

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

**MUNICIPIO DE ARROYO**  
**AUDITORIA 2001-2002**  
**30 DE JUNIO DE 2002**

OFICINA DEL GOBIERNO  
DE ARROYO P.R. 00145  
EJAPR-04 PM 1:51  
REGISTRO  
UNIDAD DE CORREO

**COMMONWEALTH OF PUERTO RICO**

**MUNICIPALITY OF ARROYO**

**SINGLE AUDIT REPORT**

**YEAR ENDED JUNE 30, 2002**

**COMMONWEALTH OF PUERTO RICO**

**MUNICIPALITY OF ARROYO**

**YEAR ENDED JUNE 30, 2002**

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**COMMONWEALTH OF PUERTO RICO**

**MUNICIPALITY OF ARROYO**

**YEAR ENDED JUNE 30, 2002**

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**López-Vega, CPA, PSC**

Certified Public Accountants / Management Advisors

Member of:

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

## **INDEPENDENT AUDITORS' REPORT**

**To the Honorable Mayor and  
the Municipal Legislature  
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, 2002, as listed in the table of contents. These general purpose financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit. 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 \$2,729,278 (net of fixed assets accumulated depreciation) as of June 30, 2002, and total revenues of \$586,153 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, 2002.

## INDEPENDENT AUDITORS' REPORT (Continued)

As indicated in Note 13, at June 30, 2002, 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, 2002, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 5, 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.

  
LÓPEZ- VEGA, CPA, PSC

San Juan, Puerto Rico  
November 5, 2002

Stamp No. 1854004 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, 2002**

	GOVERNMENTAL FUND TYPES				ACCOUNT GROUPS		TOTALS (MEMORANDUM ONLY)
	General	Special Revenue	Debt Service	Capital Projects	General Fixed Assets	General Long-term Debt	
<b>ASSETS AND OTHER DEBITS</b>							
Cash	\$461	\$2,239,256					\$2,239,717
Cash with fiscal agent	570,456		\$743,431	\$1,403,463			2,717,350
Intergovernmental receivables	86,542	65,354					151,896
Federal grants receivable		442,189					442,189
Due from other funds	855,815	2,121,723		445,201			3,422,739
Other receivables	34,956	1,766					36,722
Other assets		5,485					5,485
Property and equipment					\$14,838,089		14,838,089
Amount available in Debt Service Fund						\$743,431	743,431
Amount to be provided for retirement of general long term debt						8,552,425	8,552,425
<b>Total assets and other debits</b>	<b>\$1,548,230</b>	<b>\$4,875,773</b>	<b>\$743,431</b>	<b>\$1,848,664</b>	<b>\$14,838,089</b>	<b>\$9,295,856</b>	<b>\$33,150,043</b>
<b>LIABILITIES AND FUND EQUITY</b>							
<b>Liabilities:</b>							
Accounts payable and accrued liabilities	\$504,474	\$547,743		\$91,425			\$1,143,642
Due to other funds	2,566,924	855,815					3,422,739
Due to other governmental entities	203,589					\$2,769,228	2,972,817
Deferred municipal license tax revenues	216,357						216,357
Deferred - other	8,561						8,561
Deferred federal grant revenues		157,548					157,548
Claims and judgments						49,371	49,371
General obligation bonds						3,346,000	3,346,000
Notes payable						2,486,025	2,486,025
Accrued compensated absences						645,232	645,232
<b>Total liabilities</b>	<b>3,499,905</b>	<b>1,561,106</b>		<b>91,425</b>		<b>9,295,856</b>	<b>14,448,292</b>
<b>Fund equity:</b>							
Investment in general fixed assets					14,838,089		14,838,089
<b>Fund balances:</b>							
Reserved for encumbrances	306,964						306,964
Reserved for debt service			743,431				743,431
<b>Unreserved:</b>							
Designated for specific fund purposes	230,823	3,314,667		1,757,239			5,302,729
Undesignated	(2,489,462)						(2,489,462)
<b>Total fund equity(deficit)</b>	<b>(1,951,675)</b>	<b>3,314,667</b>	<b>743,431</b>	<b>1,757,239</b>	<b>14,838,089</b>		<b>18,701,751</b>
<b>Total liabilities and fund equity</b>	<b>\$1,548,230</b>	<b>\$4,875,773</b>	<b>\$743,431</b>	<b>\$1,848,664</b>	<b>\$14,838,089</b>	<b>\$9,295,856</b>	<b>\$33,150,043</b>

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 30,2002**

	GOVERNMENTAL FUND TYPES				TOTALS (MEMORANDUM ONI Y)
	General	Special Revenue	Debt Service	Capital Projects	
<b>REVENUES</b>					
Property taxes	\$1,597,551		\$380,533		\$1,978,084
Municipal license taxes	418,854				418,854
Licenses and permits	1,223,793				1,223,793
Intergovernmental	3,529,742	\$184,971		\$404,541	4,119,254
Rent of property	47,760				47,760
Fines and penalties	4,975				4,975
Interest	66,489				66,489
Federal grants		2,692,524			2,692,524
Miscellaneous	208,822	629,224			838,046
<b>Total revenues</b>	<u>7,097,986</u>	<u>3,506,719</u>	<u>380,533</u>	<u>404,541</u>	<u>11,389,779</u>
<b>EXPENDITURES</b>					
<b>Current:</b>					
Mayor and Municipal Assembly	1,012,446				1,012,446
General government	2,330,047	244,237			2,574,284
Public safety	865,086	2,660			867,746
Public works	1,587,293	140,970			1,728,263
Public health and sanitation	477,688				477,688
Welfare	2,073	1,866,696			1,868,769
Economic development	8,241				8,241
Recreation	303,840				303,840
Principal retirement	30,000	19,911	248,000		297,911
Interest	9,680	158,732	77,192		245,604
Capital outlays	60,168	1,284,595		1,160,791	2,505,554
<b>Total expenditures</b>	<u>6,686,562</u>	<u>3,717,801</u>	<u>325,192</u>	<u>1,160,791</u>	<u>11,890,346</u>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<u>411,424</u>	<u>(211,082)</u>	<u>55,341</u>	<u>(756,250)</u>	<u>(500,567)</u>
<b>OTHER FINANCING SOURCES(USES):</b>					
Bond Proceeds	940,000	-	-	1,410,000	2,350,000
<b>Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing sources (uses)</b>	<u>1,351,424</u>	<u>(211,082)</u>	<u>55,341</u>	<u>653,750</u>	<u>1,849,433</u>
<b>Fund balances (deficit) beginning, as restated</b>	<u>(3,303,099)</u>	<u>3,525,749</u>	<u>688,090</u>	<u>1,103,489</u>	<u>2,014,229</u>
<b>Fund balances (deficit), ending</b>	<u>(\$1,951,675)</u>	<u>\$3,314,667</u>	<u>\$743,431</u>	<u>\$1,757,239</u>	<u>\$3,863,662</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, 2002**

	GENERAL FUND			DEBT SERVICE FUND		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
<b>REVENUES</b>						
Property taxes	\$1,597,551	\$1,597,551	-	\$405,130	\$380,533	(\$24,597)
Municipal license taxes	250,100	418,854	\$168,754			
Licenses and permits	406,000	1,223,793	817,793			
Intergovernmental	4,181,042	3,404,060	(776,982)			
Rent of property	113,620	47,760	(65,860)			
Fines and penalties	3,000	4,975	1,975			
Interest	30,000	66,489	36,489			
Federal Grants	2,000	-	(2,000)			
Miscellaneous	280,000	208,822	(71,178)			
<b>Total revenues</b>	<b>6,863,313</b>	<b>6,972,304</b>	<b>108,991</b>	<b>405,130</b>	<b>380,533</b>	<b>(24,597)</b>
<b>EXPENDITURES AND ENCUMBRANCES:</b>						
<b>Current:</b>						
Mayor and Municipal Assembly	1,216,230	1,079,904	136,326			
General government	2,043,973	2,354,103	(310,130)			
Public safety	1,049,690	877,715	171,975			
Public works	1,600,861	478,026	1,122,835			
Public health and sanitation	518,842	479,508	39,334			
Welfare	2,100	2,073	27			
Economic development	8,241	8,241	-			
Recreation	326,208	313,244	12,964			
<b>Capital outlays</b>	<b>57,488</b>	<b>60,168</b>	<b>(2,680)</b>			
<b>Debt service:</b>						
Principal retirement	30,000	30,000		315,164	248,000	67,164
Interest	9,680	9,680	-	89,966	77,192	12,774
<b>Total expenditures and encumbrances</b>	<b>6,863,313</b>	<b>5,692,662</b>	<b>1,170,651</b>	<b>405,130</b>	<b>325,192</b>	<b>79,938</b>
<b>Excess (deficiency) of revenues over (under) expenditures and encumbrances</b>		<b>1,279,642</b>	<b>1,279,642</b>		<b>55,341</b>	<b>55,341</b>
<b>OTHER FINANCING USES:</b>						
Bond Proceeds		940,000			-	
<b>Excess (deficiency) of revenues over (under) expenditures, encumbrances and other financing uses</b>		<b>2,219,642</b>			<b>55,341</b>	
<b>ADJUSTMENTS TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES</b>						
GAAP adjustments to revenues		125,682				
GAAP adjustments to expenditures- Operational Bond		(940,000)				
Current year encumbrances treated as current year expenditures for budgetary basis		150,089				
Prior year encumbrances paid during the current year		(203,989)				
<b>Fund balances (deficit) beginning, as restated</b>		<b>(3,303,099)</b>			<b>688,090</b>	
<b>Fund balances (deficit), ending</b>		<b>(\$1,951,675)</b>			<b>\$743,431</b>	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS**

**YEAR ENDED JUNE 30, 2002**

**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, 2002**

**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, 2002

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, 2002**

**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, 2002**

**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, 2002**

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

**H. Cash and cash equivalents:**

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

Cash with fiscal agent 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, 2002**

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

**J. Compensated absences:**

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

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

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

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

**K. Insurance:**

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

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

**L. Total columns (memorandum only):**

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

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

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

**N. Claims and judgments:**

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

**2. DUE TO OTHER GOVERNMENTAL ENTITIES:**

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

Internal Revenue Services (FICA tax)	\$ 5,397
Retirement System Administration	49,072
Puerto Rico Aqueduct and Sewer Authority	52,596
General Services Administration	3,980
Treasury Department	<u>92,544</u>
Total	<u>\$ 203,589</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**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, 2002. The following is the balance of these accounts:

Department of Labor	\$ 45,948
Municipal Revenue Collection Center	<u>2,723,280</u>
Total	<u>\$ 2,769,228</u>

**2. 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, 2002**

**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 advances were more than collections by \$55,074. Such amount was included as Due to other governmental agencies in the General Long Term Debt Account Group because it will not be funded with available expendable financial resources at June 30, 2002.

**4. MUNICIPAL LICENSE TAXES:**

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

The tax rates are as follows:

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

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

**5. INTERGOVERNMENTAL:**

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**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:**

Cash in bank accounts \$ 2,239,717

**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, 2001	Additions and adjustments	Retirements and adjustments	Balance June 30, 2002
Building and Improvements	\$8,941,658			\$ 8,941,658
Equipment Brisas de Arroyo Housing	2,176,403	\$ 13,773		2,190,176
	3,690,916	15,339		3,706,255
Total	<u>\$14,808,977</u>	<u>\$ 29,112</u>		<u>\$14,838,089</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**9. GENERAL OBLIGATION BONDS:**

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

Balance at July 1, 2001	\$ 1,164,000
Debt issued	2,350,000
Principal retirements	(168,000)
Adjustments and/or Reclassifications	_____
 Balance at June 30, 2002	 <u>\$3,346,000</u>

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

Type of bonds	Maturity date	Original Amount	Range of Interest Rates	Balance at June 30, 2002
1981 Series	1-1-04	102,000	5.00%	\$ 10,000
1987 Series	7-1-02	630,000	8.20% to 9.00%	45,000
1997 Series	1-1-04	96,000	4.88%	31,000
2000 Series	7-1-09	1,065,000	5.00% to 8.00%	910,000
2002 Series	7-1-26	940,000	5.00% to 7.50%	940,000
2002 Series	7-1-26	1,410,000	5.00% to 8.00%	1,410,000
 Total general obligation bonds				 <u>\$ 3,346,000</u>

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

Year ended June 30	Total
2003	\$ 180,000
2004	146,000
2005	135,000
2006	150,000
2007	160,000
Thereafter	<u>2,575,000</u>
 Total	 <u>\$ 3,346,000</u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**10. NOTES PAYABLE:**

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

Balance at July 1, 2001	\$2,645,936
Debt issued	
Payments during the current year	(129,911)
Adjustments and/or Reclassifications	(30,000)
Balance at June 30, 2002	<u>\$2,486,025</u>

Notes payable at June 30, 2002 are as follows:

Description	Maturity Date	Original Amount	Range of Interest rates	Balance June 30, 2002
1987 Series	7-1-06	440,000	0.00% to 8.50%	\$ 160,000
Section 515 Loan	7-1-29	Not Available	7.00% to 9.00%	2,146,025
1999 Series	7-1-03	405,000	4.87% to 6.31%	<u>180,000</u>
Total notes payable				<u>\$ 2,486,025</u>

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

Year ended June 30	Total
2003	\$ 145,556
2004	157,449
2005	69,483
2006	81,670
2007	34,019
Thereafter	<u>1,997,848</u>
Total	<u>\$ 2,486,025</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**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:

<b>Years of Service</b>	<b>Participant Age</b>	<b>Pension Benefits</b>
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, 2002**

**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, 2002**

**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, 2002 recorded as pension expenditures was approximately \$ 221,567. This amount represent 100% of the required contribution for the fiscal year ended June 30, 2002.

The amount of the total pension benefit obligation is based on a standardized measurement established by GASB Number 27, *Accounting for Pensions by State and Local Governmental Employers*. The standardized measurement is the actuarial present value of credited projected benefits. This pension valuation method reflects the present value of estimated pension benefits that will be paid in future years as a result of 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, 2002**

**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, 2002, 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, 2002**

**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 \$49,371 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, 2002**

**15. BEGINNING FUND BALANCES RESTATEMENT:**

The beginning Fund Balance (Deficit) for General Fund and Debt Service Fund, 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	Debt Service
Beginning Fund Balances (Deficit) at July 1, 2001	\$(3,679,077)	\$761,515
Account Receivables from CRIM related to 2001 Final Liquidation	207,692	
Due from Special Revenue Fund related to Child Care Development Block Grant	168,286	
Account Payable to CRIM related to CAE Liquidations 2000 and 2001		(73,425)
Beginning Fund Balances (Deficit) at July 1, 2001, as restated	\$(3,303,099)	\$688,090

**16. SUBSEQUENT EVENTS**

During fiscal year 2002-2003 the Legislative Body authorized the payment of a legal claim from prior years for a total of \$22,951 through the Legislative Body Resolution number three.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**YEAR ENDED JUNE 30, 2002**

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
<b>U.S. DEPARTMENT OF AGRICULTURE:</b>			
Pass-through the Commonwealth of Puerto Rico - Department of Education: Child and Adult Care Food Program	10.558	Not Available	\$ 12,550
<b>Total U.S. Department of Agriculture</b>			<u>12,550</u>
<b>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:</b>			
Direct Program:			
Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation	14.856		597,565
Direct Program:			
Section 8 Housing Choice Voucher Program	14.871		362,110
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 95-FD-07 96-FD-07 97-FD-07 98-FD-07 99-FD-07 00-FD-07 01-FD-07	<u>1,396,148</u>
<b>Total U.S. Department of Housing and Urban Development</b>			<u>2,355,823</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

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

**YEAR ENDED JUNE 30, 2002**

<b>Federal Grantor/Pass-through Grantor/Program or Cluster Title</b>	<b>Federal CFDA Number</b>	<b>Pass-through Entity Identifying Number</b>	<b>Expenditures</b>
<b>U.S. DEPARTMENT OF JUSTICE:</b>			
Pass-through the Commonwealth of Puerto Rico - Governor's Office (Youth Office) Juvenile Justice and Delinquency Prevention	16.540	Not Available	<u>2,660</u>
<b>Total U.S. Department of Justice</b>			<u><b>2,660</b></u>
<b>U.S. FEDERAL EMERGENCY MANAGEMENT AGENCY:</b>			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR): Public Assistance Grants	83.544	1136-DRPR 1247-DRPR	<u>126,873</u>
<b>Total U.S. Federal Emergency Management Agency</b>			<u><b>126,873</b></u>
<b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:</b>			
Pass-through the Commonwealth of Puerto Rico - Administration for Children and Families: Child Care and Development Block Grant	93.575	Not Available	<u>194,618</u>
<b>Total U.S. Department of Health and Human Services</b>			<u><b>194,618</b></u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<u><b>\$ 2,692,524</b></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, 2002**

**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 Fund in the Municipality's general-purpose financial statements. The reconciliation between the expenditures in the general-purpose financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Description	Special Revenue
Per Schedule of Expenditures of Federal Awards	\$ 2,692,524
Non federal programs Expenditures	<u>1,025,277</u>
Total expenditures in the general purpose financial statements	<u>\$ 3,717,801</u>

**3. SUBRECIPIENTS:**

The **Municipality of Arroyo** provided Federal Awards to a sub recipient as follows:

Program Title	Federal CFDA Number	Amount Provided
Community Development Block Grants – State's Program	14.228	<u>\$ 35,000</u>



Certified Public Accountants / Management Advisors

*López-Vega, CPA, PSC*

Member of:

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

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

**To the Honorable Mayor  
and the Municipal Legislature  
Municipality of 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, 2002, and have issued our report thereon dated November 5, 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 **02-01** through **02-07**.

**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 considered to be material weaknesses. However, we believe items **02-01** through **02-02** 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 November 5, 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  
November 5, 2002

Stamp No. 1854005 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.





**López-Vega, CPA, PSC**

Certified Public Accountants / Management Advisors

Member of:

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

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

**To the Honorable Mayor  
and the Municipal Legislature  
Municipality of 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, 2002. 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.

The **Municipality of Arroyo's** general purpose financial statements include the operations of the Brisas de Arroyo Housing Project no. 66-006-69066021, a blended component unit, which received \$ 2,719,666 in federal awards which is not included in the schedule during the year ended June 30, 2002. Our audit, described below, did not include the operations of Brisas de Arroyo Housing Project no. 66-006-69066021 because the Housing Project Administrator engaged other auditors to perform an audit in accordance with *U.S. Office of Management and Budget (OMB) Circular A-133*.

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.

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

In our opinion, the **Municipality of 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, 2002. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, **02-08** through **02-24**.

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 **02-08** through **02-24**.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees on the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness. However, of the reportable conditions described above, we consider items **02-09** through **02-17**, **02-19**, **02-22** and **02-24** 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 21, 2003.



**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)**

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 21, 2003

Stamp No. 1854006 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**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**YEAR ENDED JUNE 30, 2002**

**Section I – Summary of Auditors’ Results**

**Financial Statements**

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

**Federal awards**

Internal Control over major programs:			
Material weakness identified?	Yes	X	No
Reportable conditions identified not considered to be material weaknesses?	Yes	X	None reported

Type of auditors’ report issued on compliance for major programs: **Unqualified**

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes	X	No
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**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
14.856	Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation
14.871	Section 8 Housing Choice Voucher Program

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section II - Financial Statements Findings**

**Finding Reference**      02-01

**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: balance in the Property Subsidiary Ledger does not reconcile with the ending balances reported in the audited financial statements; 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 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, Chapter IX 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 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, 2002**

**Section II - Financial Statements Findings**

<b>Finding Reference</b>	<b>02-02</b>
<b>Requirement</b>	<b>Financial Reporting</b>
<b>Statement of Condition</b>	The Municipality did not include in its general-purpose financial statements, an estimate of the obligation for landfill closure and post closure costs.
<b>Criteria</b>	<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.
<b>Cause of Condition</b>	The Municipality did not perform a study of the estimated cost of the closure and post closure cost of its landfill facilities.
<b>Effect of Condition</b>	The Municipality's is not in compliance with the <i>GASB Statement No. 18</i> requirements.
<b>Recommendation</b>	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> .
<b>Questioned Cost</b>	None
<b>Management Response</b>	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, 2002**

**Section II - Financial Statements Findings**

**Finding Reference 02-03**

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

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

**Effect of Condition**              The Municipality's accounting system did not provide updated and complete financial information that 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 and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.

**Questioned Costs**                None

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section II - Financial Statements Findings**

**Finding Reference**      **02-04**

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

**Statement of Condition** During our examination of the Municipality's procedures related to the formal procurement process we examined six (6) bid files and other related documents and we noted the following situations:

- a. We did not find evidence in the examined files about bid bond required by the Municipality's Bid Board for one (1) bidder who participated in the formal bids.
- b. We did not find evidence in the bid files or contract files about the following bonding, insurance or tax requirements:
  - 1. Payment and Performance Bond - Three (3) cases
  - 2. Workmen Compensation Insurance - Three (3) cases
  - 3. Municipal Volume of Business License Tax - Three (3) cases
  - 4. Municipal Excise Construction Tax - Three (3) cases
  - 5. General Liability Insurance - Three (3) cases

**Criteria**                    Chapter VIII Article 8.016 (c) of State Act Number 81 of August 30, 1991 establishes that prior to the execution of construction contracts, the Municipality shall obtain from contractors evidence of Workmen Compensation Insurance payment, a Payment and Performance Bond, and whatever bond or insurance required by the Municipality's Bid Board. The Chapter Eight (8) of the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico establishes the procedures related to the formal bids for the purchase of goods or services.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section II - Financial Statements Findings**

<b>Finding Reference</b>	<b>02-04 (Continued)</b>
<b>Cause of Condition</b>	The Municipality's internal control procedures failed to assure that all required documents has been retained in a file (bid and contract files) as evidence of compliance with the procurement requirements.
<b>Effect of Condition</b>	The Municipality is not in compliance with the Chapter VIII Article 8.016 (c) of State Act Number 81 of August 30, 1991, and with Chapter Eight (VIII) of the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico.
<b>Recommendation</b>	We recommend to the Municipality's management to improve its internal control and procedures in order to assure that formal bid files includes all required documents. Also, we recommend retaining in contract files all documents required by Law or Regulation prior to any contract execution in order to demonstrate compliance with procurement requirements.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section II - Financial Statements Findings**

**Finding Reference      02-05**

**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 sixty seven (67) disbursement vouchers and we noted the following exceptions.

- a. Thirteen (13) disbursement vouchers were not available for our examination.
- b. In four (4) instances the expenditure transactions was miscoded.
- c. Six (6) disbursement vouchers did not have all supporting documents stamped as paid.
- d. Two (2) disbursement vouchers were not signed by the Pre-auditor.
- e. Eight (8) disbursement vouchers were not pre-numbered.
- f. Eight (8) disbursement vouchers did not include the purchase order.
- g. In three (3) disbursement vouchers the purchase orders did not include all the approvals.
- h. Nineteen (19) disbursement vouchers did not include the purchase requisition.
- i. In one (1) disbursement voucher the purchase requisition did not include all the approval signatures.
- j. One (1) disbursement voucher did not include the invoice.
- k. In five (5) disbursement vouchers there was no evidence of receiving report or the certification of the Municipality's employee who received the goods or services.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section II - Financial Statements Findings**

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

**Recommendation**      We recommend that the Municipality should improve its internal control and procedures in order to assure that all disbursement vouchers contain all supporting documents before the payment is made. Also, we recommend that the Municipality should improve its procedures to assure that at least three quotations be requested for all purchases of 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 these 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, 2002**

**Section II -- Financial Statements Findings**

**Finding Reference**        **02-06**

**Requirement**            **Payroll and Related Liabilities - Payroll Preparation and Timekeeping**

**Statement of Condition** We performed a payroll test and examined a sample of 60 personnel files, and the related payroll documents of these employees for the semimonthly payroll from June 1, 2002 through June 15, 2002. The following will summarize the exceptions found:

- a. In six (6) cases the employee's time assistance cards did not agree with the compensated absences cards.
- b. In one (1) case the gross wage rate per payroll did not agree with the gross wage rate included in the employee's file.
- c. Nine (9) cancelled checks were not available for our examination.
- d. In four (4) cases the employee's position or department per payroll did not agree with the employee's position or department included on the employee's file.

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

**Cause of Condition**        The Municipality's internal control procedures failed to assure the proper payment and preparation of payroll, and the accuracy of compensated absences balances subsidiary ledger.

**Effect of Condition**        The Municipality is not in compliance with Chapter (IV), Section 18 (1) of Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section II - Financial Statements Findings**

**Finding Reference**      **02-06 (Continued)**

**Recommendation**      We recommend the Municipality to improve its internal control procedures to assure that documents inside each employee file and other related documents supports the payroll payments.

**Questioned Costs**      None

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section II – Financial Statements Findings**

<b>Finding Reference</b>	<b>02-07</b>
<b>Requirement</b>	<b>Cash Receipts-Revenue, Receivable - Collections</b>
<b>Statement of Condition</b>	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:  a. For several receipts the Municipality did not maintain an effective internal control to assure the proper filing of the receipts supporting documents.
<b>Criteria</b>	The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter III, Section V, establish 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.
<b>Cause of Condition</b>	The Municipality did not establish effective internal control to assure that revenues were properly documented.
<b>Effect of Condition</b>	The Municipality is not in compliance with the Chapter III, Section V Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.
<b>Recommendation</b>	We recommend that the Municipality should maintain supporting evidence for all collections received.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-08</b>
<b>Program</b>	<b>Section 8 Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (CFDA 14.856) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Eligibility of Individuals</b>
<b>Statement of Condition</b>	During our verification of twenty (25) participant files we noted the following situations:  a. In seven (7) participant files the PHA did not obtain during the admission or re-examination process a complete third party evidence to support family annual income.
<b>Criteria</b>	Code of Federal Regulations 24, Subpart E, Section 882.514 state that PHA is responsible for receipt and review of applications, and determination of family eligibility for participation in accordance with HUD regulations.
<b>Cause of Condition</b>	The Federal Program Department does not maintain adequate monitoring procedures to assure that the participant files include all required documentation.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart E, Section 882.514.
<b>Recommendation</b>	We recommend the Program to establish monitoring procedures to assure that the participant's files include all documentation required by federal agencies.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-09</b>
<b>Program</b>	<b>Section 8 Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (CFDA 14.856) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Special Reporting</b>
<b>Statement of Condition</b>	We noted that the form HUD 50058, Family Report Form (OMB No. 2577-0083) was not submitted electronically to HUD during the fiscal year 2001-2002.
<b>Criteria</b>	Code of Federal Regulations 24, Section 908 and 982.158 requires to the PHA to submit the form HUD-50058, Family Report Form, electronically to HUD each time the PHA completes an admission, annual reexamination, interim reexamination, portability move-in, or other change or unit for a family. The PHA must also submit the Family Report when a family ends participation in the program or moves out to the PHA's jurisdiction under portability.
<b>Cause of Condition</b>	The person in charge to submit the Form HUD-50058 to HUD had problems with the transmission computer system. The Municipality did not correct the situation during the fiscal year 2001-2002.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Part 908 and 982.158.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

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

**Recommendation**      We recommend the Municipality to strength its procedures in order to assure that the form HUD-50058, Family Report Form,(OMB No. 2577-0083) was submitted electronically to HUD each time the PHA completes an admission, annual reexamination, interim reexamination, portability move-in, portability move-out, and when a family end participation in the program.

**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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-10</b>
<b>Program</b>	<b>Section 8 Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (CFDA 14.856) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Special Test - Utility Allowance Schedule</b>
<b>Statement of Condition</b>	The Municipality did not maintain and up-to-date utility allowance schedule for the audit period ending June 30, 2002. There is no evidence of the last time that the Utility Allowance Schedule was actualized.
<b>Criteria</b>	Code of Federal Regulations 24, Section 882.510 states that the Municipality must establish or ensure tenant utility allowances based on utility consumption and rate date for various sized units, structure types and fuel types and make annual review of tenant utility allowances to determine their reasonableness, and adjust the allowance, when appropriate.
<b>Cause of Condition</b>	The Municipality did not follow the procedures established to review utility rate data each year.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Section 882.510.
<b>Recommendation</b>	The Municipality should evaluate the utility allowance rate each year as established in the Federal Regulations.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**        **02-11**

**Program**                    **Section 8 Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (CFDA 14.856) U.S. Department of Housing and Urban Development**

**Requirement**            **Special Test – Housing Quality Standards**

**Statement of Condition** During our verification of twenty five (25) participant files we noted the following situations:

- a. Six (6) participant files did not indicate if Housing Quality Inspections were performed at the time of the initial occupancy and at least annually thereafter to assure that units are decent, safe and sanitary.
- b. Seventeen (17) participant files did not contain evidence that the Municipality followed up the deficiencies noted on the unit inspection. Also, did not show that the PHA property stopped HAP's or terminated (abated) the HAPs contract.

**Criteria**                    Code of Federal Regulations 24, sections 880.612 and 882.516, states that the Municipality must provide housing that is decent, safe and sanitary. To achieve this end, the Municipality must perform housing quality inspections at the time of initial occupancy and at least annually thereafter to assure that the units are decent, safe and sanitary.

**Cause of Condition**    The Municipality did not maintain adequate monitoring procedures to assure that the inspection reports completed by the inspectors evaluate all the requirements established in the Housing Quality Standards.

**Effect of Condition**    The Municipality is not in compliance with Code of Federal Regulations 24, sections 880.612 and 882.516.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**      **02-11 (Continued)**

**Recommendation**      We recommend management to improve its monitoring procedures in order to assure that annual inspections are properly completed by the inspectors verifying the housing unit's compliance with all Housing Quality Standards Requirements. Also, we recommend management to improve its monitoring procedures to assure that the inspections are properly documented in the participant files and to assure that the exceptions detailed in the inspection reports are duly corrected by the owner or the participant in the required period.

**Questioned Costs**      None

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-12</b>
<b>Program</b>	<b>Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Eligibility of individuals</b>
<b>Statement of Condition</b>	<p>We performed an eligibility test and examined a sample of twenty five (25) participant's files. The following summarizes the situations found:</p> <ul style="list-style-type: none"><li>a. Twenty five (25) participant files did not include a release form to allow the PHA to obtain information from third parties.</li><li>b. In twenty five (25) participant files there was no evidence that the PHA provided to the assistance applicants and to the participants in the annual income recertification a "Privacy Act Notice".</li><li>c. Seventeen (17) participant files did not contain a release form to allow the PHA to obtain information from third parties, signed by the head of household spouse or by any members of the family composition who is at least eighteen (18) years of age.</li></ul>
<b>Criteria</b>	<p>Code of Federal Regulations 24, Sections 5.230, and 982.516 states that as a condition of admission or continued occupancy, it requires the tenant and other family members to provide necessary information, documentation and releases for the PHA to verify income eligibility.</p> <p>Code of Federal Regulations 24, Subpart B, Section 5.212 (b) states that all assistance applicants shall be provided with a Privacy Act Notice at the time of application. Also, all participants shall be provided with a Privacy Act Notice at each annual income recertification.</p>
<b>Cause of Condition</b>	<p>The Federal Program Department does not maintain adequate monitoring procedures to assure that the participant files include all required documentation and releases required by federal agencies.</p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-12 (Continued)</b>
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Sections 5.212, 5.230 and 982.516.
<b>Recommendation</b>	We recommend the Program to establish monitoring procedures to assure that the participant's files include all documentation required by federal agencies.
<b>Questioned Costs</b>	None.
<b>Management Response</b>	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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-13</b>
<b>Program</b>	<b>Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Performance Reporting</b>
<b>Statement of Condition</b>	The Municipality answers a (yes) in the items 2, 3, 4, 5, 6, and 11 of the SEMAP Report and we found exceptions during our audit related to those requirements.
<b>Criteria</b>	Code of Federal Regulations 24, Section 985.3 states that under SEMAP, PHAs must submit an annual certification, Form HUD-52648 (OMB No. 2577-0215), to HUD concerning their compliance with program requirements under 14 indicators of performance. Finally, HUD will realize on site visits and verify the Independent Auditors' Annual Audit Reports to assure the compliance with this requirement.
<b>Cause of Condition</b>	The Municipality does not maintain adequate monitoring procedures to assure the compliance with the answers detailed in the SEMAP Report submitted to HUD.
<b>Effect of Condition</b>	The Municipality is in not compliance with Code of Federal Regulations 24, Section 985.3.
<b>Recommendation</b>	We recommend to the Municipality to improve it's internal controls and monitoring procedures to assure that the program comply with federal regulations.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-14</b>
<b>Program</b>	<b>Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Special Reporting</b>
<b>Statement of Condition</b>	We noted that HUD 50058, Family Report Form (OMB No. 2577-0083) was not transmitted electronically to HUD as required by Federal Regulation.
<b>Criteria</b>	Code of Federal Regulations 24, Part 908 requires to the PHA to submit HUD-50058 Family Report Form electronically to HUD each time the PHA completes an admission, annual reexamination, interim reexamination, portability move-in or other change of unit for a family. The PHA must also submit the Family Report when a family ends participation in the program or moves out of the PHA's jurisdiction under portability.
<b>Cause of Condition</b>	The person in charge to submit the Form HUD-50058 to HUD had problems with the transmission computer system. The Municipality did not correct the situation during the fiscal year 2001-2002.
<b>Effect of Condition</b>	The Municipality is in not compliance with Code of Federal Regulations 24, Part 908.
<b>Recommendation</b>	We recommend the Municipality to establish internal control procedures to assure that any transmission problem with the HUD system is corrected in a timely manner.
<b>Questioned Costs</b>	None
<b>Management Response</b>	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

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

**YEAR ENDED JUNE 30, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-15</b>
<b>Program</b>	<b>Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Special Test - Reasonable Rent</b>
<b>Statement of Condition</b>	During our Reasonable Rent test we found the following situations:  a. On nine (9) participant files we noted that the reasonable rent was not duly determined. The certification did not include the comparable rent with other similar units.
<b>Criteria</b>	Code of Federal Regulations 24, Section 982.507 states that the PHA must determine reasonable rent at the time of the initial leasing and must maintain records to document the basis for the determination that the rent paid to the owner is reasonable.
<b>Cause of Condition</b>	The Federal Program Department did not maintain adequate documentation to support the basis for the determination that the rent paid to the owner is reasonable.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Section 982.507.
<b>Recommendation</b>	We recommend that the Federal Program Department establish controls to assure appropriate documentation of the determination of reasonable rent is maintained in participant's files.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-16</b>
<b>Program</b>	<b>Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Special Test - Utility Allowance Schedule</b>
<b>Statement of Condition</b>	The Municipality did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2002. There is no evidence of the last time that the Utility Allowance Schedule was actualized.
<b>Criteria</b>	Code of Federal Regulations 24, Section 982.517 states that the Municipality must maintain an up-to-date utility allowance schedule. The Municipality must review utility rate data for each utility category each year and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category or fuel type since the last time utility allowance was revised.
<b>Cause of Condition</b>	The Municipality did not follow the procedures established to review the utility rate data each year.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Section 982.517.
<b>Recommendation</b>	The Municipality should evaluate utility allowance rate each year as established in the federal regulations.
<b>Questioned Costs</b>	None.
<b>Management Response</b>	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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-17</b>
<b>Program</b>	<b>Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Special Test - Housing Quality Standards Inspections and Housing Quality Standards Enforcement</b>
<b>Statement of Condition</b>	<p>During our examination of twenty five (25) participant files we noted the following situations:</p> <ul style="list-style-type: none"><li>a. In three (3) participant files the PHA staff did not realize at least an annual inspection to determine compliance with HQS.</li><li>b. In five (5) participant files the Municipality did not document the time frame that the owner or the family had to correct the deficiencies detected on the unit inspection.</li><li>c. Seventeen (17) participant files did not contain evidence that the Municipality followed-up up the deficiencies noted on the unit inspection. Also, did not show that the PHA property stopped HAP's or terminated the HAP contract.</li><li>d. In our examination of twenty (25) participant files there was no evidence of a quality control re-inspections performed and documented by a reasonable official. The Program Coordinator represented to us that during the fiscal year 2001-2002 the Municipality did not perform quality control re-inspections.</li></ul>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-17 (Continued)</b>
<b>Criteria</b>	Code of Federal Regulations 24, Sections 982.158 (d) and 982.404 established that for units under contract that fail to meet HQS, the PHA must require the owner to correct any cited life threatening HQS deficiencies within 24 hours after the inspections and all other HQS deficiencies within 30 calendar days or within a specified PHA-approved extensions. If the owner does not correct the cited HQS deficiencies within the specified correction period the PHA must stop the Housing Assistance Payment or must terminate the HAP contract. Also, for family-cause defects, if the family does not correct the cited HQS deficiencies within the specified correction period, the PHA must take prompt and vigorous action to enforce the family obligations.
<b>Cause of Condition</b>	Management does not maintain adequate monitoring procedures to assure that annual inspections and quality control re-inspections were properly performed and documented in participant files and to assure that adequate follow up visits are realized by the management. Also, to assure that the exceptions detailed in the inspection report are corrected in the required period as required in the Housing Quality Standards Enforcement.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Section 982.158 (d) and 982.404.
<b>Recommendation</b>	We recommend management to improve monitoring its procedures to assure that annual inspections and quality control re-inspections are properly documented in the participant files and to assure that the exceptions detailed in the inspection reports are duly corrected by the owner or the participant in the required period.
<b>Questioned Costs</b>	None.
<b>Management Response</b>	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, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-18</b>
<b>Program</b>	<b>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</b>
<b>Requirement</b>	<b>Davis-Bacon Act</b>
<b>Statement of Condition</b>	During our Davis-Bacon Act test for the project 98-FD-07-01, we noted the following situations:  a. There is no evidence that the Municipality’s Employee responsible of applying monitoring procedures reviewed the weekly payrolls to assure that the contractor complied with prevailing wages rates.
<b>Criteria</b>	Davis-Bacon Act, as amended (40 USC 276A-276A-5), Subpart K, 24 CFR 570.603.
<b>Cause of Condition</b>	The Municipality did not apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
<b>Effect of Condition</b>	The Municipality is not in compliance with Davis Bacon Act, as amended (40 USC 276A-276A-5) Subpart K, 24, CFR 570.603.
<b>Recommendation</b>	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 to establish the degree of compliance and the nature and extend of violations, if any, and then, communicate contractors promptly about any failure in the payroll process.
<b>Questioned Costs</b>	None
<b>Management Response</b>	The Municipality Management concurs with the finding. Auditor’s recommendation would be considered as part of corrective action plan development and implementation.

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

**YEAR ENDED JUNE 30, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

**Finding Reference      02-19**

**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                Equipment and Real Property Management**

**Statement of Condition    Section II - Financial Statements Findings - Finding Reference 02-01**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-20</b>
<b>Program</b>	<b>Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs</b>
<b>Requirement</b>	<b>Procurement</b>
<b>Statement of Condition</b>	During our disbursement test of the Community Development Block Grants – State’s Program we did not find evidence that the Municipality requested proposals when procuring a contract for professional services.
<b>Criteria</b>	Code of Federal Regulations 24, Subpart I, 570.489 (g) states that when procuring property or services to be paid for in whole or in part with CDBG funds, the state shall follow its procurements policies and procedures. The state shall establish requirements for procurement policies and procedures for units of general local government, based on full and open competition.
<b>Cause of Condition</b>	The Municipality did not maintain effective controls to assure an adequate procurement process for all purchase of goods or services.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, 570.489 (g), provisions regarding procurement process.
<b>Recommendation</b>	We recommend that the Municipality should improve its procedures to assure that proposals should be requested for the acquisition of professional services.
<b>Questioned Cost</b>	None.
<b>Management Response</b>	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, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-21</b>
<b>Program</b>	<b>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)</b>
<b>Requirement</b>	<b>Procurement and Suspension and Debarment</b>
<b>Statement of Condition</b>	<p>During our contract provision test we noted the following situations:</p> <ul style="list-style-type: none"><li>a. Four (4) contracts did not include a provision for granting access to GAO or other federal Agencies, to books and other documents, etc.</li><li>b. One (1) contract did not include a provision for compliance with the Clean Air Act and Water Act.</li><li>c. One (1) contract did not include a provision for compliance with Energy Policy and Conservation Act.</li><li>d. One (1) contract did not include a provision for compliance with the Copeland “Anti-Kickback” Act.</li><li>e. Four (4) contracts did not include a provision for retention of all required records for three years.</li><li>f. Three (3) contracts did not include a provision for compliance with Executive Order-1991-55 (Certification of Income Tax).</li><li>g. Four (4) contracts did not include a provision about contractor debarment and suspension certification.</li></ul>
<b>Criteria</b>	Code of Federal Regulations 24, Part 570.489 (g) requires that all purchase orders and contracts include all clauses required by Federal Statutes, executive orders and implementing regulations.
<b>Cause of Condition</b>	The Municipality did not maintain appropriate monitoring procedures to detect the exclusion of contract clauses.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-21 (Continued)</b>
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Part 570.489 (g).
<b>Recommendation</b>	We recommend management to update contract model according with the federal requirements, executive orders and regulations.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-22</b>
<b>Program</b>	<b>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</b>
<b>Requirement</b>	<b>Program Income</b>
<b>Statement of Condition</b>	<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"><li>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.</li><li>b. That all program income was properly recorded in the accounting records.</li><li>c. That program income was used in accordance with the program requirements and other regulations applicable.</li></ul>
<b>Criteria</b>	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
<b>Cause of Condition</b>	The Municipality did not maintain adequate internal controls in order to assure the proper determination, accounting and use of program income.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2).

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>01-22 (continue)</b>
<b>Recommendation</b>	We recommend management to develop internal controls and procedures in order to assure that the program income is: properly determined and calculated; properly recorded and used for allowable costs.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III - Major Federal Award Program Findings and Questioned Costs**

**Finding Reference** 02-23

**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** Reporting

**Statement of Condition** During our examination of reporting we noted the following situations on the Closing Report for the Grant Year 1996:

- a. Cash outlays per general ledger pertaining to program year 1996 disagree with cash outlays reported in the Closing Report as follows:
  - 1. The Closing Report did not present available balance for the Cumulative Administrative Account (96-FD-ADM), but the General Ledger presents an available balance of \$5,097.99.
  - 2. The Closing Report did not present available balance for the project 96-FD-07-001, but the General Ledger presents an available balance of \$68.29.
  - 3. The Closing Report did not present available balance for the project 96-FD-07-005, but the General Ledger presents an available balance of \$14,657.98.

**Criteria** Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. This requirement must be available for Federal inspection and must: (i) be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions; (ii) ensure that funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of state and local governments.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2002

**Section III - Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	<b>02-23 (Continued)</b>
<b>Cause of Condition</b>	The Municipality financial management system failed to ensure accurate, current, and complete disclosure of the financial results of financially assisted activities.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Sec. 570.489 (d) (1).
<b>Recommendation</b>	We recommend to the Municipality Management to reconcile differences between the closing report and the general ledgers before report submission to the pass-through grantor.
<b>Questioned Costs</b>	None
<b>Management Response</b>	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, 2002**

**Section III - Mayor Federal Award Program Finding and Questioned Cost**

<b>Finding Reference</b>	<b>01-24</b>
<b>Program</b>	<b>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</b>
<b>Requirement</b>	<b>Sub-recipient Monitoring</b>
<b>Statement of Condition</b>	The Municipality pass through program funds to another entity without signing a written agreement with this sub recipient. Also, the Municipality did not perform the necessary monitoring procedures to obtain a reasonable assurance that the sub recipient administers program funds in compliance with Federal requirements.
<b>Criteria</b>	Code of Federal Regulations 24, Section 570.503 states that before disbursing any CDBG funds to a sub-recipient the Municipality should assure that the agreement between parties include provisions concerning: the statement of work, records and reports, program income and uniform administrative requirements. In addition, the Municipality must perform monitoring activities in order to review the financial information and observes that operations of the sub-recipients are realized in accordance with the agreement.
<b>Cause of Condition</b>	There are no adequate internal controls procedures to assure that sub-recipient complies with Program requirements.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Section 570.503.
<b>Recommendation</b>	We recommend management to sign written agreements with all sub recipients before disbursing any CDBG funds. Those contracts will include the following: a provision concerning the statement of work (scope of work, goals, budget, etc.), a provision concerning the record and reports to be maintained by the sub recipient, a provision concerning the program income requirement applicable to CDBG program and a provision concerning the uniform administrative requirement.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)**

**YEAR ENDED JUNE 30, 2002**

**Section III - Mayor Federal Award Program Finding and Questioned Cost**

**Finding Reference**      **01-24**

**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, 2002**

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
01-07	14.228	<u>The Municipality did not apply monitoring procedures to assure contractors compliance with Davis-Bacon Act.</u>  Partial corrective action has been taken.
01-08	14.228	<u>Inadequate Property Records</u>  No corrective action has been taken.
01-09	14.228	<u>Failures with the procedures and controls over program income</u>  No corrective action has been taken.
01-10	83.544	<u>Activities Allowed or Unallowed - Allowable Cost/Cost Principles</u>  No corrective action has been taken.
01-11	83.544	<u>Failure to provide the quarterly progress reports</u>  No corrective action has been taken.
01-12	83.544	<u>Special Tests-Project Accounting</u>  No corrective action has been taken.
99-III-04	14.228, 83.544	<u>Davis Bacon Act</u>  Partial corrective action has been taken.
99-III-06	14.228	<u>Municipality does not have a property register</u>  No corrective action has been taken.

COMMONWEALTH OF PUERTO RICO  
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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2002

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
00-III-01	83.544	<u>Activities Allowed or Unallowed – Allowed Cost</u>  No corrective action plan has been taken.
00-III-02	83.544	<u>Activities Allowed or Unallowed – Allowable Cost</u>  No corrective action has been taken.
00-III-05	14.228 83.544	<u>Davis Bacon Act</u>  Partial corrective action has been taken.
00-III-06	14.228	<u>Equipment and Real Property Management</u>  No corrective action has been taken.