- The deferred revenues of approximately \$9,992,585 in the general fund relates to municipal license tax collected in fiscal year 2004-05 that will be earned in fiscal year 2005-06.

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>
Child and Adult Care Food Program	\$ 203,850
Head Start Program	<u>1,384</u>
Total	<u>\$ 205,234</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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**8. DEFERRED REVENUES (Continued)**

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>
Emergency Management Performance Grant	\$ 59,480
Federal Transit Authority	1,446
Community Development Block Grant/Entitlement Grants	28,006
Urban Development Action Grant	4,639
Home Investment Partnership Program	6,491
Community Service Block Grant	4,719
Local Law and Enforcement Block Grants	12,320
Public Assistance Grant	75,607
Child Care and Development Block Grant	15,304
Others	<u>1,773</u>
<b>Total</b>	<b><u>\$ 209,785</u></b>

The deferred revenues presented in other governmental funds represent 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	<u>\$ 476,151</u>
<b>Total</b>	<b><u>\$ 476,151</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

**8. LONG-TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2005, 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	\$ 44,129,294	\$ 10,308,100	\$ (1,793,823)	\$ 52,643,571	\$ 3,210,100
Notes Payable	815,000	-	(115,000)	700,000	120,000
Property Tax Debt - Law 42	1,186,326	-	(94,691)	1,091,635	94,691
Property Tax Debt - Law 146	2,227,714	-	-	2,227,714	-
Compensated Absences	3,941,635	860,877	(561,724)	4,240,788	1,273,643
Landfill Obligation	5,064,621	2,137,265	-	7,201,886	-
Disallowed Cost HUD	2,608,561	-	(2,608,561)	-	-
Internal Revenue Service	-	-	-	-	-
Social Security Debt	-	3,633,418	-	3,633,418	-
Claims and judgments	<u>6,543,766</u>	<u>97,282</u>	<u>(6,500,000)</u>	<u>141,048</u>	<u>141,048</u>
<b>Total</b>	<b><u>\$ 66,516,917</u></b>	<b><u>\$ 17,036,942</u></b>	<b><u>\$(11,673,799)</u></b>	<b><u>\$ 71,880,060</u></b>	<b><u>\$ 4,839,482</u></b>

- 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, 2005**

**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 \$10,308,100. Bonds payable outstanding at June 30, 2005 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, 2005</u>
1984-Series	1-1-2009	\$675,000	5.00%	\$170,000
1987-Series	1-1-2012	875,000	5.00%	384,000
1989-Series	1-1-2014	500,000	5.00%	265,000
1989-Series	7-1-2008	3,000,000	5.00%	477,470
1990-Series	7-1-2005	3,395,000	5.00%	400,000
1991-Series	7-1-2006	2,060,000	6.31% to 6.36%	465,000
1994-Series	1-1-2019	400,000	4.87%	309,000
1995-Series	7-1-2020	14,975,000	5.93% to 6.63%	12,420,000
1998-Series	1-1-2023	900,000	4.75%	757,000
1999-Series	7-1-2024	7,365,000	2.89% to 5.60%	6,740,000
2001-Series	7-1-2026	10,545,000	5.00% to 8.00%	9,895,000
2002-Series	7-1-2026	5,030,000	2.89% to 5.60%	4,795,000
2003-Series	7-1-2028	4,235,000	6.00%	4,080,000
2004-Series	7-1-2013	360,000	5.00% to 6.00%	335,000
2004-Series	7-1-2028	605,000	5.00% to 6.00%	595,000
2004-Series	7-1-2013	294,000	6.00%	248,000
2004-Series	7-1-2029	410,000	4.00%	410,000
2004-Series	7-1-2029	1,610,000	4.00%	1,610,000
2004-Series	1-1-2006	618,100	4.50%	618,100
2005-Series	7-1-2014	7,670,000	5.50%	7,670,000
<b>Total general obligation bonds</b>				<b><u>\$52,643,570</u></b>

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, 2004-Series amounting \$294,000 and 2004 Series amounting to \$618,100 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

**8. LONG-TERM LIABILITIES (CONTINUED)**

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 3,210,100	\$ 2,363,059
2007	2,327,000	2,971,628
2008	2,213,000	2,847,269
2009	2,232,470	2,723,466
2010	2,295,000	2,596,222
2011-2015	13,555,000	10,782,790
2016-2020	12,468,000	6,920,267
2021-2025	11,093,000	3,063,050
2026-2030	<u>3,250,000</u>	<u>403,250</u>
<b>Total</b>	<b><u>\$ 52,643,570</u></b>	<b><u>\$ 34,671,001</u></b>

- 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, 2005</u>
2003-Series	7-1-2009	\$ 920,000	2.70% to 4.10%	<u>\$ 700,000</u>
<b>Total notes payable</b>				<b><u>\$ 700,000</u></b>

This 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>
2006	\$ 120,000	\$ 13,543
2007	130,000	19,422
2008	140,000	14,858
2009	150,000	9,470
2010	<u>160,000</u>	<u>3,280</u>
<b>Total</b>	<b><u>\$ 700,000</u></b>	<b><u>\$ 60,573</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

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**8. LONG-TERM LIABILITIES (CONTINUED)**

- 4. Property Tax Debt-** These amounts represent the balance owed to the Municipal Revenue Collection Center (CRIM) at June 30, 2005, as described in Note 6.
- 5. Compensated absences-** The government-wide statement of net assets includes \$2,237,664 of accrued sick leave benefits, and \$2,003,124 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 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 \$7,201,886 as of June 30, 2005 reported in the Government -Wide Financial Statements, which is based on 51% usage (filled) of the landfill. It is estimated that an additional \$6,954,514 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, 2005. 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 \$208,942 and \$715,324 in a bank account held for landfill improvements.
- 7. Disallowed costs HUD -** These amounts represent the balance due to Housing Urban Development (HUD) at June 30, 2005, as described in Note 13.
- 8. Internal Revenue Service -** These amount represents penalties due to Internal Revenue Service (IRS) for Social Security Debt regarding 940PR, 499 R-2/W-2 PR and W-3PR reports from years 2000 and 2001.
- 9. Claims and Judgments-** - These amounts represent the balance related to legal claims at June 30, 2005, as described in Note 13.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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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, 2005:

<u>Year Ending</u> <u>June 30,</u>	<u>Total</u>
2006	\$ 46,014
2007	20,925
2008	20,925
2009	<u>17,529</u>
Total minimum payments required	<u>\$105,393</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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**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, 2005**

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**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, 2005 amounted to approximately **\$726,379** and **\$814,159**, 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, 2005, 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, 2005**

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**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 on 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, 2005, the Municipality reimbursed \$5,706,231 from the general fund resources. Also, in the current period, the Municipality issued a general obligation bond of \$7,670,000 to liquidate operational debts, which includes the \$1,141,245 outstanding debt balance with HUD scheduled for payment on September 15, 2005 as per the 2001 agreement. This debt was reclassified from the Long-Term Liabilities Section in the Government-Wide Financial Statements to the General Fund Financial Statements. Also, the proceeds from the bond issuance to liquidate the corresponded debts were recognized as Cash with Fiscal Agent in the General Fund.

**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 \$6,500,000 in the General Fund and \$141,048 reported in the Government-Wide Financial Statements for a total of \$6,641,048 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 was realized on July 1, 2005 with the proceeds of the general obligation bond of \$7,670,000. The remaining balance of \$2,500,000 will be paid on July 1, 2006.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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**13. COMMITMENTS AND CONTINGENCIES (Continued)**

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. 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 Balances for Debt Service Fund has been restated by approximately \$430,388 to properly present the previously reported fund balances at June 30, 2004. The restatement is mainly due to the recognition of the amount due from CRIM related to Final Liquidation 2003-2004.

The beginning Fund Balance for Special Revenue Fund – Other Federal Grants has been restated by approximately \$92,506 to properly present the previously reported fund balance at June 30, 2004. The restatement is mainly due to the elimination of a federal grant receivable.

The beginning Net Assets for Governmental Activities has been restated by approximately \$5,337,229 to properly present the previously reported Net Assets at June 30, 2004. The restatement is mainly due to the recognition of an increase in prior year Capital Assets, and fund balances restatements described above.

**15. SUBSEQUENT EVENTS**

On August 12, 2005, the Municipality of Arecibo authorized the sale of the Puerto Rico Distillers for the amount of \$3,000,000. A non-interest bearing Note Receivable for a period of ten (10) years was issued by contract for a total of \$2,850,000. During the month of August, 2005, the Municipality collected \$150,000 corresponding to the down payment.

On August 18, 2005, the Municipality of Arecibo authorized a final transaction in the case of the unavoidable expropriation of land by the Public Building Authority for a total of \$396,000 already collected by the Municipality in July, 2002 instead the estimated amount by the Municipality appraiser of \$645,000.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO  
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND  
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)  
YEAR ENDED JUNE 30, 2005**

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
<b>REVENUES AND BUDGET CARRYOVER:</b>				
Property taxes	\$ 10,829,569	\$ 10,829,569	\$ 10,829,569	\$ -
Municipal license tax	15,010,000	15,010,000	13,611,771	(1,398,229)
Licenses, permits and other local taxes	1,050,000	1,050,000	968,702	(81,298)
Charges for service	261,000	261,000	174,208	(86,792)
Intergovernmental	5,892,596	5,892,596	6,179,131	286,535
Rent of property	380,000	433,332	493,515	60,183
Fines and forfeitures	5,000	5,000	194,131	189,131
Interest	375,000	375,000	595,543	220,543
Miscellaneous	280,000	1,048,366	1,064,752	16,386
Budget Carryover (1)	<u>                    </u>	<u>610,000</u>	<u>610,000</u>	<u>                    </u>
<b>Total revenues , and budget carryover</b>	<b><u>\$ 34,083,165</u></b>	<b><u>\$ 35,514,863</u></b>	<b><u>\$ 34,721,322</u></b>	<b><u>(\$ 793,541)</u></b>
<b>EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:</b>				
Current:				
General government	\$ 19,872,707	\$ 20,883,312	\$ 19,736,633	\$ 1,146,679
Public safety	2,988,792	3,196,429	2,535,653	660,776
Public works	8,694,958	8,844,106	8,534,797	309,309
Culture and recreation	415,823	450,130	444,154	5,976
Operating transfer to other fund	<u>2,110,885</u>	<u>2,140,886</u>	<u>2,054,368</u>	<u>86,518</u>
<b>Total expenditures, encumbrances and other financing uses</b>	<b><u>\$ 34,083,165</u></b>	<b><u>\$ 35,514,863</u></b>	<b><u>\$ 33,305,605</u></b>	<b><u>\$ 2,209,258</u></b>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)</b>				
	<u>                    </u>	<u>                    </u>	<b><u>\$ 1,415,717</u></b>	<b><u>\$ 1,415,717</u></b>
<b>Explanation of Differences:</b>				
<b>Sources/inflows of resources:</b>				
Actual amounts (budgetary basis)*available for appropriation* from the budgetary comparison schedule				\$34,721,322
Differences-budget to GAAP:				
Budget Carryover				(610,000)
Nonbudgeted revenues				<u>505,283</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<b><u>\$ 34,616,605</u></b>
<b>Uses/outflows of resources:</b>				
Actual amounts (budgetary basis)*total charges to appropriations* from the budgetary comparison schedule				\$ 33,305,605
Differences-budget to GAAP:				
Adjustment to expenditures Operational Loan				7,670,000
Adjustments to expenditures Law 52 proposal salaries expenses				521,340
Prior year encumbrances recorded as current year expenditures for GAAP basis				3,631,019
Current year encumbrances recorded as expenditures for budgetary basis				(890,255)
Operating transfer to other fund				<u>(2,054,368)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<b><u>\$ 42,183,341</u></b>

(1) Represents fund balances carried over from prior years

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO  
NOTES TO BUDGETARY COMPARISON SCHEDULE - GENERAL FUND  
YEAR ENDED JUNE 30, 2005**

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**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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**YEAR ENDED JUNE 30, 2005**

<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>
<b>U.S. DEPARTMENT OF AGRICULTURE:</b>			
Pass-through the Commonwealth of Puerto Rico Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	\$ 817,888
Pass-through the Commonwealth of Puerto Rico Governor Office for the Elderly Food Distribution:			
Nutrition Program for the Elderly	10.570	Not Available	<u>29,022</u>
<b>Total U.S. Department of Agriculture</b>			<u><b>846,910</b></u>
<b>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:</b>			
Direct Program:			
Community Development Block Grants/Entitlement Grants	14.218		5,862,688
Direct Program:			
Emergency Shelter Grants Program	14.231		97,344
Direct Program:			
HOME Investment Partnerships Program	14.239		495,783
Direct Program:			
Section 8 Housing Choice Voucher Program	14.871		<u>4,035,688</u>
<b>Total U.S. Department of Housing and Urban Development</b>			<u><b>10,491,503</b></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

<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>
<b>U.S DEPARTMENT OF JUSTICE:</b>			
Pass-through the Commonwealth Office of the Governor (CFWM): Rural Domestic Violence and Child Victimization Enforcement Grant Program	16.589	Not Available	177,724
Pass-through the Commonwealth of Puerto Rico - Local Department of Justice			
Local Law and Enforcement Block Grants	16.592	2001-IB-PMA-01	<u>8,409</u>
<b>Total U.S. Department of Justice</b>			<u><b>186,133</b></u>
<b>U.S. DEPARTMENT OF HOMELAND SECURITY:</b>			
Pass-through the Commonwealth of Puerto Rico Emergency Management Agency: Emergency Management Performance Grant	83.552	Not Available	10,746
Pass-through the Commonwealth of Puerto Rico Governor Authorized Representative (GAR): Public Assistance Grants	83.544	Not Available	57,137
Hazard Mitigation Grant	83.548	Not Available	<u>118</u>
<b>Total U.S. Department of Homeland Security</b>			<u><b>68,001</b></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

<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>
<b>U.S. DEPARTMENT OF EDUCATION</b>			
Pass-through the Commonwealth of Puerto Rico Department of Education: Even Start Family Literacy Program	84.213	Not Applicable	<u>98,888</u>
<b>Total U.S. Department of Education</b>			<u><b>98,888</b></u>
<b>U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:</b>			
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	88,915
Special Programs for Aging - Title III, Part C - Nutrition Services	93.045	Not Available	276,400
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ADFAN):			
Community Services Block Grant	93.569	Not Available 02-CH-0483-22-38	75,363
Head Start	93.600	02-CH-0483-22-39	9,602,226
Child Care and Development Block Grant	93.575	Not Available	<u>1,039,579</u>
<b>Total U.S. Department of Health and Human Services</b>			<u><b>11,082,483</b></u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<u><b>\$ 22,773,918</b></u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**YEAR ENDED JUNE 30, 2005**

**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	\$10,378,350	\$8,359,880	\$4,035,688	\$22,773,918
Non federal programs Expenditures	<u>522,000</u>	<u>435,400</u>	<u>547,915</u>	<u>1,505,315</u>
Total expenditures in the fund financial statements	<u>\$10,900,350</u>	<u>\$8,795,280</u>	<u>\$4,583,603</u>	<u>\$24,279,233</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 AUDITOR'S 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, 2005, and have issued our report thereon dated December 19, 2005, 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 05-01 through 05-03.

INDEPENDENT AUDITOR'S 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 none 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 19, 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  
December 19, 2005

Stamp No. 2106092 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 AUDITOR'S 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, 2005. The **Municipality of Arecibo's** major federal programs are identified in the summary of auditor's 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 AUDITOR'S 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, 2005. 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, **05-04** through **05-15**.

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.

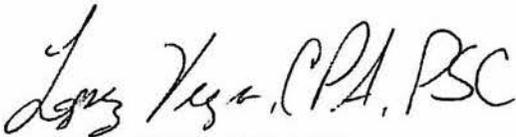
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance 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 **05-04** through **05-15**.



INDEPENDENT AUDITOR'S 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 05-04, 05-06, 05-08, 05-10, 05-13 through 05-15 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 February 14, 2006.

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



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico  
February 14, 2006

Stamp No. 2106093 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, 2005**

**Section I – Summary of Auditor’s Results**

**Financial Statements**

Type of auditor’s report issued: Unqualified, except for **adverse** for primary government financial statements

Internal control over financial reporting:  
 Material weakness identified? Yes No **X**  
 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 auditor’s 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 \$683,218

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, 2005

Section II – Financial Statements Findings

Finding Reference 05-01

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, 2005

**Section II – Financial Statements Findings**

**Finding Reference**      05-01 (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 concurs with the finding. The Finance Director will require annual audited financial statements to the “Corporación de Desarrollo Cultural Teatro Oliver”.

Responsible Person: Mr. José Ríos- Finance Director

Implementation date: June, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

Finding Reference	05-02
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"><li>a. Two (2) collections corresponding to Municipal Landfill account were deposited in the Municipal checking account and accounted in the general fund instead the Special Revenue Fund.</li><li>b. The Treasurer 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.</li><li>c. In fifteen (15) 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.</li></ul>
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, 2005

**Section II – Financial Statements Findings**

**Finding Reference**            05-02 (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. Also, an evaluation of office space and document control should be made to safeguard important documentation about daily transactions and taxpayer's files.

**Management Response  
And Corrective Action**

The Municipality concurs with the finding. The Municipality's Treasury Department relocated to another site where filing space its limited. Currently, the Department is working to establish updated taxpayers files with all current information and transfer inactive taxpayer's files to the Municipality's General Archives. Also, the Municipality will establish monitoring procedures over the Treasury Department so that every fund collected is deposited in the correct bank account.

Responsible Person: Mr. Carlos Aponte-Director Treasury Department

Implementation Date: March, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

<b>Finding Reference</b>	<b>05-03</b>
<b>Requirement</b>	<b>Expenditures for Goods and Services and Accounts Payables- Purchasing and receiving</b>
<b>Statement of Condition</b>	<p>We performed a cash disbursement test and examined twenty three (23) disbursement vouchers which belonged to CDBG Program, twenty five (25) which belonged to Child Care Development Grant, twelve (12) which belonged to Child Care Food Program, and twenty five (25) which belong to Section 8 Housing Voucher Program. The following will summarize the internal control exceptions noted:</p> <ul style="list-style-type: none"><li>a. In twenty two (22) cases the Purchase Order was issued after receipt of goods and services.</li><li>b. Ten (10) documents within the disbursement vouchers were not marked as paid.</li><li>c. Fifty six (56) disbursement vouchers did not include all required approvals before funds were disbursed.</li><li>d. Eight (8) disbursement vouchers (968851, 968815, 92392, 968892, 92308, 92351, 969183 and 92626) for a total amount of \$5,743 and one (1) cancelled check ( check number 92057 for \$335 ) from Section 8 Housing Voucher Program were not available for examination.</li></ul>
<b>Criteria</b>	<p>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.</p>
<b>Cause of Condition</b>	<p>The Municipality's internal control failed to assure that all documents supporting disbursement of funds are approved before disbursement of funds.</p>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

**Section II – Financial Statements Findings**

<b>Finding Reference</b>	05-03 (Continued)
<b>Effect of Condition</b>	The Municipality is not in compliance with Chapter Four (4) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.
<b>Recommendation</b>	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.
<b>Questioned Costs</b>	None
<b>Management Response And Corrective Action</b>	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. José Ríos, Director Finance Department

Implementation date: March, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-04
Program	Child and Adult Care Food Program (CFDA. No. 10.558); U.S. Department of Agriculture; Pass through State – Commonwealth of Puerto Rico Department of Education.
Requirement	Eligibility
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 two (2) cases, the participants are not included in the client prepared list classifying them as free, reduced price and fully paid meal. We could not determine if they were properly classified.
Criteria	7 CFR Sections 226.17 (b)(7), 226.19 (b)(8)(i), and 226.19a (b)(8) states that to be eligible for Federal reimbursement, institutions must determine each enrolled participant's eligibility for free and reduced price meals in order to claim reimbursement for the meals served to that individual at the correct rate.
Cause of Condition	The Municipality did not maintain adequate controls to assure that each enrolled participant eligibility determination as free or reduced price meals was properly documented according to Federal Regulations.
Effect of Condition	The Municipality is not in compliance with 7 CFR Sections 226.17 (b)(7), 226.19 (b)(8)(i), and 226.19a (b)(8).
Recommendation	We recommend that the Municipality should implement controls and procedures in order to assure that each participant is subjected to an annual eligibility test to determine its classification as free, reduced or fully paid meal.
Questioned Cost	None
Management Response And Corrective Action	The Municipality concurs with the finding. The program established a monitoring process to assure the inclusion of all participants in the correct classification.  Responsible Person: Mrs. Zaida Santiago-Family Liaison Coordinator, and Mrs. Lilliam Feliciano – Nutrition Coordinator.

Implementation date: August, 2005

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Federal Award Findings and Questioned Costs

<b>Finding Reference</b>	05-05
<b>Program</b>	Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development
<b>Requirement</b>	Cash Management
<b>Statement of Condition</b>	During our audit procedures we examined a sample of twenty five (25) fund requisitions and identified three (3) cases in which the program did not pay its obligations in the time required by Federal Regulations.
<b>Criteria</b>	OMB Common Rules, Subpart C, Section 85.20 (b) (7), requires a cash management system; in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by the grantee.
<b>Cause of Condition</b>	The Federal Program Department did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs.
<b>Effect of Condition</b>	The Municipality did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).
<b>Recommendation</b>	We recommend that management should strengthen it's procedures to minimize the time elapsed between the transfer of funds from the federal agency and the disbursements made by the Municipality.
<b>Questioned Costs</b>	None
<b>Management Response And Corrective Action</b>	<p>The Municipality concurs with the finding. Mr. Luis Corchado is the Accounting Section Coordinator for the CDBG Program. He is responsible to monitor that the petition of CDBG funds is made in a timely manner in order to expend the funds in a period of five days as the most. The Accounting Coordinator will pursue compliance of the 5 day rule for the timely expenditure of the funds requested.</p> <p>Responsible Person: Mr. Luis Corchado, Accounting Section Coordinator for CDBG Program.</p> <p>Implementation date: July, 2006</p>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-06
Program	Community Development Block Grant-Entitlement Program (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Davis-Bacon Act
Statement of Condition	<p>During our Davis-Bacon Act test for a sample of five (5) construction contracts, we noted the following situations:</p> <ul style="list-style-type: none"><li>a. In one (1) case there is no evidence that contractor's and subcontractor's laborers interviews were made periodically.</li><li>b. In one (1) case the weekly payroll reports are not signed by the contractor's responsible official.</li><li>c. In three (3) cases the file did not include evidence that all weekly payroll reports were submitted. The Municipality sends written notifications to the contractors to comply with the submittal of certified weekly payrolls, but as of the date of our examination payrolls have not been submitted.</li></ul>
Criteria	Davis-Bacon Act, as amended (40 USC 276A-276A-5), Subpart K, 24 CFR 570.603.
Cause of Condition	The Municipality did not apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended (40 USC 276A-276A-5), Subpart K, 24, CFR 570.603.
Recommendation	We recommend management to follow monitoring system procedures developed, including interviewing contractor's and subcontractor's laborers periodically (up to ten percent (10%) of the workers on long term projects) to establish the degree of compliance and the nature and extend of violations, if any. Also, management should strengthen its control procedures to assure that contractors submit certified weekly payrolls on a timely manner.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-06 (Continued)
Program	Community Development Block Grant-Entitlement Program (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Davis-Bacon Act
Questioned Costs	None
Management Response And Corrective Action	<p>The Municipality concurs with the finding. Mr. Fernando Seda is the EEO Officer that will be responsible to review the contractor's and subcontractor's laborers interviews, the proper verification of weekly payroll reports and timely submission of the weekly payroll reports.</p> <p>Mr. Seda will be responsible to follow monitoring system procedures developed by management, 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. Mr. Seda would strengthen its control procedures to assure that contractors submit certified weekly payrolls on a timely manner.</p> <p>Responsible Person: Mr. Fernando Seda, Equal Employment Opportunity Officer (EEO)</p> <p>Implementation date: March, 2006</p>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-07
Program	Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Special Test and Provisions- Housing Rehabilitation
Statement of Condition	<p>During our Housing Rehabilitation test we noted the following exceptions:</p> <ul style="list-style-type: none"><li>a. The participant's files do not include a contract of participation between the Municipality and the participant.</li><li>b. Form DM-REH-05A, Description of Actual Condition of Housing Unit Structure, was not duly completed.</li><li>c. In seven (7) participant files Form DM-REH-05B, Initial Evaluation of Housing Unit, was not duly completed. Also, in one (1) file there is no evidence of such Form.</li><li>d. In one (1) participant file, initial inspection documents do not indicate the deficiencies to be corrected.</li><li>e. In seven (7) participant files, Final Determination Form, was not signed by all members of the Committee in charge of approving the donation.</li><li>f. In one (1) case, funds were used to construct a new housing unit out of the original footprint of the dwelling. The CDBG Action Plan 2004-2005 in its Housing Reconstruction Program states that this assistance will be used to rebuild the substandard housing unit into a sound, safe and sanitary dwelling bringing up the quality of life into the family dwelling. No evidence of Governmental Agencies approval of structure construction, sanitary and electrical permits were found.</li></ul>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-07 (Continued)
Program	Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Special Test and Provisions- Housing Rehabilitation
Criteria	24 CFR, Section 570.506, states that when CDBG-Entitlement Grants funds are used for rehabilitation, the grantee must assure that the work is properly completed and appropriate documentation is maintained. Also, CFR 24, Section 91.220 and 570.301, states that all activities that a grantee undertakes during their CDBG program year must be identified in an Action Plan or in an amended Action Plan. 2004-2005 Action Plan, in its Housing Reconstruction Program part states that the reconstruction of the unit will be done over the original footprint of the dwelling providing for compliance of the regulated setbacks for residential properties: no less than three (3) meters from the front setback, three (3) meters each for lateral setbacks, at least three (3) meters on one lateral setback and three (3) meters for the back setback. The rebuilt unit will comply with the property standards adopted for the HOME Program in order to establish the minimum criteria for sound, safe and sanitary housing. All units will have running hot water at the kitchen and the bathroom and wastewater will be discharged into the sanitary sewer provided by the Puerto Rico Water and Sewer Authority.
Cause of Condition	The program developed activities that are not included in the program year Action Plan. Also, the program has not established adequate internal control procedures to assure that rehabilitations are duly completed as required by regulation and appropriate documentation is maintained
Effect of Condition	The Municipality is not in compliance with 24 CFR, Section 91.220 and 570.301, and 24 CFR, Section 570.506.
Recommendation	We recommend the Program to establish the following procedures: <ol style="list-style-type: none"><li>a. Ascertain that the deficiencies to be corrected and approved amounts are incorporated into the rehabilitation contract.</li><li>b. Assign a staff to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contract specifications.</li></ol>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference 05-07 (Continued)

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

Requirement Special Test and Provisions- Housing Rehabilitation

c. Assure that all participant files include all required documentation duly approved and certified.

d. Ascertain that the projects developed are included in the program Action Plan or in an amendment to such Plan

Questioned Costs \$39,900

Management Response  
And Corrective Action

The Municipality concurs with the finding. Currently, the Municipal Development Department is reviewing the Housing Rehabilitation Program in order to re-engineer it as a much easier program to manage.

Mr. Guillermo Ruiz, the Housing Rehabilitation Coordinator will be responsible to monitor program compliance and to follow the requirements established in the plan.

Management will not contest the question cost and will proceed to the restitution to the letter of credit.

Responsible Person: Mr. Guillermo Ruíz, Housing Rehabilitation Coordinator.

Implementation date: July, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference      05-08

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

Requirement            Allowable Cost and Cost Principles

Statement of Condition Section II – Financial Statements Findings- Finding Reference 05-03.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-09
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	<p>We observed that the program determined in the preliminary closing report an underpayment due of \$54,020. The program reports in the closing report \$4,011,425 as annual contribution due for year, exceeding the total partial payments approved by HUD of \$3,957,405. 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.</p> <p>As of June 30, 2005, the cash balance in books was \$475,253.24; the program preliminary closing reports detail an operation reserve of \$494,226.29, exceeding the total cash in books by \$18,973.05.</p>
Criteria	<p>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.</p> <p>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.</p>
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, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-09 (Continued)

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

Requirement Standards for Financial Management Systems

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 \$54,020 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

The Municipality concurs with the finding. 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, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-10
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, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-10 (Continued)

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

Management Response  
And corrective action

The Municipality concurs with the finding. The Housing Department will implement an automated waiting list in order to minimize the human factor involve in the administration of the waiting list. This project is in the planning stage.

In the meantime, a manual register along with a spreadsheet register will be kept as parallel systems in order to double check the administration of the waiting list. The spreadsheet will allow data analysis on the entries and results made in the waiting list.

The proposed corrective action concurs with the plan established for SEMAP Indicator Num. 1.

Responsible Person: Cybelle Arce Rodríguez-Housing Director

Implementation date: April 1<sup>st</sup>. 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-11
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"><li>a. The determination of reasonable rent (Reasonable Rent Certification) was not duly documented in ten (10) participant files examined. The certification did not include adequate information of comparable units (unit address, contact person, etc.).</li><li>b. One (1) participant file did not include a determination of Reasonable Rent (Reasonable Rent Certification) although rent to owner was increased.</li></ul>
Criteria	Code of Federal Regulations 24, Sections 982.54 (d) (15), 982.158 (f) (7) and 982.507 states that the PHA must determine reasonable rent at the time of the initial leasing and before any increase in the rent to the owner and all the times during the assisted tenancy, the rent to owner may not exceed the reasonable rent as most recently determined or re-determined by the PHA. In addition, the PHA must maintain records to document the basis for the determination that the rent paid to the owner is reasonable.
Cause of Condition	The Federal Program Department did not maintain adequate documentation to support the basis for the determination that the rent paid to the owner was reasonable.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-11 (Continued)
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Reasonable Rent
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 its 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 Municipality concurs with the finding. The Housing Director in coordination with the program consultant will provide technical assistance on rent reasonability to the housing inspectors in order to refresh the data needed to be collected for rent reasonability. The data will be entered in an electronic format in order to analyze it by census tract. The proposed corrective action concurs with the plan established for SEMAP Indicator Num. 2.

Responsible Person: Cybelle Arce Rodríguez-Housing Director

Implementation date: Technical assistance for rent reasonability is schedule for Monday, April 3, 2006.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-12

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. We found four (4) inspections in noncompliance for electrical, plumbing and kitchen repairs. The corrections were not realized within the time established by the PHA inspectors (from fifteen (15) to thirty (30) calendar days or thereafter). The Municipality did not stop (abate) the Housing Assistance Payment.
- b. We found three (3) inspections in noncompliance in which the PHA unit inspection report (HUD-52580) did not detailed the repairs to be made, the responsibility of making the repairs and the time given to complete them. In each case a follow up report was made and found that the units passed the inspections. Also in one (1) case, unit inspection report (HUD-52580) states that for housing units built before 1978 a Lead Warning Statement, stating a Lessor disclosure and a lessee acknowledgement of the situation is necessary. We found that the disclosure was not completed only the lessee signature was documented.

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, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-12 (Continued)

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

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 its 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 Municipality concurs with the finding. The Housing Director in coordination with the program consultant will provide technical assistance on housing quality standards inspection and enforcement. The data will be reconciled with the reports printed from UIV. The proposed corrective action concurs with the plan established for SEMAP Indicator Num. 6 and Num. 12.

Responsible Person: Cybelle Arce Rodríguez-Housing Director

Implementation date: Technical assistance for HQS standards is schedule for Friday, April 14, 2006 and Timely HQS inspection for Monday, May 1st. 2006.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-13
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:  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 \$110,061.  c. During three (3) 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 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, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference      05- 13 (Continued)

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

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. Arlyn Serpa – Program Coordinator

Implementation date: July, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	<b>05-14</b>
<b>Program</b>	<b>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</b>
<b>Requirement</b>	<b>Reporting</b>
<b>Statement of Condition</b>	During our reporting test we could not trace the amounts presented in Financial Reports (Monthly Reports and Annual Closing Report) to the accounting records.
<b>Criteria</b>	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.
<b>Cause of Condition</b>	The Municipality internal control failed to assure that the financial and programmatic reports were prepared according to Federal and State Regulations.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1), provisions regarding financial reporting.
<b>Recommendation</b>	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.
<b>Questioned Cost</b>	None
<b>Management Response And Corrective Action</b>	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: July, 2006

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-15
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 \$59,392.  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. María Torres – Program Accountant  Implementation date : July, 2005

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-05	14.871	<p><u>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.</u></p> <p><u>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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 05-09.</p>
04-06	14.871	<p><u>Management should give instructions to program staff to assure all participants HAP are calculated using actualized fair market rent tables to establish the payment standard</u></p> <p>Corrective action was taken.</p>
04-07	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>Corrective action was taken.</p>
04-08	14.871	<p><u>Management should strengthen its monitoring system in order to document information regarding performance indicators and preparation of form HUD-52648 properly signed by the responsible official.</u></p> <p>Corrective action was taken.</p>
04-09	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</u></p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>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 05-10.</p>
04-10	14.871	<p><u>Management should improve its 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 05-11.</p>
04-11	14.871	<p><u>Management should improve its 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 05-12.</p>
04-12	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 05-13.</p>
04-13	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>Corrective action has been taken.</p>
04-14	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</u></p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>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> <p>No Corrective Action was Taken. The auditors reissued the finding in the current year. See Finding Reference 05-14.</p>
04-15	93.600	<p><u>The Municipality 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 05-15.</p>
04-16	93.600	<p><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></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 from third parties and the actualized fair market rent tables to establish the payment standard.</u></p> <p>Corrective action has been taken.</p>
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>Corrective action has been taken.</p>
03-12	14.871	<p><u>Management should follow admission procedures established in the administrative plan. Also, we recommend the management to</u></p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>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 05-10.</p>
03-13	14.871	<p><u>Management should improve its 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 05-11.</p>
03-14	14.871	<p><u>Management should improve its 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 05-12.</p>
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 05-13.</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>Corrective action has been taken.</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</u></p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>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> <p>No corrective Action was Taken. The auditors reissued the finding in the current year. See Finding Reference 05-14.</p>
03-20	93.600	<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 05-15.</p>
03-21	93.600	<p><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></p> <p>Corrective action was taken.</p>
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, 2006.</p>
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>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		Audit finding is no longer valid since has passed more than two (2) 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.
02-18	14.871	<u>The Municipality should establish monitoring procedures to assure that Housing Assistance Payments are duly computed as required by the Federal Regulations.</u>  Audit finding is no longer valid since has passed more than two (2) 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.
02-19	14.871	<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>  Audit finding is no longer valid since has passed more than two (2) 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.
02-21	14.871	<u>The Municipality should establish adequate monitoring procedures in order to assure the program compliance with federal regulations.</u>  Audit finding is no longer valid since has passed more than two (2) 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.
02-23	14.871	<u>The Municipality should follow admission procedures established in</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>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>Audit finding is no longer valid since has passed more than two (2) 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.</p>
02-24	14.871	<p><u>The Municipality should establish controls to assure that appropriate documentation of the determination of reasonable rent is maintained in participant's files.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) 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.</p>
02-26	14.871	<p><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></p> <p>Audit finding is no longer valid since has passed more than two (2) 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.</p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARECIBO**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**YEAR ENDED JUNE 30, 2005**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
02-27	93.600	<p><u>The Municipality should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) 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.</p>
02-28	93.600	<p><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></p> <p>Audit finding is no longer valid since has passed more than two (2) 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.</p>