

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

MUNICIPIO DE ARROYO
AUDITORIA 2000-01
30 DE JUNIO DE 2001

OFIC. DEL COMISIONADO
DE ASUNTOS MUNICIPALES

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
REPORT ON GENERAL PURPOSE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2001

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARROYO

YEAR ENDED JUNE 30, 2001

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying general-purpose financial statements of the **Municipality of Arroyo**, as of and for the year ended June 30, 2001, as listed in the table of contents. These general purpose financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit. We did not audit the financial statements of Brisas de Arroyo Housing Project no. 66-006-69066021, a blended component unit, which statements reflect total assets of \$2,721,790 (net of fixed assets accumulated depreciation) as of June 30, 2001, and total revenues of \$514,006 for the year ended. Those statements were audited by other auditor whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included in the Special Revenue Fund, General Fixed Assets and General Long-Term Debt Accounts Groups for the Villas de Arroyo Housing Project, is based solely on the report of the other auditor.

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

As described in **Note 8**, the Municipality has not maintained complete and adequate records of its general fixed assets and, accordingly, we were unable to obtain sufficient competent evidential matter with respect to the reported value of the Municipality's general fixed assets and account group at June 30, 2001.

As indicated in **Note 13**, at June 30, 2001, the Municipality had not updated the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated the obligation for landfill closure and post closure care costs. Governmental Accounting Standard Board Statement 18 requires, among other things, the Municipality to estimate and recognize the Municipal Solid Waste Landfill Closure and Post closure Care Costs.

INDEPENDENT AUDITORS' REPORT (Continued)

In our opinion, based on our audit and the report of other auditor, except for the effect of such adjustments, if any, as might have been determined to be necessary had we been able to audit the general fixed assets account group, and the transactions disclosed in the preceding paragraph related to landfill closure and post-closure costs, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the **Municipality of Arroyo** as of June 30, 2001, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 21, 2001

Stamp No. 1700912 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
COMBINED BALANCE SHEET
ALL GOVERNMENTAL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2001**

	GOVERNMENTAL FUND TYPES				ACCOUNT GROUPS		TOTALS (MEMORANDUM ONLY)
	General	Special Revenue	Debt Service	Capital Projects	General Fixed Assets	General Long-term Debt	
ASSETS AND OTHER DEBITS							
Cash and cash equivalents		\$1,709,278		\$173,854			\$1,883,132
Cash with fiscal agent	\$250,012		\$761,515				1,011,527
Intergovernmental receivables	22,042						22,042
Municipal license taxes receivable	2,784						2,784
Federal grants receivable		316,400					316,400
Due from other funds	100,538	2,210,419		957,635			3,268,592
Other receivables	750	2,935					3,685
Other assets		5,485					5,485
Property and equipment					\$14,808,977		14,808,977
Amount available in Debt Service Fund						\$761,515	761,515
Amount to be provided for retirement of general long-term debt						6,404,868	6,404,868
Total assets and other debits	\$376,126	\$4,244,517	\$761,515	\$1,131,489	\$14,808,977	\$7,166,383	\$28,489,007
LIABILITIES AND FUND EQUITY							
Liabilities:							
Accounts payable and accrued liabilities	\$208,975	\$370,676		\$28,000			\$607,651
Due to other funds	3,168,054	100,538					3,268,592
Due to other governmental entities	438,637				\$2,693,576		3,132,213
Deferred municipal license tax revenues	229,370						229,370
Deferred - other	10,167						10,167
Deferred federal grant revenues		247,554					247,554
Claims and judgments						22,000	22,000
General obligation bonds						1,164,000	1,164,000
Notes payable						2,645,936	2,645,936
Accrued compensated absences						640,871	640,871
Total liabilities	4,055,203	718,768		28,000		7,166,383	11,968,354
Fund equity:							
Investment in general fixed assets					14,808,977		14,808,977
Fund balances:							
Reserved for encumbrances	113,637						113,637
Reserved for debt service			761,515				761,515
Unreserved:							
Designated for specific fund purposes	250,012	3,525,749		1,103,489			4,879,250
Undesignated	(4,042,726)						(4,042,726)
Total fund equity	(3,679,077)	3,525,749	761,515	1,103,489	14,808,977		16,520,653
Total liabilities and fund equity	\$376,126	\$4,244,517	\$761,515	\$1,131,489	\$14,808,977	\$7,166,383	\$28,489,007

See accompanying notes to general purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
COMBINED STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
ALL GOVERNMENTAL FUND TYPES
YEAR ENDED JUNE 30, 2001**

	GOVERNMENTAL FUND TYPES				TOTALS (MEMORANDUM ONLY)
	General	Special Revenue	Debt Service	Capital Projects	
REVENUES					
Property taxes	\$1,007,376		\$395,619		\$1,402,995
Municipal license taxes	286,964				286,964
Licenses and permits	264,370				264,370
Intergovernmental	3,464,247	\$1,303,810		\$1,529,402	6,297,459
Rent of property	59,515	514,006			573,521
Fines and penalties	3,865				3,865
Interest	84,062				84,062
Federal grants		4,228,242			4,228,242
Miscellaneous	248,884				248,884
Total revenues	<u>5,419,283</u>	<u>6,046,058</u>	<u>395,619</u>	<u>1,529,402</u>	<u>13,390,362</u>
EXPENDITURES					
Current:					
Mayor and Municipal Assembly	1,018,383				1,018,383
General government	1,428,784	208,872			1,637,656
Public safety	945,508	12,721			958,229
Public works	1,435,178	519,431			1,954,609
Public health and sanitation	584,243				584,243
Welfare	682	2,944,310			2,944,992
Economic development	4,739				4,739
Recreation	271,252				271,252
Principal retirement	30,000	18,356	257,000		305,356
Interest	15,994	160,288	86,542		262,824
Capital outlays	<u>25,950</u>	<u>2,291,647</u>		<u>2,183,016</u>	<u>4,500,613</u>
Total expenditures	<u>5,760,713</u>	<u>6,155,625</u>	<u>343,542</u>	<u>2,183,016</u>	<u>14,442,896</u>
Excess (deficiency) of revenues over (under) expenditures	(341,430)	(109,567)	52,077	(653,614)	(1,052,534)
Fund balances (deficit) beginning, as restated	* (3,337,647)	3,635,316	709,438	1,757,103	2,764,210
Fund balances (deficit), ending	<u>(\$3,679,077)</u>	<u>3,525,749</u>	<u>\$761,515</u>	<u>\$1,103,489</u>	<u>\$1,711,676</u>

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
COMBINED STATEMENT OF REVENUES, EXPENDITURES, ENCUMBRANCES,
AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
GENERAL AND DEBT SERVICE FUNDS
YEAR ENDED JUNE 30, 2001**

	<u>GENERAL FUND</u>			<u>DEBT SERVICE FUND</u>		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES						
Property taxes	\$960,741	\$960,741	-	\$264,860	\$395,619	\$130,759
Municipal license taxes	225,100	286,964	\$61,864			
Licenses and permits	167,000	264,370	97,370			
Intergovernmental	4,511,407	3,464,247	(1,047,160)			
Rent of property	103,720	59,515	(44,205)			
Fines and penalties	3,000	3,865	865			
Interest	60,000	84,062	24,062			
Miscellaneous	282,000	248,884	(33,116)			
Total revenues	<u>6,312,968</u>	<u>5,372,648</u>	<u>(940,320)</u>	<u>264,860</u>	<u>395,619</u>	<u>130,759</u>
EXPENDITURES AND ENCUMBRANCES:						
Current:						
Mayor and Municipal Assembly	1,167,154	1,035,743	131,411			
General government	1,478,745	1,443,328	35,417			
Public safety	1,068,697	948,112	120,585			
Public works	1,591,978	1,455,870	136,108			
Public health and sanitation	627,426	584,243	43,183			
Economic development	4,000	775	3,225			
Recreation	275,550	272,022	3,528			
Miscellaneous	5,000	4,980	20			
Capital outlays	45,718	32,029	13,689			
Debt service:						
Principal retirement	30,000	30,000		236,900	257,000	(20,100)
Interest	18,700	15,994	2,706	27,960	86,542	(58,582)
Total expenditures and encumbrances	<u>6,312,968</u>	<u>5,823,096</u>	<u>489,872</u>	<u>264,860</u>	<u>343,542</u>	<u>(78,682)</u>
Excess (deficiency) of revenues over (under) expenditures and encumbrances		(450,448)	(450,448)		52,077	52,077
ADJUSTMENTS TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES:						
Net change in encumbrances		62,383				
GAAP adjustments to revenues		46,635				
Fund balances (deficit) beginning, as restated		<u>(3,337,647)</u>			<u>709,438</u>	
Fund balances (deficit), ending		<u><u>(\$3,679,077)</u></u>			<u><u>\$761,515</u></u>	

See accompanying notes to general purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2001

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The **Municipality of Arroyo** (the Municipality) was established in 1855. The Municipality's governmental system consists of an executive and a legislative body. It is governed by a Mayor and a twelve member Municipal Assembly who are elected every four years through the Puerto Rico general elections.

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

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

A. Financial reporting entity:

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of *Statement No. 14* of the Governmental Accounting Standards Board. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary government appoints a voting majority of the entity's governing body and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is the nature and significance of the relationship between the entity and a primary government is such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, the financial statements of Brisas de Arroyo Housing Project no. 63-006-69066021 were included in the general-purpose financial statements as a blended component unit.

Blended Component Unit: Brisas de Arroyo Housing Project is a housing development consisting of one hundred four (104) dwelling units located in Arroyo. The Project is owned by the Municipality, but the activities on it are carried-on by a management agent unrelated to the Municipality. The housing development is designated to assist various segments of the general public in obtaining adequate and reasonable priced rental housing.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

A. Financial reporting entity (continued):

The Project operates under financing from US Department of Agriculture Section 515 Rural Rental Housing Loans Program, and with a Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with US Housing and Urban Development. For financial reporting purposes, the Housing Project is reported as if it were part of the Municipality's operations because its purpose is to provide low-income housing to citizens of the Municipality. The Financial Statements of the blended component unit can be obtained directly from the management agent office, P.O. Box 7759, Ponce, PR 00732-7759.

B. Basis of presentation:

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

Governmental fund types:

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

B. Basis of presentation (continued):

Account groups:

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

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

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

C. Basis of accounting:

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

D. Reservations of fund balance:

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

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

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

E. Budgetary data:

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

- Prior to May 31, the Major submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1. The proposed budget includes estimated expenditures and the means of financing them.
- The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- Prior to July 1, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget. Adjustments made during the year are reflected in the budget information included in the general-purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

E. Budgetary data (continued):

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

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

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

F. Inventories:

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

G. Property and equipment:

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

H. Cash and cash equivalents:

The Municipality's Director of Finance is responsible for investing available resources and is restricted by law to invest only in saving accounts and certificates of deposit with banks qualified as depositories of public funds by the Department of the Treasury of the Commonwealth of Puerto Rico. The Municipality maintains a cash and investment pool that is available for use by all funds. Each fund type's portion of this pool is displayed on the combined balance sheet as "Cash and Cash Equivalents". All cash in banks at June 30, 2001 is insured by the Federal Deposit Insurance Corporation up to \$100,000, and by collateral held by the Treasury Department to its name. Interest earned from certificates of deposit and other short-term investments is recorded as revenue in the General Fund. Cash and Cash Equivalents include investments with original maturities of ninety days or less.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenue Collection Center and Government Development Bank of the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, unused proceeds from bonds and notes issued for the acquisition or construction of permanent improvements and Federal grants resources.

I. Interfund transactions:

The Municipality has the following types of transactions among funds:

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

J. Compensated absences:

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

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

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

In accordance with the above criteria and requirements as established by *GASB Number 16*, the Municipality has accrued a liability for compensated absences, which has been earned but not taken by municipal employees. This liability is presented in the general long-term debt account group because they will not be funded with available expendable financial resources at June 30, 2001.

K. Insurance:

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

L. Total columns (memorandum only):

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

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

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

N. Claims and judgments:

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

2. DUE TO OTHER GOVERNMENTAL ENTITIES:

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

Internal Revenue Services (FICA tax)	\$ 20,885
Retirement System	71,868
Puerto Rico Aqueduct and Sewer Authority	64,493
General Services Administration	12,621
Puerto Rico Telephone Company	13,646
Treasury Department	86,916
Department of Labor	23,019
Puerto Rico Electric Power Authority	145,189
	<hr/>
Total	\$ 438,637

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

2. DUE TO OTHER GOVERNMENTAL ENTITIES (CONTINUED):

The Municipality reached agreements with other governmental entities for the payment of debts on a long- term basis. These liabilities are presented in the General Long- term Debt Account Group because they will not be funded with available expendable financial resources at June 30, 2001. The following is the balance of these accounts:

Department of Labor	\$ 58,915
CRIM	2,634,661
Total	<u>\$ 2,693,576</u>

3. PROPERTY TAXES:

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

Tax rates are 8.08% for real property and 6.08% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico. The Municipality's share is composed of the basic tax of 5.8% for real property and 3.8% for personal property, which is recorded in the General Fund, and the additional tax of 1.25% in both cases, which is restricted for debt service and retained by the CRIM for such purposes. To the extent that such taxes are informed and collected by the CRIM, they are recorded as revenue in the General Fund and in the Debt Service Fund.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

3. PROPERTY TAXES (CONTINUED):

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000.

The CRIM advances to the municipality the estimated property tax collection for each fiscal year. Advances are repaid through actual collections from the taxpayers. The CRIM periodically informs the Municipality of the amounts collected and applied to outstanding advances. The property tax advanced by the CRIM during the year is recorded as property taxes revenues in the Municipality's General Fund. During the current year the actual collections were more than advances by \$22,042. Such amount was included as an intergovernmental receivable in the General Fund.

4. MUNICIPAL LICENSE TAXES:

The municipal license tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality, and which are not totally or partially exempt from this tax under the Industrial Incentives Acts of Puerto Rico. All taxpayers are required to file their declaration by April 15, of each year.

The tax rates are as follows:

Financial institutions	1.00%
Savings and loans associations	1.00%
Other organizations	0.30%

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

5. INTERGOVERNMENTAL:

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

5. INTERGOVERNMENTAL (CONTINUED):

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

6. CASH AND CASH EQUIVALENTS:

Cash in bank accounts	\$ 1,548,667
Certificates of deposit (90 days or less)	<u>334,465</u>
 Total cash and cash equivalents	 <u>\$ 1,883,132</u>

7. DEBT SERVICE FUND:

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

8. GENERAL FIXED ASSETS:

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

Description	Balance July 1, 2000	Additions and adjustments	Retirements and adjustments	Balance June 30, 2001
Building and Improvements	\$8,941,658	-	-	\$8,941,658
Equipment	1,854,390	\$323,213	(\$1,200)	2,176,403
Brisas de Arroyo Housing	3,663,216	27,700	-	3,690,916
Total	<u>\$14,459,264</u>	<u>\$350,913</u>	<u>(\$1,200)</u>	<u>\$14,808,977</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

9. GENERAL OBLIGATION BONDS:

The general obligation bonds transactions for the year ended June 30, 2001 were as follows:

Balance at July 1, 2000	\$ 1,271,000
Debt issued	-
Principal retirements	(162,000)
Adjustments and/or Reclassifications	55,000
	<u>55,000</u>
Balance at June 30, 2001	<u>\$ 1,164,000</u>

General obligation bonds at June 30, 2001 are as follows:

Type of bonds	Maturity date	Original Amount	Range of Interest Rates	Balance at June 30, 2001
1981 Series	1-1-04	102,000	5.00%	\$ 15,000
1987 Series	7-1-02	630,000	8.20% to 9.00%	90,000
1997 Series	1-1-04	96,000	4.88%	45,000
1997 Series	1-1-02	110,000	4.50%	24,000
2000 Series	7-1-09	1,065,000	5.88% to 8.00%	990,000
				<u>990,000</u>
Total general obligation bonds				<u>\$ 1,164,000</u>

The future annual requirements for the amortization of general obligations bonds outstanding as of June 30, 2001, are as follows:

Year ended June 30	Total
2002	\$ 168,000
2003	150,000
2004	116,000
2005	100,000
2006	110,000
Thereafter	<u>520,000</u>
Total	<u>\$ 1,164,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

9. GENERAL OBLIGATION BONDS (CONTINUED):

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

10. NOTES PAYABLE:

The notes payable transactions for the year ended June 30, 2001 were as follows:

Balance at July 1, 2000	\$2,739,292
Debt issued	-
Payments during the current year	(143,356)
Adjustments and/or Reclassifications	50,000
Balance at June 30, 2001	<u>\$2,645,936</u>

Notes payable at June 30, 2001 are as follows:

<u>Description</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance June 30, 2001</u>
1987 Series	7-1-06	440,000	0.00% to 8.50%	\$ 220,000
Section 515 Loan	7-1-29	Not Available	7.00% to 9.00%	2,165,936
1999 Series	7-1-03	405,000	4.87% to 6.31%	<u>260,000</u>
Total notes payable				<u>\$ 2,645,936</u>

The future annual requirements for the amortization of notes payable outstanding as of June 30, 2001, are as follows:

<u>Year ended June 30</u>	<u>Total</u>
2002	\$ 133,794
2003	140,556
2004	157,449
2005	64,483
2006	71,670
Thereafter	<u>2,077,984</u>
Total	<u>\$ 2,645,936</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN:

Defined Benefit Pension Plan

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN (CONTINUED)

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

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

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

Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447 to establish, among other, a defined contribution saving plan program (the "Program") to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000 and former employees who participated in the defined benefit pension plan, received a refund of their contributions and are rehired on or after January 1, 2000 become members of the Program as a condition to their employment. In addition, employees who at December 14, 1999 were participants of the defined benefit pension plan, had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interest thereon to the Program.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN (CONTINUED):

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

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

Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2001 recorded as pension expenditures was approximately \$ 160,264. This amount represent 100% of the required contribution for the fiscal year ended June 30, 2001.

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN (CONTINUED):

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and nonvested is not readily available. Contributions in 2001 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by generally accepted accounting principles. An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

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

12. INTERFUND TRANSACTIONS:

Due from/to other funds

Interfund receivables and payables represent temporary loans between the funds.

Operating transfers

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

13. LANDFILL OBLIGATIONS:

The Municipality of Arroyo owns and operates a solid waste landfill. State and federal laws and regulations require the Municipality to place a final cover on its landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site after closure. At June 30, 2001, the Municipality has not prepared the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not prepared the estimated obligation for landfill closure and post closure costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

14. COMMITMENTS AND CONTINGENCIES:

A. Federal grants:

The Municipality participates in a number of Federal Financial Assistance Programs. These programs are subject to financial and compliance audits. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality expects such amounts, if any, not to be material.

B. Claims and lawsuits:

The Municipality is a defendant in legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigation, the Municipality has reported liabilities of \$22,000 in the general long-term debt account group for a final unfavorable judgment. The amount presented in the general long-term debt group of account represents the amount of determined as liability, which will require future available financial resources for its payment. The administration believes that the ultimate liability in excess of amounts provided would not be significant.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

15. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balances for General, Special Revenue, Debt Service and Capital Projects Funds, have been restated by accounting and financial statements presentation errors detected during the fiscal year that affect the Fund Equity section of those Governmental Funds, as follows:

Description	General	Special Revenue	Debt Service	Capital Projects
Beginning Fund Balances at July 1, 2000	(\$2,564,347)	\$2,138,010	\$719,507	\$2,691,744
To reestablish beginning cash overdraft as per analysis	(377,887)			
To correct due to other funds as per analysis	(43,407)			
To correct due to PREPA as per analysis	(108,644)			
To correct due to Treasury Department as per analysis	(69,424)			
General Fund classified as Special Revenue Fund	10,167	(10,167)		
Capital Project Fund classified as Special Revenue Fund		(530,769)		530,769
To correct due to other funds as per analysis		202,148		
To reestablish Cash as per analysis		(1,033,977)		1,368,549
To correct Account Receivables as per analysis				
To correct beginning balance as per analysis			(10,069)	
To correct Due To Other Funds as per analysis				36,112
To correct CWFA beginning balance as per analysis	(184,105)			
Special Revenue Fund Classified as Capital Project Fund		2,870,071		(2,870,071)
Beginning Fund Balances (Deficit) at July 1, 2000, as restate	<u>\$(3,337,647)</u>	<u>\$3,635,316</u>	<u>\$709,438</u>	<u>\$1,757,103</u>

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARROYO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2001

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARROYO

YEAR ENDED JUNE 30, 2001

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARROYO

YEAR ENDED JUNE 30, 2001

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying general-purpose financial statements of the **Municipality of Arroyo**, as of and for the year ended June 30, 2001, as listed in the table of contents. These general purpose financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit. We did not audit the financial statements of Brisas de Arroyo Housing Project no. 66-006-69066021, a blended component unit, which statements reflect total assets of \$2,721,790 (net of fixed assets accumulated depreciation) as of June 30, 2001, and total revenues of \$514,006 for the year ended. Those statements were audited by other auditor whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included in the Special Revenue Fund, General Fixed Assets and General Long-Term Debt Accounts Groups for the Villas de Arroyo Housing Project, is based solely on the report of the other auditor.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of the Office of Management and Budget Circular A-133, "*Audits of States, Local Governments, and Non-Profit Organizations*". Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the general-purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general-purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general-purpose financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in **Note 8**, the Municipality has not maintained complete and adequate records of its general fixed assets and, accordingly, we were unable to obtain sufficient competent evidential matter with respect to the reported value of the Municipality's general fixed assets and account group at June 30, 2001.

INDEPENDENT AUDITORS' REPORT (Continued)

As indicated in **Note 13**, at June 30, 2001, the Municipality had not updated the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated the obligation for landfill closure and post closure care costs. Governmental Accounting Standard Board Statement 18 requires, among other things, the Municipality to estimate and recognize the Municipal Solid Waste Landfill Closure and Post closure Care Costs.

In our opinion, based on our audit and the report of other auditor, except for the effect of such adjustments, if any, as might have been determined to be necessary had we been able to audit the general fixed assets account group, and the transactions disclosed in the preceding paragraph related to landfill closure and post-closure costs, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the **Municipality of Arroyo** as of June 30, 2001, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2002 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

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



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico

March 27, 2002

Stamp No. 1785257 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
COMBINED BALANCE SHEET
ALL GOVERNMENTAL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2001**

	GOVERNMENTAL FUND TYPES			ACCOUNT GROUPS		TOTALS (MEMORANDUM ONLY)
	General	Special Revenue	Debt Service	Capital Projects	General Fixed Assets	
ASSETS AND OTHER DEBITS						
Cash and cash equivalents		\$1,709,278		\$173,854		\$1,883,132
Cash with fiscal agent	\$250,012		\$761,515			1,011,527
Intergovernmental receivables	22,042					22,042
Municipal license taxes receivable	2,784					2,784
Federal grants receivable		316,400				316,400
Due from other funds	100,538	2,210,419		957,635		3,268,592
Other receivables	750	2,935				3,685
Other assets		5,485				5,485
Property and equipment					\$14,808,977	14,808,977
Amount available in Debt Service Fund						\$761,515
Amount to be provided for retirement of general long-term debt						6,404,868
Total assets and other debits	\$376,126	\$4,244,517	\$761,515	\$1,131,489	\$14,808,977	\$7,166,383
LIABILITIES AND FUND EQUITY						
Liabilities:						
Accounts payable and accrued liabilities	\$208,975	\$370,676		\$28,000		\$607,651
Due to other funds	3,168,054	100,538				3,268,592
Due to other governmental entities	438,637				\$2,693,576	3,132,213
Deferred municipal license tax revenues	229,370					229,370
Deferred - other	10,167					10,167
Deferred federal grant revenues		247,554				247,554
Claims and judgments					22,000	22,000
General obligation bonds					1,164,000	1,164,000
Notes payable					2,645,936	2,645,936
Accrued compensated absences					640,871	640,871
Total liabilities	4,055,203	718,768		28,000		7,166,383
Fund equity:						
Investment in general fixed assets					14,808,977	14,808,977
Fund balances:						
Reserved for encumbrances	113,637					113,637
Reserved for debt service			761,515			761,515
Unreserved:						
Designated for specific fund purposes	250,012	3,525,749		1,103,489		4,879,250
Undesignated	(4,042,726)					(4,042,726)
Total fund equity	(3,679,077)	3,525,749	761,515	1,103,489	14,808,977	16,520,653
Total liabilities and fund equity	\$376,126	\$4,244,517	\$761,515	\$1,131,489	\$14,808,977	\$7,166,383

See accompanying notes to general purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
COMBINED STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
ALL GOVERNMENTAL FUND TYPES
YEAR ENDED JUNE 30,2001**

	GOVERNMENTAL FUND TYPES				TOTALS (MEMORANDUM ONLY)
	General	Special Revenue	Debt Service	Capital Projects	
REVENUES					
Property taxes	\$1,007,376		\$395,619		\$1,402,995
Municipal license taxes	286,964				286,964
Licenses and permits	264,370				264,370
Intergovernmental	3,464,247	\$1,303,810		\$1,529,402	6,297,459
Rent of property	59,515	514,006			573,521
Fines and penalties	3,865				3,865
Interest	84,062				84,062
Federal grants		4,228,242			4,228,242
Miscellaneous	248,884				248,884
Total revenues	<u>5,419,283</u>	<u>6,046,058</u>	<u>395,619</u>	<u>1,529,402</u>	<u>13,390,362</u>
EXPENDITURES					
Current:					
Mayor and Municipal Assembly	1,018,383				1,018,383
General government	1,428,784	208,872			1,637,656
Public safety	945,508	12,721			958,229
Public works	1,435,178	519,431			1,954,609
Public health and sanitation	584,243				584,243
Welfare	682	2,944,310			2,944,992
Economic development	4,739				4,739
Recreation	271,252				271,252
Principal retirement	30,000	18,356	257,000		305,356
Interest	15,994	160,288	86,542		262,824
Capital outlays	25,950	2,291,647		2,183,016	4,500,613
Total expenditures	<u>5,760,713</u>	<u>6,155,625</u>	<u>343,542</u>	<u>2,183,016</u>	<u>14,442,896</u>
Excess (deficiency) of revenues over (under) expenditures	(341,430)	(109,567)	52,077	(653,614)	(1,052,534)
Fund balances (deficit) beginning, as restated	<u>(3,337,647)</u>	<u>3,635,316</u>	<u>709,438</u>	<u>1,757,103</u>	<u>2,764,210</u>
Fund balances (deficit), ending	<u>(\$3,679,077)</u>	<u>3,525,749</u>	<u>\$761,515</u>	<u>\$1,103,489</u>	<u>\$1,711,676</u>

See accompanying notes to general purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO
COMBINED STATEMENT OF REVENUES, EXPENDITURES, ENCUMBRANCES,
AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
GENERAL AND DEBT SERVICE FUNDS
YEAR ENDED JUNE 30, 2001**

	<u>GENERAL FUND</u>			<u>DEBT SERVICE FUND</u>		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES						
Property taxes	\$960,741	\$960,741	-	\$264,860	\$395,619	\$130,759
Municipal license taxes	225,100	286,964	\$61,864			
Licenses and permits	167,000	264,370	97,370			
Intergovernmental	4,511,407	3,464,247	(1,047,160)			
Rent of property	103,720	59,515	(44,205)			
Fines and penalties	3,000	3,865	865			
Interest	60,000	84,062	24,062			
Miscellaneous	282,000	248,884	(33,116)			
Total revenues	<u>6,312,968</u>	<u>5,372,648</u>	<u>(940,320)</u>	<u>264,860</u>	<u>395,619</u>	<u>130,759</u>
EXPENDITURES AND ENCUMBRANCES:						
Current:						
Mayor and Municipal Assembly	1,167,154	1,035,743	131,411			
General government	1,478,745	1,443,328	35,417			
Public safety	1,068,697	948,112	120,585			
Public works	1,591,978	1,455,870	136,108			
Public health and sanitation	627,426	584,243	43,183			
Economic development	4,000	775	3,225			
Recreation	275,550	272,022	3,528			
Miscellaneous	5,000	4,980	20			
Capital outlays	45,718	32,029	13,689			
Debt service:						
Principal retirement	30,000	30,000		236,900	257,000	(20,100)
Interest	18,700	15,994	2,706	27,960	86,542	(58,582)
Total expenditures and encumbrances	<u>6,312,968</u>	<u>5,823,096</u>	<u>489,872</u>	<u>264,860</u>	<u>343,542</u>	<u>(78,682)</u>
Excess (deficiency) of revenues over (under) expenditures and encumbrances		(450,448)	(450,448)		52,077	52,077
ADJUSTMENTS TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES:						
Net change in encumbrances		62,383				
GAAP adjustments to revenues		46,635				
Fund balances (deficit) beginning, as restated		(3,337,647)			709,438	
Fund balances (deficit), ending		<u>(3,679,077)</u>			<u>\$761,515</u>	

See accompanying notes to general purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2001

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The **Municipality of Arroyo** (the Municipality) was established in 1855. The Municipality's governmental system consists of an executive and a legislative body. It is governed by a Mayor and a twelve member Municipal Assembly who are elected every four years through the Puerto Rico general elections.

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

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

A. Financial reporting entity:

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of *Statement No. 14* of the Governmental Accounting Standards Board. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary government appoints a voting majority of the entity's governing body and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is the nature and significance of the relationship between the entity and a primary government is such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, the financial statements of Brisas de Arroyo Housing Project no. 63-006-69066021 were included in the general-purpose financial statements as a blended component unit.

Blended Component Unit: Brisas de Arroyo Housing Project is a housing development consisting of one hundred four (104) dwelling units located in Arroyo. The Project is owned by the Municipality, but the activities on it are carried-on by a management agent unrelated to the Municipality. The housing development is designated to assist various segments of the general public in obtaining adequate and reasonable priced rental housing.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

A. Financial reporting entity (continued):

The Project operates under financing from US Department of Agriculture Section 515 Rural Rental Housing Loans Program, and with a Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with US Housing and Urban Development. For financial reporting purposes, the Housing Project is reported as if it were part of the Municipality's operations because its purpose is to provide low-income housing to citizens of the Municipality. The Financial Statements of the blended component unit can be obtained directly from the management agent office, P.O. Box 7759, Ponce, PR 00732-7759.

B. Basis of presentation:

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

Governmental fund types:

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

B. Basis of presentation (continued):

Account groups:

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

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

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

C. Basis of accounting:

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

D. Reservations of fund balance:

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

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

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

E. Budgetary data:

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

- Prior to May 31, the Major submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1. The proposed budget includes estimated expenditures and the means of financing them.
- The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- Prior to July 1, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget. Adjustments made during the year are reflected in the budget information included in the general-purpose financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

E. Budgetary data (continued):

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

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

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

F. Inventories:

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

G. Property and equipment:

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

H. Cash and cash equivalents:

The Municipality's Director of Finance is responsible for investing available resources and is restricted by law to invest only in saving accounts and certificates of deposit with banks qualified as depositories of public funds by the Department of the Treasury of the Commonwealth of Puerto Rico. The Municipality maintains a cash and investment pool that is available for use by all funds. Each fund type's portion of this pool is displayed on the combined balance sheet as "Cash and Cash Equivalents". All cash in banks at June 30, 2001 is insured by the Federal Deposit Insurance Corporation up to \$100,000, and by collateral held by the Treasury Department to its name. Interest earned from certificates of deposit and other short-term investments is recorded as revenue in the General Fund. Cash and Cash Equivalents include investments with original maturities of ninety days or less.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenue Collection Center and Government Development Bank of the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, unused proceeds from bonds and notes issued for the acquisition or construction of permanent improvements and Federal grants resources.

I. Interfund transactions:

The Municipality has the following types of transactions among funds:

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

J. Compensated absences:

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

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

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

In accordance with the above criteria and requirements as established by *GASB Number 16*, the Municipality has accrued a liability for compensated absences, which has been earned but not taken by municipal employees. This liability is presented in the general long-term debt account group because they will not be funded with available expendable financial resources at June 30, 2001.

K. Insurance:

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

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

L. Total columns (memorandum only):

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

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

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

N. Claims and judgments:

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

2. DUE TO OTHER GOVERNMENTAL ENTITIES:

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

Internal Revenue Services (FICA tax)	\$ 20,885
Retirement System Administration	71,868
Puerto Rico Aqueduct and Sewer Authority	64,493
General Services Administration	12,621
Puerto Rico Telephone Company	13,646
Treasury Department	86,916
Department of Labor	23,019
Puerto Rico Electric Power Authority	145,189
Total	<hr/> <u>\$ 438,637</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

2. DUE TO OTHER GOVERNMENTAL ENTITIES (CONTINUED):

The Municipality reached agreements with other governmental entities for the payment of debts on a long- term basis. These liabilities are presented in the General Long- term Debt Account Group because they will not be funded with available expendable financial resources at June 30, 2001. The following is the balance of these accounts:

Department of Labor	\$ 58,915
Municipal Revenue Collection Center	<u>2,634,661</u>
Total	<u>\$ 2,693,576</u>

3. PROPERTY TAXES:

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

Tax rates are 8.08% for real property and 6.08% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico. The Municipality's share is composed of the basic tax of 5.8% for real property and 3.8% for personal property, which is recorded in the General Fund, and the additional tax of 1.25% in both cases, which is restricted for debt service and retained by the CRIM for such purposes. To the extent that such taxes are informed and collected by the CRIM, they are recorded as revenue in the General Fund and in the Debt Service Fund.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

3. PROPERTY TAXES (CONTINUED):

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000.

The CRIM advances to the municipality the estimated property tax collection for each fiscal year. Advances are repaid through actual collections from the taxpayers. The CRIM periodically informs the Municipality of the amounts collected and applied to outstanding advances. The property tax advanced by the CRIM during the year is recorded as property taxes revenues in the Municipality's General Fund. During the current year the actual collections were more than advances by \$22,042. Such amount was included as an intergovernmental receivable in the General Fund.

4. MUNICIPAL LICENSE TAXES:

The municipal license tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality, and which are not totally or partially exempt from this tax under the Industrial Incentives Acts of Puerto Rico. All taxpayers are required to file their declaration by April 15, of each year.

The tax rates are as follows:

Financial institutions	1.00%
Savings and loans associations	1.00%
Other organizations	0.30%

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

5. INTERGOVERNMENTAL:

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

5. INTERGOVERNMENTAL (CONTINUED):

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

6. CASH AND CASH EQUIVALENTS:

Cash in bank accounts	\$ 1,548,667
Certificates of deposit (90 days or less)	<u>334,465</u>
 Total cash and cash equivalents	 <u>\$ 1,883,132</u>

7. DEBT SERVICE FUND:

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

8. GENERAL FIXED ASSETS:

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

Description	Balance July 1, 2000	Additions and adjustments	Retirements and adjustments	Balance June 30, 2001
Building and Improvements	\$8,941,658	-	-	\$8,941,658
Equipment	1,854,390	\$323,213	(\$1,200)	2,176,403
Brisas de Arroyo Housing	3,663,216	27,700	-	3,690,916
Total	<u>\$14,459,264</u>	<u>\$350,913</u>	<u>(\$1,200)</u>	<u>\$14,808,977</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

9. GENERAL OBLIGATION BONDS:

The general obligation bonds transactions for the year ended June 30, 2001 were as follows:

Balance at July 1, 2000	\$ 1,271,000
Debt issued	-
Principal retirements	(162,000)
Adjustments and/or Reclassifications	55,000
	\$ 1,164,000
Balance at June 30, 2001	\$ 1,164,000

General obligation bonds at June 30, 2001 are as follows:

Type of bonds	Maturity date	Original Amount	Range of Interest Rates	Balance at June 30, 2001
1981 Series	1-1-04	102,000	5.00%	\$ 15,000
1987 Series	7-1-02	630,000	8.20% to 9.00%	90,000
1997 Series	1-1-04	96,000	4.88%	45,000
1997 Series	1-1-02	110,000	4.50%	24,000
2000 Series	7-1-09	1,065,000	5.88% to 8.00%	990,000
				\$ 1,164,000
Total general obligation bonds				\$ 1,164,000

The future annual requirements for the amortization of general obligations bonds outstanding as of June 30, 2001, are as follows:

Year ended June 30	Total
2002	\$ 168,000
2003	150,000
2004	116,000
2005	100,000
2006	110,000
Thereafter	520,000
	\$ 1,164,000
Total	\$ 1,164,000

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

10. NOTES PAYABLE:

The notes payable transactions for the year ended June 30, 2001 were as follows:

Balance at July 1, 2000	\$2,739,292
Debt issued	-
Payments during the current year	(143,356)
Adjustments and/or Reclassifications	50,000
Balance at June 30, 2001	<u>\$2,645,936</u>

Notes payable at June 30, 2001 are as follows:

<u>Description</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance June 30, 2001</u>
1987 Series	7-1-06	440,000	0.00% to 8.50%	\$ 220,000
Section 515 Loan	7-1-29	Not Available	7.00% to 9.00%	2,165,936
1999 Series	7-1-03	405,000	4.87% to 6.31%	<u>260,000</u>
Total notes payable				<u>\$ 2,645,936</u>

The future annual requirements for the amortization of notes payable outstanding as of June 30, 2001, are as follows:

<u>Year ended June 30</u>	<u>Total</u>
2002	\$ 133,794
2003	140,556
2004	157,449
2005	64,483
2006	71,670
Thereafter	<u>2,077,984</u>
Total	<u>\$ 2,645,936</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN:

Defined Benefit Pension Plan

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN (CONTINUED)

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

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

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

Defined Contribution Plan

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447 to establish, among other, a defined contribution saving plan program (the "Program") to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000 and former employees who participated in the defined benefit pension plan, received a refund of their contributions and are rehired on or after January 1, 2000 become members of the Program as a condition to their employment. In addition, employees who at December 14, 1999 were participants of the defined benefit pension plan, had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interest thereon to the Program.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN (CONTINUED):

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

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

Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2001 recorded as pension expenditures was approximately \$ 160,264. This amount represent 100% of the required contribution for the fiscal year ended June 30, 2001.

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

11. RETIREMENT PLAN (CONTINUED):

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and nonvested is not readily available. Contributions in 2001 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by generally accepted accounting principles. An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

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

12. INTERFUND TRANSACTIONS:

Due from/to other funds

Interfund receivables and payables represent temporary loans between the funds.

Operating transfers

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

13. LANDFILL OBLIGATIONS:

The Municipality of Arroyo owns and operates a solid waste landfill. State and federal laws and regulations require the Municipality to place a final cover on its landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site after closure. At June 30, 2001, the Municipality has not prepared the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not prepared the estimated obligation for landfill closure and post closure costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

14. COMMITMENTS AND CONTINGENCIES:

A. Federal grants:

The Municipality participates in a number of Federal Financial Assistance Programs. These programs are subject to financial and compliance audits. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality expects such amounts, if any, not to be material.

B. Claims and lawsuits:

The Municipality is a defendant in legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigation, the Municipality has reported liabilities of \$22,000 in the general long-term debt account group for a final unfavorable judgment. The amount presented in the general long-term debt group of account represents the amount of determined as liability, which will require future available financial resources for its payment. The administration believes that the ultimate liability in excess of amounts provided would not be significant.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

15. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balances (Deficit) for General, Special Revenue, Debt Service and Capital Projects Funds, have been restated by accounting and financial statements presentation errors detected during the fiscal year that affect the Fund Equity section of those Governmental Funds, as follows:

Description	General	Special Revenue	Debt Service	Capital Projects
Beginning Fund Balances (Deficit) at July 1, 2000	(\$2,564,347)	\$2,138,010	\$719,507	\$2,691,744
To correct beginning cash overdraft as per our analysis	(377,887)			
To correct due to other funds as our per analysis	(43,407)			
To correct due to PREPA as per our analysis	(108,644)			
To correct due to Treasury Department as per our analysis	(69,424)			
General Fund classified as Special Revenue Fund	10,167	(10,167)		
Capital Project Fund classified as Special Revenue Fund		(530,769)		530,769
To correct due to other funds as per our analysis		202,148		
To reestablish Cash as per our analysis				1,368,549
To correct Account Receivables as per our analysis		(1,033,977)		
To correct beginning balance as per our analysis			(10,069)	
To correct Due To Other Funds as per our analysis				36,112
To correct CWFA beginning balance as per our analysis	(184,105)			
Special Revenue Fund Classified as Capital Project Fund		2,870,071		(2,870,071)
Beginning Fund Balances (Deficit) at July 1, 2000, as restated	<u>\$(3,337,647)</u>	<u>\$3,635,316</u>	<u>\$709,438</u>	<u>\$1,757,103</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2001

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico - Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	\$ 17,652
Total U.S. Department of Agriculture			17,652
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT			
Direct Program: (Cluster of Programs)			
Section 8 Rental Voucher Program	14.855		287,509
Section 8 Rental Certificate Program	14.857		49,527
Total Cluster of Programs			337,036
Direct Program:			
Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation	14.856		580,900
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs:			
Community Development Block Grants-State's Program	14.228	98-DR-07 93-FD-07 95-FD-07 96-FD-07 97-FD-07 98-FD-07 99-FD-07 00-FD-07	2,675,557
Total U.S. Department of Housing and Urban Development:			3,593,493

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2001

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF JUSTICE:			
Direct Program:			
Public Safety Partnership and Community Policing Grants	16.710		10,493
Pass-through the Commonwealth of Puerto Rico - Local Department of Justice:			
Local Law and Enforcement Block Grants	16.592	Not Available	<u>2,228</u>
Total U.S. Department of Justice			<u>12,721</u>
U.S. FEDERAL EMERGENCY MANAGEMENT AGENCY:			
Pass-through the Commonwealth of Puerto Rico-Governor Authorized Representative (GAR):			
Public Assistance Grants	83.544	1136-DRPR 1247-DRPR	<u>540,359</u>
Total U.S. Federal Emergency Management Agency			<u>540,359</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico - Administration for Children and Families:			
Child Care and Development Block Grant	93.575	Not Available	<u>64,017</u>
Total U.S. Department of Health and Human Services			<u>64,017</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 4,228,242</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2001

1. BASIS OF PRESENTATION:

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

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

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

Description	Special Revenue
Per Schedule of Expenditures of Federal Awards	\$ 4,228,242
Non federal programs Expenditures	<u>1,927,383</u>
Total expenditures in the general purpose financial statements	<u>\$ 6,155,625</u>

3. SUBRECIPIENTS:

The **Municipality of Arroyo** provided Federal Awards to subrecipients as follows:

Program Title	Federal CFDA Number	Amount Provided
Community Development Block Grants – State's Program	14.228	<u>\$ 54,987</u>



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

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

We have audited the general purpose financial statements of the **Municipality of Arroyo** as of and for the year ended June 30, 2001, and have issued our report thereon dated March 27, 2002, which was qualified because we been unable to audit the fixed assets of the general fixed assets account group. Also, at year end the Municipality's had not updated the study of the activities that need to be implemented at the Municipality's landfill to guarantee the compliance with applicable state and federal regulations, and had not estimated the obligation for landfill closure and post closure care costs as required by Governmental Accounting Standard Board Statement 18. Except as discussed in the preceding sentences, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the **Municipality of Arroyo's** general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of general purpose financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of 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 to be material weaknesses. However, we believe items **01-01** through **01-02** of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs are material weaknesses. We also noted other matters involving internal control over financial reporting, which we have reported to management of the **Municipality of Arroyo** in a separate letter dated March 27, 2002.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 27, 2002

Stamp No.1785258 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

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

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

Compliance

We have audited the compliance of the **Municipality of Arroyo** 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, 2001. The **Municipality of Arroyo's** major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Arroyo's** management. Our responsibility is to express an opinion on the **Municipality of Arroyo's** compliance based on our audit.

Except as discussed in the following paragraph, we conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Municipality of Arroyo'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 Arroyo's** compliance with those requirements.

We were unable to obtain sufficient documentation supporting the compliance of the **Municipality of Arroyo** with the Public Assistance Grant, regarding the Activities Allowed or Unallowed, Allowable Cost/Cost Principles, Special Tests-Project Accounting, and Reporting requirements (findings 01-10 through 01-12), nor were we able to satisfy ourselves as to the **Municipality of Arroyo** compliance with those requirements by other auditing procedures.

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

Because of the significance of the matters discussed in the third paragraph of this report regarding the **Municipality of Arroyo** compliance with the Public Assistance Grant requirements regarding the Activities Allowed or Unallowed, Allowable Cost/Cost Principles, Special Tests-Project Accounting, and Reporting, the scope of our work was not sufficient to enable us to express, and we do not express, and opinion on the compliance with the requirements applicable to that Program.

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the **Municipality of Arroyo** compliance with Activities Allowed or Unallowed, Allowable Cost/Cost Principles, Special Tests-Project Accounting, and Reporting requirements of Public Assistance Grant, as discussed in the third paragraph of this report, the **Municipality of Arroyo** 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 30,2001. 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, **01-07** through **01-09**.

Internal Control Over Compliance

The management of the **Municipality of Arroyo** 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 Arroyo'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 Arroyo'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 **01-07** through **01-12**.



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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees on the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness. However, of the reportable conditions described above, we consider items **01-07** through **01-09,01-11** and **01-12** 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 Arroyo** in a separate letter dated March 27, 2002.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 27, 2002

Stamp No. 1785259 of the Puerto Rico
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was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2001

Section I - Summary of Auditors' Results

Financial Statements

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

Federal awards

Internal Control over major programs:	
Material weakness identified?	Yes <u> X </u> No <u> </u>
Reportable conditions identified not considered to be material weaknesses?	Yes <u> X </u> None reported <u> </u>
Type of auditors' report issued on compliance for major programs:	Unqualified for 14.228 Disclaimer for 83.544
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes <u> X </u> No <u> </u>

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
14.228	Community Development Block Grants - State's Program
83.544	Public Assistance Grant Program

Dollar threshold used to distinguish between Type A and Type B programs	<u>\$ 300,000</u>
Auditee qualified as low-risk auditee?	Yes <u> </u> No <u> X </u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-01
Requirement	Fixed\ Capital Assets and Expenditures - Subsidiary Ledger
Statement of Condition	During our examination of the Municipality's property records and reports we noted the following deficiencies: (a) balance in the Property Subsidiary Ledger does not reconcile with the ending balances reported in the audited financial statements; (b) there is no adequate internal control procedures to assure the proper valuation and timeliness of recognition of real and personal property in the Property Subsidiary Ledger and (c) Construction in Progress account were not maintained in the General Ledger and Property Subsidiary Ledger.
Criteria	The federal regulations establish that a financial management system shall provide for effective control and accountability for all funds, property and other assets. Also, Article 9.002 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain updated property accounting records.
Cause of Condition	There is no internal control procedures implemented to assure the completeness of the property records and reports.
Effect of Condition	The Municipality did not maintain an adequate control of the accountability regarding equipment and real property transactions.
Recommendation	We recommend that the Municipality should implement procedures in order to assure the proper valuation and timeliness of recognition of real and personal property as well as Construction in Progress in the Property Subsidiary Ledger in a manner that it provides updated and complete financial information
Questioned Cost	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-02
Requirement	Financial Reporting
Statement of Condition	The Municipality did not include in its general-purpose financial statements, an estimate of the obligation for landfill closure and post closure.
Criteria	<i>GASB Statements No. 18</i> requires that the Municipality should estimate the closure and post closure cost of its landfill facilities. That estimate should include the current cost of capital assets, final cover, and monitoring and maintenance activities.
Cause of Condition	The Municipality did not perform a study of the estimated cost of the closure and post closure cost of its landfill facilities.
Effect of Condition	Municipality is not in compliance with the <i>GASB Statement No. 18</i> requirements.
Recommendation	We recommend that the Municipality should contract professional services in order to prepare a formal study of the costs related to the landfill closure. Also, we recommend that the Municipality should include in its general-purpose financial statement the landfill costs necessary to comply with the <i>GASB Statement No. 18</i> .
Questioned Cost	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-03
Requirement	Financial Reporting - Accounting Records
Statement of Condition	During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal funds) and Account Groups.
Criteria	Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.
Cause of Condition	The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger.
Effect of Condition	The Municipality accounting system did not provide update and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.
Recommendation	We recommend that the Municipality should implement internal control procedures in order to maintain an accounting system that contain information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.
Questioned Cost	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-04
Requirement	Payroll and Related Liabilities- Payroll Preparation and Timekeeping
Statement of Condition	<p>We performed a payroll test and examined a sample of sixty (60) personnel files. The following summarize the deficiencies noted:</p> <ul style="list-style-type: none">a. For two (2) employees the sick leave and regular vacations balance at June 30, 2001 as per the accumulative vacation card were not included in the List of Accrued Compensated Absences (Vacations and Sick Leave) as of June 30, 2001 prepared by the Human Resources Department.b. For two (2) employees we noted differences between the sick leave and regular vacations balance at June 30, 2001 as per the accumulative vacation cards and the balance included in the List of Accrued Compensated Absences (Vacations and Sick Leave) as of June 30, 2001 prepared by the Human Resources Departmentc. For one (1) employee we noted that the regular vacations discounted as per the assistance cards did not agree with the regular vacations as per the accumulative vacation cards.d. Eight (8) pay stubs related to the payroll electronic payment transfer were not available for our examination.
Criteria	Revised Regulations on Basic Standards for the Municipalities of Puerto Rico in Chapter IV Section 18-(1) establishes that the Municipality will prepare the payroll based on the employee files.
Cause of Condition	There is no effective internal control procedure implemented to assure the correctness of accrued vacation and sickness balances. Also, there are no effective internal controls implemented to assure the proper file of the payroll supporting documents.
Effect of Condition	The Municipality does not maintain an adequate control over the personnel files, the payroll supporting documents, and vacation and sick leave computation worksheets.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-04 (continued)
Requirement	Payroll and Related Liabilities- Payroll Preparation and Timekeeping
Recommendation	We recommend that the Municipality should establish procedures to assure that the accumulative vacations cards are accurately prepared based on the information obtained from the time assistance cards duly certified by the employee and the supervisor. Also, we recommend that the Municipality should strength its procedures in order to assure the proper file of the payroll supporting documents.
Questioned Cost	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-05
Requirement	Cash Receipts-Revenue, Receivable - Collections
Statement of Condition	<p>During our examination of the Municipality's procedures related to the cash receipts process we examined sixty (60) collections and we noted the following situations:</p> <ul style="list-style-type: none">a. For some receipts the Municipality did not maintain an effective internal control to assure the proper filing of the receipts supporting documents.b. Five (5) official receipts were prepared after the deposit was made.c. Two (2) Municipal License Taxpayer's files did not contain evidence of an Income Tax Return or an Audited Financial Statements.
Criteria	<p>The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter III Section V establishes that the Finance Director or any other designed public official are responsible for the maintenance and conservation of the records, documents and files related to the revenues transactions.</p> <p>The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter III Section IV establishes that the Official Collector should print and sign and official receipt for any revenue received. A copy of that official receipt should be given up to the person or entity that made the payment.</p> <p>The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter IX establishes that the Municipality should maintain adequately documented taxpayer files including evidence of audited financial statement in the case of taxpayers with a volume of business in excess of one million \$1,000,000, Municipal License Tax Certificate, etc..</p>
Cause of Condition	<p>The Municipality did not establish effective internal control to assure that revenues were properly documented. Also, the Municipality did not establish effective internal control to assure that an official receipt was prepared at the moment the collection is made.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-05 (continued)
Requirement	Cash Receipts-Revenue, Receivable - Collections
Effect of Condition	The Municipality is not in compliance with Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.
Recommendation	We recommend that the Municipality should maintain evidence for all collections received by it; this include maintain in the Municipal License Taxpayer's files a copy of the income tax return or a copy of an audited financial statements. Also, we recommended that the Municipality should strength its procedures in order to prepare the official receipts at the moment of collections.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference **01-06**

Requirement **Expenditures for Goods and Services and Account Payables -
Purchasing and Receiving**

Statement of Condition During our examination of the Municipality's procedures related to the purchasing and receiving process we examined thirty-five (35) disbursement vouchers for the general and special revenue fund and we noted the following situations.

- a. One (1) disbursement voucher was not available for our examination.
- b. In five (5) disbursement vouchers there was no evidence that the goods or services were rendered as requested.
- c. In fourteen (14) disbursement vouchers there was no evidence that the Municipality requested at least three (3) quotations or realized formal bids for these purchases.
- d. In one (1) disbursement voucher we could not obtain evidence of the authenticity of two quotations.
- e. In four (4) disbursement vouchers there was no evidence of an invoice or other related document related the to purchase of goods or service.
- f. In five (5) disbursement vouchers we noted that the purchase orders were prepared after they received the goods or services.
- g. In two (2) disbursement vouchers the expenditure were charged to the erroneous account.
- h. Five (5) disbursement vouchers were not marked or cancelled as paid along the document.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section II - Financial Statements Findings

Finding Reference	01-06 (continued)
Requirement	Expenditures for Goods and Services and Account Payables - Purchasing and Receiving
Criteria	The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico establish in Chapter four (IV) states that the Finance Director will be responsible to account and prepare disbursements through documents duly prepared and certified, including sufficient evidential matter to support the transactions. Also, the Chapter eight (VIII) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico establishes the procedures related to the formal bids or quotations for the purchase of goods or services.
Cause of Condition	The Municipality did not establish effective internal control to assure that all transactions include all the required documentation.
Effect of Condition	The Municipality is not in compliance with Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.
Recommendation	We recommend that the Municipality should improve its internal control procedures in order to assure that all disbursement vouchers contain all supporting documents before making the payment. Also, we recommend that the Municipality should improve its procedures to assure that at least three quotations should be requested for all purchase off goods or services that do not exceed \$10,000 and construction contracts that do not exceed \$40,000 or realize formal bids for purchases that exceed that limits.
Questioned Cost	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	01-07
Program	Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of Commissioner of Municipal Affairs
Requirement	Davis-Bacon Act
Statement of Condition	<p>During our Davis-Bacon Act test for the projects (00-FD-07-01, 99-FD-07-02, 98-FD-07-02, 97-FD-07-01) we noted the following situations:</p> <ul style="list-style-type: none">a. The Municipality did not obtain all weekly payrolls during activity of construction project to be reviewed by the Municipality’s employee responsible of applying monitoring procedures.b. There is no evidence that the Municipality’s employee responsible of applying monitoring procedures, review the weekly payrolls to assure that the contractor complied with prevailing wages.c. The Municipality did not perform periodical interviews to contractors and subcontractor’s laborers. There is only evidence of one interview during the activity of the construction project. <p>During our Davis-Bacon Act test for the projects (99-FD-07-06) we noted the following situation:</p> <ul style="list-style-type: none">a. The Municipality did not apply the monitoring system developed to ensure contractors compliance with payment of prevailing wages to employees.
Criteria	Davis-Bacon Act, as amended (40 USC 276A-276A-5), Subpart K, 24 CFR 570.603.
Cause of Condition	Municipality did not apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	01-07 (continued)
Requirement	Davis-Bacon Act
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 obtaining contractor's and subcontractor's weekly payrolls to be reviewed on a weekly basis by the responsible Municipal Employee, and interview 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, we recommend management to communicate contractors promptly any failure in the payroll process.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	01-08
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Equipment and Real Property Management
Statement of Condition	Section II - Financial Statements Findings - Finding Reference 01-01

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	01-09
Program	Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of Commissioner of Municipal Affairs
Requirement	Program Income
Statement of Condition	<p>During our audit of the program income requirements we noted that the Municipality did not maintain internal controls to assure:</p> <ul style="list-style-type: none">a. That the program income was properly determined or calculated in accordance with stated criteria and that program income was only collected from allowable sources.b. That all program income was properly recorded in the accounting records.c. That program income was used in accordance with the program requirements and other applicable regulations.
Criteria	<p>Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income</p>
Cause of Condition	<p>The Municipality did not maintain adequate internal controls in order to assure the proper determination; accountability; and use of program income.</p>
Effect of Condition	<p>The Municipality is not in compliance with the Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2).</p>
Recommendation	<p>We recommend management to develop internal controls and procedures in order to assure that the program income was: properly determined and calculated; was properly recorded and was used for allowable costs.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **01-09 (continue)**

Requirement **Program Income**

Questioned Costs None

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	01-10
Program	Public Assistance Grant (CFDA NO. 83.544) U.S. Federal Emergency Management Agency; Pass through State - Office of Governor Authorized Representative (GAR)
Requirement	Activities Allowed or Unallowed - Allowable Cost/Cost Principles
Statement of Condition	<p>During our examination of twelve (12) disbursement vouchers of the Public Assistance Grant we noted the following situations:</p> <ul style="list-style-type: none">a. Two (2) disbursement vouchers and cancelled checks were not available for our examination. The Comptroller Office of Puerto Rico maintained under their custody those disbursement vouchers and cancelled checks totaling \$110,928.43.b. Eight (8) original disbursement vouchers were not available for our examination. The Municipality's management represented us that they only maintain copy of that disbursement vouchers since the Office of the Governors Authorized Representative (GAR) maintained under their custody the originals totaling \$376,060.c. Three (3) disbursement vouchers contained a global invoice for the works performed instead of a certification detailing the work performed by the contractor.d. Six (6) invoices did not contain all the approval signatures.e. Two (2) disbursement vouchers did not contain evidence that the services were rendered as requested.f. For one (1) disbursement voucher the Municipality did not discount for the payment the retention of ten percentage applicable to construction contracts.g. One (1) invoice was not marked or cancelled as paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	01-10 (continue)
Requirement	Activities Allowed or Unallowed - Allowable Cost/Cost Principles
Criteria	Code of Federal Regulations 44, Subpart C, 13.20 (b) (6) states that accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and sub grant award documents and others.
Cause of Condition	<p>Municipality did not maintain adequate controls to assure that all disbursements made have all supporting documents and were realized for allowable costs.</p> <p>Also, the Comptroller Office of Puerto Rico and the Office of the Governors Authorized Representative maintained under their custody some original disbursement vouchers and cancelled checks.</p>
Effect of Condition	Municipality is not in compliance with Code of Federal Regulation 44, Subpart C, Part 13.20 (b) (6).
Recommendation	We recommend that the Municipality should strength its procedures to assure that all disbursements vouchers contain all supporting documents and approval signatures before the related payments are made.
Questioned Cost	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 01-11

Program Public Assistance Grant (CFDA NO. 83.544) U.S. Federal Emergency Management Agency; Pass through State - Office of Governor Authorized Representative (GAR)

Requirement Reporting

Statement of Condition The Municipality did not provide to us the quarterly progress reports (P-4) required by the Governor's Authorized Representative (GAR) during the fiscal year 2000-2001.

Criteria Code of Federal Regulations 44, Section 206.204 (f), require to States to submit quarterly financial and progress reports to the Regional Director. The report should describe the status of those projects on which a final payment of the Federal share has not been made to the State and outline any problems or circumstance expected to result in noncompliance with the approved grant conditions. Sub-grantee reporting is required by the State. Governor's Authorized Representative (GAR) Office requires to Sub-grantee submit to it quarterly progress reports for all projects approved by FEMA.

Cause of Condition There Municipality control procedures fail to maintain on file evidence about compliance with the reporting requirement.

Effect of Condition The Municipality cannot prove to us compliance with the reporting requirements.

Recommendation We recommended the Municipality to establish internal control and procedures to maintain a copy of quarterly progress reports in its files.

Questioned Costs None

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 01-12

Program Public Assistance Grant (CFDA NO. 83.544) U.S. Federal Emergency Management Agency; Pass through State - Office of Governor Authorized Representative (GAR)

Requirement Special Tests-Project Accounting

Statement of Condition During our special tests audit we could not obtain evidence of the files for the project worksheets (PW)(Number: 5061, 650, 55858, 57355, 71350, 55915) as required by the Office of Governor Authorized Representative (GAR), to support that costs incurred were in performance of eligible works, that approved works were completed, that the projects were in compliance with the provisions of the FEMA-State Agreement and that payments charged to projects were made in accordance with OMB A-102 Common Rule.

Criteria OMB Circular A-87 has established that any cost allocable to a particular Federal award must be adequately documented. Code of Federal Regulations 44 CFR 13.20 (b) (6) has established that transactions posted in the accounting records must be supported by such source documentation such as cancelled checks, paid bills, payrolls, time and attendance records, contracts, sub-grant award documents, and others. Also, 44 CFR 13.20 (b) (3) requires to grantees and sub-grantees to maintain effective control and accountability over grants and sub-grants cash, real and personal property, and other assets, to assure them be used solely for authorized purposes.

Cause of Condition There is not internal control procedures implemented to assure compliance with OMB Circular A-87 and 44 CFR 13.20 (b) (3) and 13.20 (b) (6) and the Office of Governor Authorized Representative (GAR) requirements.

Also, the Comptroller Office of Puerto Rico and the Office of the Governors Authorized Representative maintained under their custody some original files for the project worksheet (PW).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	01-12 (continued)
Requirement	Special Tests-Project Accounting
Effect of Condition	Municipality's is not in compliance with OMB Circular A-87, 44 CFR 13.20 (b) (3) and 13.20 (b) (6) and the Office of Governor Authorized Representative (GAR) requirements.
Recommendation	We recommend to the Municipality Management to assign an employee to prepare files by each Project, that contain all documents required by the Office of Governor Authorized Representative (GAR). Also, the Municipality should follow procedures described in the Public Assistance Guide issued by U.S. Federal Emergency Management Agency.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2001

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
99-III-04	14.228, 83.544	<u>Davis Bacon Act</u> No corrective action plan has been taken. The Municipality will give instruction to the employee assigned for the compliance with the Davis Bacon to strength the internal control procedures.
99-III-06	14.228	<u>Municipality does not have a property register</u> No corrective action has been taken. The Municipality will organize a GASB 34 Team composed by municipal employees and contracted professionals (if necessary) in order to actualize real property, personal property and infrastructure inventory to comply with GASB 34 requirements.
00-III-01	83.544	<u>Activities Allowed or Unallowed – Allowed Cost</u> No corrective action plan has been taken. The Municipality is waiting a final determination by the pass-trough grantor about this matter.
00-III-02	83.544	<u>Activities Allowed or Unallowed – Allowable Cost</u> No corrective action plan has been taken. The Municipality assigned an employee to prepare the required files to the project worksheet (PW).
00-III-03	14.228	<u>Allowable Cost/Cost Principle</u> Full corrective action plan has been taken.
00-III-04	14.228	<u>Cash Management</u> Full corrective action plan has been taken.
00-III-05	14.228 83.544	<u>Davis Bacon Act</u> No corrective action plan has been taken. The Municipality will give instruction to the employee assigned for the compliance with the Davis Bacon to strength the internal control procedures

COMMONWEALTH OF PUERTO RICO
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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2001

00-III-06	14.228	<u>Equipment and Real Property Management</u> No corrective action has been taken. The Municipality will organize a GASB 34 Team composed by municipal employees and contracted professionals (if necessary) in order to actualize real property, personal property and infrastructure inventory to comply with GASB 34 requirements.
00-III-07	83.544	<u>Procurement and Suspension and Debarment</u> Full corrective action plan has been taken.
