

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

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

Cmde H. J. S. 2005

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

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COMMONWEALTH OF PUERTO RICO
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SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

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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 financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arroyo, Puerto Rico**, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit. 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 \$2,635,261 (net of capital assets accumulated depreciation) as of June 30, 2004, and total revenues of \$505,788 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-FmHA Project and Statement of Net Assets for the Brisas de Arroyo Housing Project, is solely on the report of the other auditor.

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

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

INDEPENDENT AUDITORS' REPORT (CONTINUED)

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on page 43 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2004 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 10, 2004

Stamp No. 2019427 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**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2004

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

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

FINANCIAL HIGHLIGHTS

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

1. Total assets of the Municipality amounted to \$20,119,643 which represents an increase of 11% compared to prior fiscal year;
2. At the end of fiscal year 2004, total liabilities amounted to \$16,620,243. Out of said amount, \$13,617,980 corresponded to long-term liabilities of which \$5,216,206 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
3. Total net assets of the Municipality amounted to 3,499,400 which represents an increase of 107% compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$12,809,150, derived from the following sources: \$743,557 charges for services; \$3,122,651 from operating grants and contributions; \$1,597,777 from capital grants and contributions obtained from other sources, and \$7,345,165 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$11,000,969;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$1,808,181;
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$1,241,142;
8. As the end of the current fiscal year the Municipality's General Fund deficit amounted to \$3,045,154, compared to a fund deficit of \$2,858,433 in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in an unfavorable balance of \$213,006.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

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

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

FINANCIAL STATEMENTS COMPONENTS

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

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

A brief review of The Statements of Activities of the Municipality at June 30, 2004, shows total expenses incurred to afford the cost of all functions and programs amounted to \$11,000,969. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$5,463,985 was derived from the following sources: \$743,557 charges for services; \$3,122,651 from operating grants and contributions; and \$1,597,777 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$7,345,165. When such figure is added to the \$5,463,985 previously mentioned, total revenues available for the financing of activities amounted to \$12,809,150. There was an excess of revenues over expenses in the amount of \$1,801,181 which contributed with an increase to the figure of net assets attained at the end of the fiscal year.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

INFRASTRUCTURE ASSETS

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

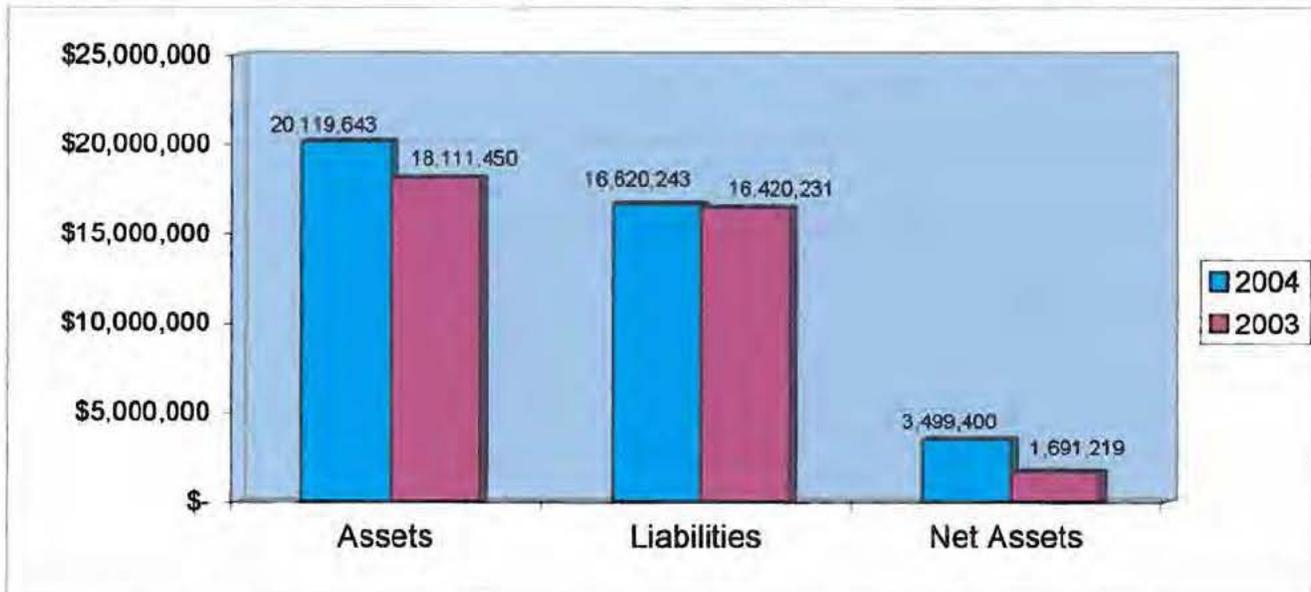
YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Arroyo, primary government liabilities exceeded total assets by \$3,499,400 at the end of 2004, compared to \$1,691,219 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

Condensed Statement of Net Assets	2004	2003	Change	%
Current and other assets	\$ 4,169,237	\$ 4,742,794	\$ (573,557)	(12%)
Capital assets	15,950,406	13,368,656	2,581,750	19%
Total assets	20,119,643	18,111,450	2,008,193	11%
Current and other liabilities	3,002,263	2,144,516	857,747	40%
Long-term liabilities	13,617,980	14,275,715	(657,735)	(5%)
Total liabilities	16,620,243	16,420,231	200,012	1%
Invested in capital assets, net of related debt	12,369,678	9,638,707	2,730,971	28%
Restricted	4,234,964	5,284,262	(1,049,298)	(20%)
Unrestricted deficit	(13,105,242)	(13,231,750)	126,508	(1%)
Total net assets	\$ 3,499,400	\$ 1,691,219	\$ 1,808,181	107%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2004, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to \$1,808,181 increase in the Municipality's net assets. Approximately 22 percent of the Municipality's total revenue came from taxes, while 70 percent resulted from grants and contributions, including federal aid. The Municipality's expenses cover a range of services. The largest expenses were for general government, health and welfare services, public works, and community development. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

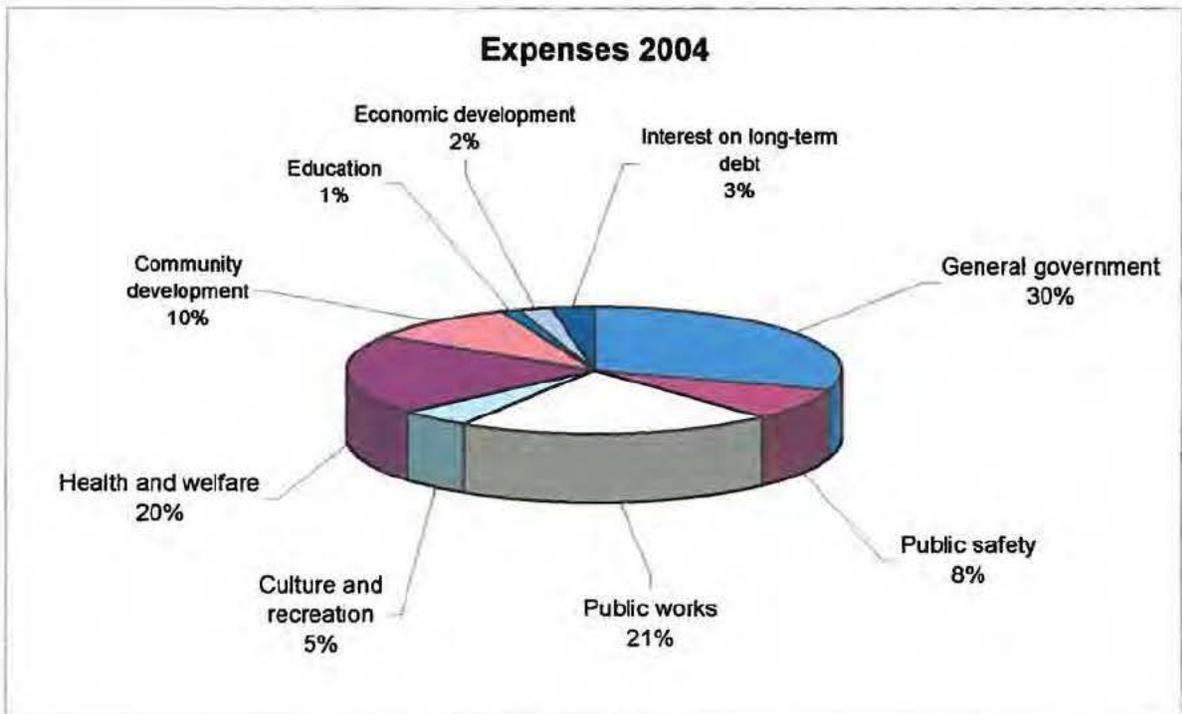
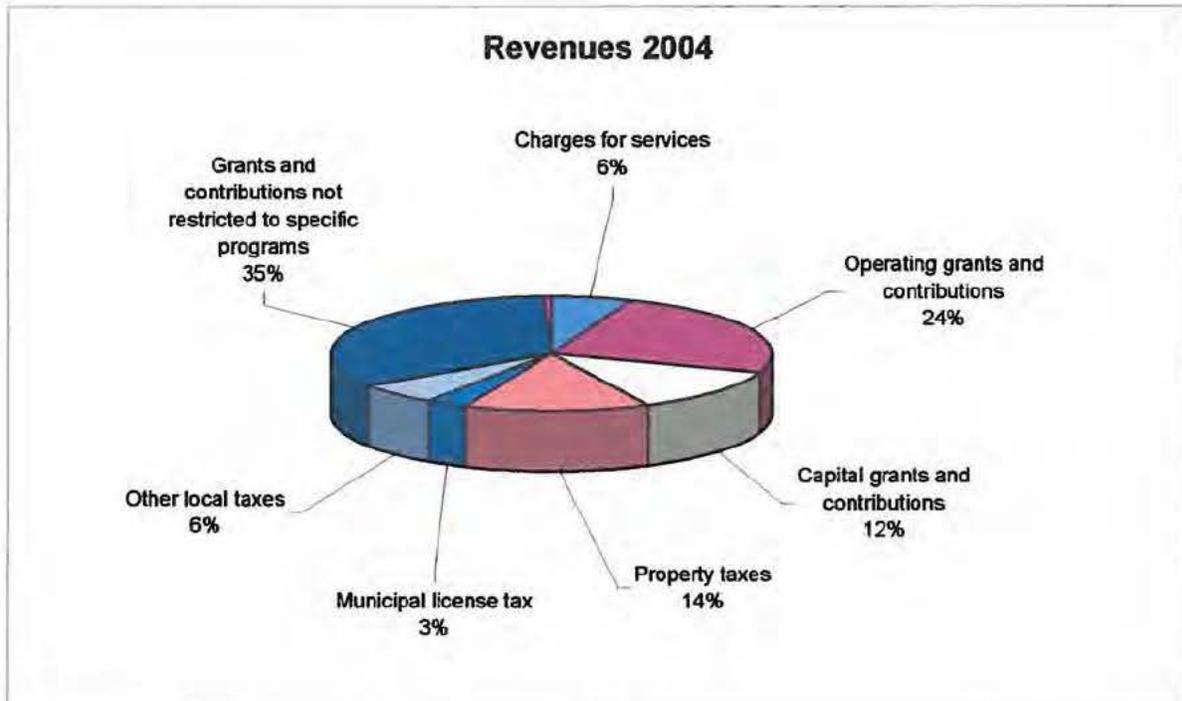
Condensed Statement of Activities	2004	2003	Change	%
Program revenues:				
Charges for services	\$ 743,557	\$ 759,667	\$ (16,110)	(2%)
Operating grants and contributions	3,122,651	3,441,204	(318,553)	(9%)
Capital grants and contributions	1,597,777	49,043	1,548,734	3158%
General revenues:				
Property taxes	1,772,310	1,562,185	210,125	13%
Municipal license tax	364,220	301,081	63,139	21%
Other local taxes	794,257	182,153	612,104	336%
Grants and contributions not restricted to specific programs	4,359,413	4,005,247	354,166	9%
Interest and investment earnings	47,918	68,305	(20,387)	(30%)
Gain (loss) on retirement of capital assets	(725)		(725)	100%
Miscellaneous	7,772	67,825	(60,053)	(89%)
Total revenues	12,809,150	10,436,710	2,372,440	23%
Expenses:				
General government	3,310,327	3,704,209	(393,882)	(11%)
Public safety	870,334	894,898	(24,564)	(3%)
Public works	2,284,770	2,240,611	44,159	2%
Culture and recreation	538,414	444,701	93,713	21%
Health and welfare	2,236,749	2,439,720	(202,971)	(8%)
Community development	1,076,662	925,992	150,670	16%
Education	122,118	123,354	(1,236)	(1%)
Economic development	242,639	195,283	47,356	24%
Interest on long-term debt	318,956	322,831	(3,875)	(1%)
Total expenses	11,000,969	11,291,599	(290,630)	(3%)
Change in net assets	1,808,181	(854,889)	2,663,070	(312%)
Net assets, beginning of year, as restated	1,691,219	2,546,108	(854,889)	(34%)
Net assets, end of year	\$ 3,499,400	\$ 1,691,219	\$ 1,808,181	107%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$1,241,142, a decrease of \$1,357,136 in comparison with the prior year. There are reservations of fund balance amounting to \$4,699,348. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$376,249), 2) to pay debt service (\$392,799), 3) to pay for capital projects (\$289,318) and 4) for other purposes (\$3,640,982).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2004, the general fund has an undesignated fund deficit of \$3,458,206.

GENERAL FUND BUDGETARY HIGHLIGHTS

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

The actual General Fund budgetary activities resulted in an unfavorable balance of \$213,006.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has not maintained complete and adequate records related to the Capital Assets acquired and constructed in the past years, but the Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets, and then, comply with such requirement. The Municipal Administration expects to develop a broad and comprehensive identification and assessments project of all fixed assets owned by the local government in order to capitalize them in its Statement of Net Assets, and then, reflects the correct net assets figure of the Municipality as a whole.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$25,338,139, net of accumulated depreciation of \$9,387,733 (including depreciation charges for the year totaled \$630,452), leaving a net book value of \$15,950,406. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2004, the Municipality has \$979,001 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

Debt Administration

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

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

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

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

FINAL COMMENTS

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

On September 7, 2004, Public Law 255 was enacted to amend Section 22 of the Public Law 83 of May 2, 1941, know as the Puerto Rico Electric Power Authority ("PREPA") Act. This Law stipule a new formula to determine the contribution in lieu of taxes to be distributed to the Municipalities of the Commonwealth of Puerto Rico. From fiscal year 2002-2003 the PREPA is required by law to distribute as contribution in lieu of taxes a twenty percentage of its net revenues, after deduction of subsidies granted, or an amount equal to the actual cost of electric power consumed by each Municipality, or an average of the contribution in lieu of taxes paid to each Municipality in the last most recent five fiscal years, whichever is greater.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 477, Arroyo, Puerto Rico 00714-0477, or call (787) 839-2030.

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

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 1,543,567
Cash with fiscal agent	1,738,876
Accounts receivable:	
Intergovernmental	143,479
Federal grants	721,082
Other	22,233
Capital assets	
Land, improvements, and construction in progress	4,404,962
Other capital assets, net of depreciation	11,545,444
Total capital assets	15,950,406
Total assets	20,119,643
 Liabilities	
Accounts payable and accrued liabilities	1,910,536
Due to other governmental entities	568,888
Deferred revenues:	
Municipal license tax	307,970
Federal grant revenues	126,734
Interest payable	88,135
Noncurrent liabilities:	
Due within one year	575,476
Due in more than one year	13,042,504
Total liabilities	16,620,243
 Net Assets	
Invested in capital assets, net of related debt	12,369,678
Restricted for:	
Capital projects	289,318
Debt service	304,664
Other purpose	3,640,982
Unrestricted (deficit)	(13,105,242)
Total net assets	\$ 3,499,400

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

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

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 3,310,327	\$ 15,484	\$ 124,952	\$ -	\$ (3,169,891)
Public safety	870,334		36,010		(834,324)
Public works	2,284,770	98,976	100,652	1,551,480	(533,662)
Health and welfare	2,236,749	505,788	1,536,829		(194,132)
Culture and recreation	538,414	123,309			(415,105)
Economic development	242,639		252,230		9,591
Community development	1,076,662		1,051,794	46,297	21,429
Education	122,118		20,184		(101,934)
Interest on long-term debt	318,956				(318,956)
Total governmental activities	\$ 11,000,969	\$ 743,557	\$ 3,122,651	\$ 1,597,777	(5,536,984)
General revenues:					
Property taxes					1,772,310
Municipal license tax					364,220
Other local taxes					794,257
Grants and contributions not restricted to specific programs					4,359,413
Interest and investment earnings					47,918
Gain (Loss) on retirement of capital assets					(725)
Miscellaneous					7,772
Total general revenues					7,345,165
Change in net assets					1,808,181
Net assets - beginning, as restated					1,691,219
Net assets - ending					\$ 3,499,400

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

	General Fund	Special Revenue Fund Local and State Grants	Special Revenue Fund FmHA Project	Special Revenue Fund Other Federal Grants	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
Assets							
Cash and cash equivalents	\$ -	\$ 506,297	\$ 827,772	\$ 86,361	\$ -	\$ 123,137	\$ 1,543,567
Cash with fiscal agent	376,436				979,001	383,439	1,738,876
Accounts receivable:							
Intergovernmental	7,561	126,115		721,082		9,803	864,561
Due from other funds	750,720	2516,693			29,701	-	3,297,114
Other			2,544			237	2,781
Other assets			5,485			-	5,485
Total assets	\$ 1,134,717	\$ 3,149,105	\$ 835,801	\$ 807,443	\$ 1,008,702	\$ 516,616	\$ 7,452,384
Liabilities and Fund Balances							
Liabilities:							
Accounts payable and accrued liabilities	\$ 929,734	\$ 21,426	\$ 122,603	\$ 413,548	\$ 408,310	\$ 14,915	\$ 1,910,536
Due to other governmental entities	568,888						568,888
Due to other funds	2,373,279	259,503		313,841	311,074	39,417	3,297,114
Deferred revenues:							
Municipal license tax	307,970					-	307,970
Federal grant revenues				57,249		69,485	126,734
Total liabilities	4,179,871	280,929	122,603	784,638	719,384	123,817	6,211,242
Fund balances:							
Reserved for:							
Encumbrances	376,249						376,249
Capital projects					289,318		289,318
Other purposes		2,868,176	713,198	22,805			3,604,179
Reserved reported in nonmajor funds:							
Debt service fund						392,799	392,799
Unreserved:							
Designated for specific fund purposes	36,803						36,803
Undesigned	(3,458,206)						(3,458,206)
Total fund balances	(3,045,154)	2,868,176	713,198	22,805	289,318	392,799	1,241,142
Total liabilities and fund balances	\$ 1,134,717	\$ 3,149,105	\$ 835,801	\$ 807,443	\$ 1,008,702	\$ 516,616	

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

Accrual basis of accounting account receivables recognized in government-wide financial statements	13,967
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	15,950,406
Long-term liabilities and accrued interests are not due and payable in the current period, and therefore, are not reported in the funds	<u>(13,706,115)</u>
Net assets of governmental activities	\$ 3,499,400

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

	General Fund	Special Revenue Fund Local and State Grants	Special Revenue Fund FmHA Project	Special Revenue Fund Other Federal Grants	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
Revenues							
Property taxes	\$ 1,482,050	\$ -	\$ -	\$ -	\$ -	\$ 290,260	\$ 1,772,310
Municipal license taxes	364,220	-	-	-	-	-	364,220
Licenses, permits and other local taxes	819,884	-	-	-	-	-	819,884
Intergovernmental	4,457,864	495,300	-	-	54,800	26,405	5,034,369
Rent of property	113,382	-	505,788	-	-	-	619,170
Interest	47,918	-	-	-	-	-	47,918
Federal grants	-	-	-	1,550,606	-	1,007,077	2,557,683
Miscellaneous	92,565	-	-	17,315	-	-	109,880
Total revenues	7,377,883	495,300	505,788	1,567,921	54,800	1,323,742	11,325,434
Expenditures							
Current							
General government	\$ 4,192,910	13,947	-	2,736	-	-	4,209,593
Public safety	829,539	25,396	-	-	-	-	854,935
Public works	1,766,628	46,130	-	81,007	524,238	-	2,417,903
Health and welfare	343,127	29,648	515,733	447,889	-	1,033,482	2,369,879
Culture and recreation	376,150	14,551	-	-	27,470	-	418,171
Economic development	-	242,839	-	-	-	-	242,839
Community development	-	22,300	-	1,051,794	356,900	-	1,430,994
Education	-	122,118	-	-	-	-	122,118
Debt service	-	-	23,429	-	-	270,792	294,221
Interest	-	-	158,332	-	-	163,645	321,977
Total expenditures	7,508,354	516,729	697,494	1,583,426	908,608	1,467,939	12,882,570
Excess (deficiency) of revenues over (under) expenditures	(130,471)	(21,429)	(191,706)	(15,505)	(853,808)	(144,217)	(1,357,136)
Other financing sources (uses)							
Transfers in	-	15,000	-	-	-	41,250	56,250
Transfers out	(56,250)	-	-	-	-	-	(56,250)
Total other financing sources (uses)	(56,250)	15,000	-	-	-	41,250	-
Net change in fund balances	(186,721)	6,429	(191,706)	(15,505)	(853,808)	(102,967)	(1,357,136)
Fund balances (deficit), beginning as restated	17,358,433	2,874,605	904,904	38,310	1,143,126	495,786	20,815,164
Fund balances (deficit), ending	\$ 17,171,712	\$ 2,881,034	\$ 713,198	\$ 22,805	\$ 289,318	\$ 392,799	\$ 19,464,067

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2004

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Arroyo** (the Municipality) was founded on the year 1855. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a twelve member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

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

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2003. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality has elected to delay the capitalization of infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

Based on the above criteria, the financial statements of Brisas de Arroyo Housing Project no. 66-006-69066021 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, Puerto Rico. 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. The Project operated 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 Municipality's Chief Financial Officer at P.O. Box 477, Arroyo, Puerto Rico 00714-0477, or call (787) 839-2030.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

B. Government-wide and fund financial statements

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

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

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

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

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

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

Special Revenue Fund – FmHA Housing Project - Special Revenue Funds are used to account for revenues derived from the blended component unit activities. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

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

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

C. Financial reporting presentation

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

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

Special Revenue Fund – Section 8 Moderate Rehabilitation - Special Revenue Funds are used to account for revenues derived from section 8 moderate rehabilitation program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund – FmHA Housing Project - Special Revenue Funds are used to account for revenues derived from the blended component unit activities. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

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

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

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

D. Measurement focus, basis of accounting and financial presentation

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

E. Assets, liabilities and net assets

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

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

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

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the General Fund represents mostly contributions from the Puerto Rico Electric Power Authority (PREPA), which, pays the municipalities as contributions in lieu of taxes greater of the following amounts: (a) twenty percent (20%) of its net revenues as defined in the Trust Indenture signed with the Trustee as representative of the bondholders, adjusted by subsidies granted by the PREPA; (b) an amount equal to the actual cost of electric power consumed by each Municipality in its common facilities during the current year; or (c) an average of the contribution in lieu of taxes paid by PREPA to each municipality during the past five fiscal years. The contribution in lieu of tax revenue and related receivable recorded in the General Fund for the current fiscal year was determined based on the preliminary liquidation made by the PREPA. Such liquidation is subject to final results of the PREPA financial statements audit. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

- 4. Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

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

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

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

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

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

7. **Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.
8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:
 - a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
 - b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
 - c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
 - d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:
 - a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
10. **Risk financing-** The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2004 amounted to approximately \$228,809. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$144,897 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

11. Reconciliation of Government-wide and Fund Financial Statements

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

		<u>Total Net Assets</u> <u>Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 15,950,406	
Deduct:		
Section 515 direct loan	(2,100,998)	
Bonds payable related to capital assets	<u>(1,479,730)</u>	\$ 12,369,678
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		289,318
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service	\$ 392,799	
Deduct:		
Interest payable	<u>(88,135)</u>	304,664
<u>Net assets restricted for other purposes</u>		
Funds balance restricted for other purposes	\$ 3,604,179	
Fund balance restricted for specific purposes	<u>36,803</u>	3,640,982
<u>Net assets unrestricted (deficit)</u>		
General Fund – total deficit:	\$ (3,045,154)	
Add:		
Accrual basis account receivables	13,967	
Deduct:		
Bond payables related to operational debts	(1,545,478)	
Notes payables related to operational debts	(90,000)	
Compensated absences debt	(1,173,958)	
Property taxes debt – Treasury Department	(259,391)	
Fund balance restricted for specific purposes	(36,803)	
Claims and judgments debt	(7,400)	
Landfill obligation	(3,743,418)	
CRIM-Law 42	(2,269,608)	
CRIM-Law 146	<u>(947,999)</u>	<u>(13,105,242)</u>
Total net assets – governmental activities		<u>\$ 3,499,400</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

2. DEPOSITS

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

The Municipality's bank balances in commercial banks of approximately \$506,297 in the special revenue fund - local and state grants, \$827,772 in the special revenue fund - FmHA housing project, and \$86,361 in the special revenue fund - other federal grants were fully collateralized at June 30, 2004. In the other governmental funds there were deposits with commercial banks of approximately \$123,137 that were fully collateralized.

The deposits at GDB of approximately \$376,436, that is restricted for specific purposes in the general fund, the \$979,001, that is restricted principally for capital projects in the capital project fund - local and state and federal grants, and the \$383,439 in the other governmental funds that is restricted for debt service are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality impose a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 24 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2004, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues

2. Other organizations- 0.50% of gross revenues

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

3. RECEIVABLES (CONTINUED)

B. Intergovernmental Receivables- Intergovernmental receivables in the general fund consist of the amount due from the Puerto Rico Electric Power Authority ("PREPA") resulting from the revenues the Municipality is entitled to receive in lieu of payment of taxes. The amounts receivable from PREPA is as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Puerto Rico Electric Power Authority ("PREPA")	<u>\$ 7,561</u>
Total	<u>\$ 7,561</u>

On September 7, 2004, Act Num. 255 was enacted and a new formula as described in Note 1 (E) (2), was established for the calculation of the contribution in lieu of taxes to be paid to the municipalities by PREPA. Since the final liquidation following such formula was not available for fiscal year 2003-2004, the PREPA issued a preliminary liquidation, which could be affected by final results of the PREPA financial statements audit.

Intergovernmental receivable in special revenue fund – local and state grants represent expenditures incurred not yet reimbursed by a state agency. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Department of Labor	<u>\$ 126,115</u>
Total	<u>\$ 126,115</u>

Federal Grant receivable in special revenue fund – other federal grants represent expenditures incurred not yet reimbursed by the pass-through grantors. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$ 451,679
Child and Adult Care Food Program	3,534
Child Care and Development Block Grant	<u>265,869</u>
Total	<u>\$ 721,082</u>

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

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	<u>\$ 9,803</u>
Total	<u>\$ 9,803</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

4. INTERFUND TRANSACTIONS

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

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund – Local and State Grants	Payrolls, accruals, and other expenditures not reimbursed	\$ 259,503
General Fund	Special Revenue Fund – Other Federal Grants	Payrolls, accruals, and other expenditures not reimbursed	313,841
General Fund	Capital Projects Fund – Local, State and Federal Grants	Cash pool in the same bank account	137,959
General Fund	Other Governmental Funds	Payrolls, accruals, and other expenditures not reimbursed	39,417
Special Revenue Fund – Local and State Grants	General Fund	Cash pool in the same bank account	2,343,578
Special Revenue Fund – Local, State and Federal Grants	Capital Projects Fund – Local, State and Federal Grants	Loan to finance capital project activities	173,115
Capital Projects Fund – Local, State and Federal Grants	General Fund	Cash pool in the same bank account	<u>29,701</u>
Total			<u>\$ 3,297,114</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Capital Project Fund – State and Local Grants	Transfer for culture and recreational activities	\$ 15,000
General Fund	Other Governmental Funds	Debt Retirement	<u>41,250</u>
Total			<u>\$ 56,250</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2004, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2004</u>
Capital asset, not being depreciated:				
Land	\$ 862,024	\$ 929,471	(\$862,024)	\$ 929,471
Construction in progress	1,410,016	1,470,475		2,880,491
Land and improvements-Housing Project	<u>625,118</u>	<u> </u>	<u>(30,118)</u>	<u>595,000</u>
Total capital assets not being depreciated	<u>2,897,158</u>	<u>2,399,946</u>	<u>(892,142)</u>	<u>4,404,962</u>
Capital assets, being depreciated:				
Buildings	13,401,540			13,401,540
Buildings improvements	209,680	48,900		258,580
Infrastructure	4,500	1,145,477		1,149,977
Infrastructure improvements	282,417	33,818		316,235
Equipment	308,469	140,759	(4,024)	445,204
Furnishing	259,993	22,993	(1,395)	281,591
Work of Art	3,410			3,410
Computers	36,419	19,624	(981)	55,062
Vehicles	1,587,801	40,588		1,628,389
Housing Projects - depreciable assets	<u>3,140,225</u>	<u>252,964</u>		<u>3,393,189</u>
Total capital assets being depreciated	<u>19,234,454</u>	<u>1,705,123</u>	<u>(6,400)</u>	<u>20,933,177</u>
Less accumulated depreciation for:				
Buildings	(4,801,149)	(335,038)		(5,136,187)
Buildings improvements	(11,918)	(6,246)		(18,164)
Infrastructure	(56)	(113)		(169)
Infrastructure improvements	(4,578)	(18,828)		(23,406)
Equipment	(185,440)	(57,127)	3,363	(239,204)
Furnishing	(183,227)	(22,435)	1,353	(204,309)
Work of Art	(227)	(341)		(568)
Computers	(29,947)	(5,737)	959	(34,725)
Vehicles	(1,442,954)	(98,218)		(1,541,172)
Housing Project - depreciable assets	<u>(2,103,460)</u>	<u>(86,369)</u>		<u>(2,189,829)</u>
Total accumulated depreciation	<u>(8,762,956)</u>	<u>(630,452)</u>	<u>5,675</u>	<u>(9,387,733)</u>
Total capital assets being depreciated, net	<u>10,471,498</u>	<u>1,074,671</u>	<u>(725)</u>	<u>11,545,444</u>
Governmental activities capital assets, net	<u>\$13,368,656</u>	<u>\$3,474,617</u>	<u>(\$892,867)</u>	<u>\$15,950,406</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:	Amount
General government	\$ 290,704
Public safety	31,152
Public works	68,081
Culture and recreation	89,717
Health and welfare	125,132
Community development	<u>25,666</u>
Total depreciation expense-governmental activities	<u>\$ 630,452</u>

6. PROPERTY TAXES

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

6. PROPERTY TAXES (CONTINUED)

On December 31, 1992 the Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2004, the related unpaid property tax advances included in the Statement of Net Assets amounted to \$259,391 and is payable as follows:

<u>Year Ending</u> <u>June 30,</u>	<u>Amount</u>
2005	\$ 43,231
2006	43,231
2007	43,231
2008	43,231
2009	43,231
2010	<u>43,236</u>
Total	<u>\$ 259,391</u>

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

On June 26 1997, Public Law Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable o equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

6. PROPERTY TAXES (CONTINUED)

In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The Government-Wide Statement of Net Assets includes an outstanding debt balance of \$2,269,608 and \$947,998 related to Law 42 and Law 146, respectively.

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

The annual tax rate is 8.08% for real property and 6.08% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.25% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

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

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM) – Fiscal Year 2003-2004 Liquidation	\$ 15,234
General Services Administration	6,712
Department of Labor – Unemployment	88,984
Department of Treasury	340,685
Retirement System Administration	56,696
Internal Revenue Service	23,509
Puerto Rico Aqueduct and Sewer Authority	<u>37,068</u>
Total	<u>\$ 568,888</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. DEFERRED REVENUES

A. Municipal License Tax- The deferred revenues of approximately \$307,970 in the general fund relates to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

8. DEFERRED REVENUES (CONTINUED)

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

<u>Program Description</u>	<u>Amount</u>
Public Assistance Grants	\$ 22,758
Juvenile Justice and Delinquency Prevention	12,340
Public Safety Partnership and Community Policing Grant	22,130
Others	<u>21</u>
Total	<u>\$ 57,249</u>

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

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Voucher	\$ 49,815
Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation	<u>19,670</u>
Total	<u>\$ 69,485</u>

9. LONG-TERM LIABILITIES

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

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable	\$ 3,166,000	\$ -	(\$ 140,792)	\$ 3,025,208	\$ 140,208
Notes payable	220,000		(130,000)	90,000	40,000
Property taxes debt	3,753,837		(276,840)	3,476,997	230,868
Compensated absences	1,052,185	121,774		1,173,959	129,350
Landfill obligation	3,743,418			3,743,418	
Section 515 direct loan	2,124,427		(23,429)	2,100,998	27,650
Department of Labor	98,964		(98,964)	-	
Claims and judgments	<u>25,688</u>	<u>7,400</u>	<u>(25,688)</u>	<u>7,400</u>	<u>7,400</u>
Total	<u>\$ 14,184,519</u>	<u>\$ 129,174</u>	<u>(\$ 695,713)</u>	<u>\$ 13,617,980</u>	<u>\$ 575,476</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

9. LONG-TERM LIABILITIES (CONTINUED)

1. **Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.
2. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. Bonds payable outstanding at June 30, 2004 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2004</u>
1997-Series	1-1-2004	\$ 96,000	4.88%	\$ 5,208
2000-Series	7-1-2009	1,065,000	5.00% to 8.00%	730,000
2002-Series	7-1-2026	940,000	5.00% to 7.50%	920,000
2002-Series	7-1-2026	1,410,000	2.70% to 5.60%	<u>1,370,000</u>
Total general obligation bonds				<u>\$ 3,025,208</u>

These bonds are payable from the ad valorem property tax of 1.25% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 140,208	\$ 148,143
2006	150,000	181,190
2007	160,000	170,115
2008	175,000	158,082
2009	185,000	145,069
2010-2014	475,000	595,438
2015-2019	475,000	473,545
2020-2024	690,000	298,458
2025-2029	<u>575,000</u>	<u>56,583</u>
Total	<u>\$ 3,025,208</u>	<u>\$ 2,226,623</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

9. LONG-TERM LIABILITIES (CONTINUED)

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

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2004</u>
1987-Series	7-1-2006	\$440,000	0% to 8.50%	\$ 90,000
Section 515 loan	7-1-2029	5,125,000	7.00% to 9.00%	<u>2,100,998</u>
Total notes payable				<u>\$ 2,190,998</u>

The 1987 Series Note is payable with General Fund sources of revenues, and the Section 115 Note is payable with the blended component unit source of revenues

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 67,650	\$ 154,933
2006	79,698	150,894
2007	31,901	144,263
2008	24,267	141,705
2009	36,811	138,955
2010-2014	247,486	645,730
2015-2019	354,808	538,408
2020-2024	509,195	384,022
2025-2029	712,957	162,160
2030-2034	<u>126,225</u>	<u>1,551</u>
Total	<u>\$ 2,190,998</u>	<u>\$ 2,462,621</u>

- 4. Property Tax Debt** - These amounts represent the balance owned to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2004, as described in Note 6.
- 5. Compensated absences** - The government-wide statement of net assets includes approximately \$821,849 of accrued sick leave benefits, and approximately \$352,110 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

9. LONG-TERM LIABILITIES (CONTINUED)

6. **Landfill obligation** - State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on the future closure and post-closure care cost that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and post-closure care costs is based on the amount of landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$3,743,418 as of June 30, 2004 reported in the Government -Wide Financial Statements, which is based on percent usage (filled) of the landfill. It is estimated that an additional \$200,000 will be recognized as closure and post-closure care expenses between the date of the balance sheet and the date the landfill is expected to be filled to capacity (2007). The estimated total current cost of the landfill closure and post-closure care (\$3,743,418) is based on the amount that would be paid if all equipment, facilities and services required to close, monitor, and maintain the landfill were acquired as of June 30, 2004. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations.

10. PENSION PLAN

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

10. PENSION PLAN (CONTINUED)

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

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2003 amounted to approximately \$213,745 and \$239,575, respectively.

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

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age.

The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

10. PENSION PLAN (CONTINUED)

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

11. RISK MANAGEMENT

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

12. CONTINGENCIES

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$7,400 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

13 BEGINNING FUND BALANCES RESTATEMENT

The beginning Fund Balance (Deficit) for General Fund has been restated by approximately \$50,250 to properly presents the previously reported fund balance at June 30, 2003. The restatement is mainly due to the elimination of interfund transactions pending at year end.

The beginning Fund Balance for Special Revenue - Other Federal Grants has been restated by approximately \$38,310 to properly present the previously reported fund balance at June 30, 2003. The restatement is mainly due to the reclassification of fund balance to deferred revenue.

The beginning Fund Balance for Debt Service Fund, included in the Other Governmental Funds, has been restated by approximately \$42,943 to properly presents the previously reported fund balances at June 30, 2003. The restatement is mainly due to the recognition of the amount due from CRIM related to Final Liquidation for the fiscal year 2002-2003.

The beginning Governmental Activities Net Assets has been restated by approximately \$68,299 to properly present the previously reported net assets at June 30, 2003. The restatement is mainly due to fund balances restatement described above, the recognition of bond and notes accrued interest as of the beginning of the current fiscal year, and adjustment to beginning capital assets and long-term debt balances.

14. SUBSEQUENT EVENTS

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2004**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u> (Budgetary Basis)	<u>Variance with</u> <u>Final Budget</u>
	<u>Original</u>	<u>Final</u>	<u>(See Note 1)</u>	<u>Positive</u> <u>(Negative)</u>
REVENUES:				
Property taxes	\$ 1,103,631	\$ 1,286,996	\$ 1,482,050	\$ 195,054
Municipal license tax	465,100	465,100	364,220	(100,880)
Licenses, permits and other local taxes	628,595	628,595	819,884	191,289
Charges for service	110,000	110,000		(110,000)
Intergovernmental	4,845,955	4,845,955	4,262,019	(583,936)
Rent of property	100,000	100,000	113,381	13,381
Fines and forfeitures	1,000	1,000		(1,000)
Interest	65,000	65,000	47,918	(17,082)
Miscellaneous	25,000	25,000	444,660	419,660
Total revenues	<u>7,344,281</u>	<u>7,527,646</u>	<u>7,534,132</u>	<u>6,486</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	3,564,848	4,093,204	4,294,340	(201,136)
Public safety	1,002,840	858,868	832,786	26,082
Public works	1,969,802	1,778,460	1,844,244	(65,784)
Health and welfare	358,329	356,611	343,866	12,745
Culture and recreation	402,837	394,878	390,652	4,225
Operating transfer to other fund	45,625	45,625	41,250	4,375
Total expenditures, encumbrances and other financing uses	<u>7,344,281</u>	<u>7,527,646</u>	<u>7,747,138</u>	<u>(219,492)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (213,006)</u>	<u>\$ (213,006)</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 7,534,132
Differences-budget to GAAP:				
GAAP adjustments to revenues				<u>(156,249)</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,377,883</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 7,747,138
Differences-budget to GAAP:				
Non-budgeted expenditures				36,775
Non-budgeted transfer				15,000
Net change in encumbrances				<u>(234,309)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,564,604</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

NOTES TO BUDGETARY COMPARISON SCHEDULE

YEAR ENDED JUNE 30, 2004

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

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

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

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

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

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

B. Excess Expenditures, Encumbrances and Other Financial Sources Over Budget

The Municipality's General Fund had excess of expenditures, encumbrances and other financial uses over appropriations at the legal level of budgetary control in the following functions\programs:

<u>Expenditures, Encumbrances and Other Financing Uses:</u>	<u>Appropriations</u>	<u>Actual Amounts</u>	<u>Excess</u>
General government	\$ 4,093,204	\$ 4,294,340	(\$201,136)
Public works	1,778,460	1,844,244	(65,784)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico - Department of Education: Child and Adult Care Food Program	10.558	Not Available	\$ 8,963
Total U.S. Department of Agriculture			<u>8,963</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program: Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation	14.856		608,063
Direct Program: Section 8 Housing Choice Voucher Program	14.871		399,014
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs: Community Development Block Grants -State's Program	14.228	97-FD-07 98-FD-07 98-DR-07 99-FD-07 00-FD-07 01-FD-07 02-AB-07 02-FC-07 02-RI-07 03-FC-07 03-AB-07	1,132,801
Total U.S. Department of Housing and Urban Development			<u>2,139,878</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - CONTINUED

YEAR ENDED JUNE 30, 2004

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico - Administration for Children and Families:			
Child Care and Development Block Grant	93.575	Not Available	<u>408,842</u>
Total U.S. Department of Health and Human Services			<u>408,842</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$2,557,683</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, 2004

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 fund financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

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

Description	Special Revenue Fund Other Federal Grants	Other Governmental Funds	Total
Per Schedule of Expenditures of Federal Awards	\$1,550,606	\$1,007,077	\$2,557,683
Non federal programs Expenditures	32,820	460,882	493,702
Total expenditures in the fund financial statements	\$1,583,426	\$1,467,959	\$3,051,385



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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

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

We have audited the basic financial statements of the **Municipality of Arroyo** as of and for the year ended June 30, 2004, and have issued our report thereon dated December 10, 2004, which was unqualified. 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** basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

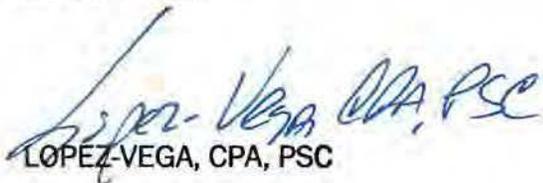
Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Arroyo's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Arroyo's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items **04-01** through **04-03**.

**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 described in the accompanying Schedule of Findings and Questioned Costs are not 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 December 10, 2004.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 10, 2004

Stamp No. 2019428 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:

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- 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, 2004. 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** basic financial statements include the operations of the Brisas de Arroyo Housing Project no. 66-006-69066021, a blended component unit, which received \$2,523,649 in federal awards which is not included in the schedule during the year ended June 30, 2004. 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*.

Except as discussed in the following paragraph, we conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Municipality of Arroyo's** compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the **Municipality of Arroyo's** compliance with those requirements.

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)

We were unable to obtain sufficient documentation supporting the compliance of the Municipality of Arroyo with Child Care and Development Block Grant Program, regarding Reporting Requirement and Financial Administration related to the Standards for Financial Management System (Finding 04-15), nor were we able to satisfy ourselves as to the Municipality of Arroyo's compliance with those requirements by other auditing procedures.

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the Municipality of Arroyo's compliance with the Reporting Requirement and Financial Administration related to the Standards for Financial Management System, 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, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, 04-04 through 04-15.

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 04-04 through 04-15.



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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees on the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness. However, of the reportable conditions described above, we consider items 04-04, through 04-05, 04-08 through 04-13 and 04-15 to be material weaknesses. We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the Municipality of Arroyo in a separate letter dated March 18, 2005.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 18, 2005

Stamp No. 2019429 of the Puerto Rico
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was affixed to the record copy of this report.



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2004

Section I – Summary of Auditors' Results

Financial Statements

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

Federal awards

Internal Control over major programs:		
Material weakness identified?	Yes X	No
Reportable conditions identified not considered to be material weaknesses?	Yes X	None reported
Type of auditors' report issued on compliance for major programs:	Unqualified except for qualified for Child Care and Development Block Grant 93.575	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes X	No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
14.228	Community Development Block Grants – State's Program Lower Income Housing Assistance Program Section 8
14.856	Moderate Rehabilitation
14.871	Section 8 Housing Choice Voucher Program
93.575	Child Care and Development Block Grant 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, 2004

Section II - Financial Statements Findings

Finding Reference	04-01
Requirement	Financial Reporting - Accounting Records
Statement of Condition	During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal funds) and Account Groups.
Criteria	Chapter VIII, Article 8.010 of the 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 update and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.
Recommendation	We recommend that the Municipality should implement internal control 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.

Responsible Person: Néstor Alicea - Finance Director

Implementation Date: April 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

Finding Reference **04-02**

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

Statement of Condition We performed a cash disbursement test and examined thirty one (31) disbursements related to CDBG State Program, thirty nine (39) related to General Fund and twelve (12) related to Child Care and Development Block Grant. The following will summarize the internal control exceptions noted:

- a. Twenty nine (29) General Fund disbursement vouchers, twenty one (21) CDBG State Program disbursement vouchers and eight (8) Child Care Development Block Grant disbursement vouchers were not approved and evaluated by the preinterventor's office.
- b. Five (5) General Fund disbursement vouchers amounting to \$9,011 did not include evidence of the invoice, duly approved by the suppliers.
- c. Five (5) General Fund invoices included with the disbursements vouchers amounting to \$7,535 were not signed by the suppliers.
- d. Sixteen (16) General Fund disbursement vouchers did not include a certification with the name, title and signature of the functionary who requested the quotations and authorized the purchases.
- e. In five (5) General Fund disbursement vouchers amounting to \$14,744, we did not found evidence in the disbursement voucher which support that three (3) quotations were requested and obtained prior to order the goods or services, or prior to the contract date.

Criteria

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

Finding Reference	04-02 (Continued)
Cause of Condition	The Municipality internal control procedures failed to assure that all transactions include all the required documentation.
Effect of Condition	The Municipality is not in compliance with Chapter Four (4) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.
Recommendation	We recommend that the Municipality should improve its internal control and procedures in order to assure that disbursement vouchers contain all the necessary supporting documents before making the payments.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. The Finance Director will review the disbursement process in order to improve the procedures to evaluate them and will instruct the Finance Department staff to assure that disbursement vouchers contain all the necessary supporting documents before making the payments.

Responsible Person: Nestor Alicea - Finance Director

Implementation Date: April 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

Finding Reference	04-03
Requirement	Cash Receipts-Revenue, Receivable - Collections
Statement of Condition	<p>During our examination of the Municipality's procedures related to the cash receipts process we examined twenty five (25) collections and noted the following situations:</p> <ul style="list-style-type: none">a. In four (4) cash collections related to Municipal license, rent and state grants amounting to \$11,608.88, \$1,500 and \$258,079.68 respectively the Municipality did not maintain an effective internal control to assure the proper filing of the receipts supporting documents.b. The Municipality collected and deposited \$258,079.68 in July 1, 2003 , however, the Treasurer Receipt was issued in July 8, 2003.
Criteria	<p>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.</p> <p>The Section IV of the Chapter III, of the Revised Regulation on Basic Standards for Municipalities of Puerto Rico establishes that the Official Treasurer should realize a daily revision of amount collected and amounts credited in bank to assure that revenues has been duly accounted and processed in the period of collection.</p>
Cause of Condition	<p>The Municipality internal controls failed to assure that revenues were properly documented and accounted and processed in the period of collection.</p>
Effect of Condition	<p>The Municipality is not in compliance with the Chapter III, Section V Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.</p>
Recommendation	<p>We recommend that the Municipality should maintain supporting evidence for all collections received.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference **04-03 (continued)**

Questioned Costs None

Management Response The Municipality Management concurs with the finding. The Finance Director will instruct the Finance Department Staff to be more specific in describing the source of the collection in the cash receipts and to maintain the records, documents and files related to the revenues transactions.

Responsible Person: Nestor Alicea – Finance Director

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-04
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	<p>During our verification of ten (10) participant's files, we noted the following situations:</p> <p>a. In six (6) cases, the program staff detected deficiencies as roof leaking, broken doors etc. as detailed in the inspections report. The reinspections were not performed immediately. Those re-inspections were performed after sixty days of the original inspections. After the results of the reinspections, the deficiencies were not corrected.</p>
Criteria	<p>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, 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.</p>
Cause of Condition	<p>The Municipality did not enforce the housing unit owner to correct the deficiencies founded during the inspections in order to maintain housing units decent, safe and sanitary.</p>
Effect of Condition	<p>The Municipality is not in compliance with Code of Federal Regulations 24, sections 880.612 and 882.516.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-04 (continued)**

Recommendation We recommend management to establish enforcement control procedures in order to assure that deficiencies founded in the annual inspections, are corrected immediately, in order to provide decent, safe and sanitary housing units.

Questioned Costs None

Management Response and corrective action The Section 8 Director has been instructed to follow-up failed inspections to ascertain that the dwelling units are in full compliance with HQS as stipulated in Federal Regulations or commence the abatement process against the owner that does not comply with this requirement or the voucher cancellation process against the family. Prior to initiate these severe remedies of HQS violations, the owner and family will receive a briefing process of their responsibilities and the consequences of noncompliance. Once the briefing process has been completed, the owner and the family will be required to sign a briefing certification, which will form part of the file.

Responsible Person: Damaris Hernandez - Section 8 Program Director
Luis A. Torres- Technician

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-05
	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test - Selection from the Section 8 Waiting List
Statement of Condition	We verified if five (5) participants were selected from the top of the waiting list according with the PHA's applicant selection policies. After our procedures we found that three (3) participants were not included in the waiting list.
Criteria	<p>Code of Federal Regulations 24, section 882.514 states that the PHA must select families for participation in accordance with the provisions of the program and in accordance with the PHA's application, including any PHA requirement or preferences as approved by HUD.</p> <p>The PHA administrative plan states that, except for special admissions, participant must be selected from the PHA waiting list. The PHA must select participant from the waiting list on a first-come, first-served basis, in accordance with this same plan, which includes equal opportunity.</p>
Cause of Condition	The Municipality controls and procedures failed to assure that the participants were selected from the top of the waiting list according with the PHA's applicant selection policies.
Effect of Condition	The Municipality is not in compliance with 24 CFR Section 882.514 and with the PHA administrative plan.
Recommendation	We recommend management to improve monitoring procedures to assure that the participants are admitted to the program or are provided the opportunity to be admitted to the program according with the PHA administrative plan.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-05 (continued)**

**Management Response
and Correction Action**

All files have been revised in order to assure compliance with applicable federal statues. The Section 8 Director has been instructed to establish an internal work group to examine internal policies and procedures regarding the waiting list. The waiting list will be revised to include all information required in accordance with Federal Regulations and the Housing Choice Guidebook. Selection from the approved "Waiting List" is based on first-come-first served basis, and/or under federal or local preferences as a results of a well-document emergency situation, such as fire, natural disaster, etc. Furthermore, an eligibility form has been prepared so as to document the certification and determination of eligibility of the family prior to issuing a Housing Choice Voucher to the family.

Responsible Person: Damaris Hernández- Section 8 Program Director

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-06
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test - Reasonable Rent
Statement of Condition	<p>The determination of reasonable rent (reasonable rent certification) was not duly documented. We examined a sample of ten (10) participant's files and found the following situations:</p> <ul style="list-style-type: none">a. In one (1) new participant file the certification of reasonable rent included only one comparable unassisted unit.b. In three (3) participant's files the determination of reasonable rent included only one comparable unassisted unit in a change of unit during fiscal year 2003-2004.c. In two (2) participant file the determination of reasonable rent did not include the comparable rent with other similar unit in a change of unit during fiscal year 2003-2004.
Criteria	<p>Code of Federal Regulations 24, Section 982.507 a (1) 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. Also, Code of Federal Regulations 24, Section 982.507 (b) states that the PHA must determine whether the rent to owner is a reasonable rent in comparison to rent for other comparable unassisted units.</p>
Cause of Condition	<p>The Federal Program Department did not maintain adequate documentation to support the basis for the determination that the rent paid to the owner is reasonable.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-06 (continued)
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Section 982.507 a (1) and 982.507 (b).
Recommendation	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.
Questioned Costs	None
Management Response and Corrective Action	The Section 8 Director has been instructed to develop a staff training protocol that will address this issue. Mandatory training is being schedule for the Municipal Housing Inspector. The Section 8 Director will ensure that the staff is provided with the necessary knowledge and information to perform their duties so that this finding does not occur in the future.

Responsible Person: Damaris Hernández- Section 8 Program Director
Edna Torres – Inspector

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-07
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Allowable Costs and Cost Principles
Statement of Condition	Section II - Financial Statement Findings - Finding Reference 04-02

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Mayor Federal Award Program Finding and Questioned Cost

Finding Reference	04-08
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Allowable Activities
Statement of Condition	<p>During our examination of six (6) housekeeping assistance project participant files, we noted the following situations:</p> <ul style="list-style-type: none">a) In six (6) files the participant did not maintained evidence the Application Form OCAM-AH-002.b) In four (4) files the participant did not complete a housekeeper assessments form OCAM-AH-006, when visited the participant housing unit.c) In six (6) cases the Service Coordinator performed periodical visits to the participant housing unit, but not visited twice a month to ensure quality of services.
Criteria	Code of Federal Regulations 24, Section 570.484 states that the Municipality must assure that the program funds benefit very low, low- and moderate income persons and retain documentation justifying its certification. Also, the Office of the Commissioner of Municipal Affairs ("OCAM") issued a procedures manual for housekeeper activities.
Cause of Condition	The Municipality controls and procedures failed to assure that the housekeeper activities participant's files include all the required documents to comply with the program requirements.
Effect of Condition	The Municipality is in noncompliance with 24 CFR, Section 570.484 and with the Office of the Commissioner of Municipal Affairs ("OCAM") procedures.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **04-08 (Continued)**

Recommendation We recommended management to follow the procedures established by the Office of the Commissioner of Municipal Affairs (OCAM) in the procedures guide title “Guia operacional para la prestación del servicio de Auxiliares en el Hogar”, including the use of the forms included on it.

Questioned Costs None

Management Response The Municipality’s Management concurs with the finding. The Federal Program Director will give instructions to the Program Coordinator to follow the procedures established by the Office of the Commissioner of Municipal Affairs (OCAM) in the procedures guide title “Guia operacional para la prestación del servicio de Auxiliares en el Hogar”, including the use of the forms included on it.

Responsible Person: Nilda García –Housekeeping Program Coordinator

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-09
Program	Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Davis-Bacon Act
Statement of Condition	<p>During our Davis-Bacon Act test for the construction projects, we noted the following situations:</p> <ul style="list-style-type: none">a. In the project 01-FD-07-003 with a cost of \$1,512,000 we found no evidence supporting that the federal program staff, applied adequately the monitoring system developed to ensure contractors compliance with payment of prevailing wages rates to employees. We noted the following:<ul style="list-style-type: none">➤ The contract begun in October 8, 2003 to June 6, 2004 for a period of eight months and we did not find in the contractor’s file the contract weekly payrolls related to the period from October, 2003 to February, 2004.➤ The program staff performed only two interviews to the contractor’s and subcontractor’s laborers in March 31, 2004 and June 25, 2004.b. The Davis Bacon file related to the project 00-FD-07-006 with a cost of \$84,505 was not available for examination.
Criteria	Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
Cause of Condition	The Municipality did not apply adequate and reasonable monitoring procedures developed to assure the compliance with the Davis Bacon requirements for construction contracts in excess of \$2,000.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-09 (Continued)**

Recommendation We recommend management to follow monitoring system procedures developed, including obtaining contractor's and subcontractor's weekly payrolls to be reviewed on a weekly basis by the responsible Municipal Employee 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.

Questioned Costs None

Management Response The Municipality's Management concurs with the finding. The Program Director will monitor the proper submittal of weekly payrolls by contractors. In the cases in which the contractors fails to submit the certified payrolls, the Program Director will notify the Finance Department to withhold the contractors payment until the payrolls are received.

Responsible Person: Néstor Ramirez – Federal Program Director

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-10
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Procurement and Suspension and Debarment
Statement of Condition	<p>During our contract provision test we examined to construction contract with a cost of \$1,512,000 and \$84,505 respectively, we noted the following situations:</p> <ul style="list-style-type: none">a. Two (2) contracts did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours & Safety Standards Act.b. Two (2) contracts did not include a provision for granting accesses to GAO or other federally agency, to books and other documents.c. One (1) contract did not include a provision for compliance with the Clean Air Act and Water Act.d. Two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act.e. Two (2) contracts did not include a provision for compliance with the Copeland "Anti-Kickback".f. Two (2) contracts did not include a provision for retention of all required records for three years.g. Two (2) contracts did not include a provision for executive order 11246 "Equal Employment Opportunity".h. Two (2) contracts did not include a provision for Davis Bacon Act.i. One (1) contract did not include provision for suspension and debarment.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-10 (Continued)
Criteria	Code of Federal Regulations 24, Part 570.489 (g) requires that all purchase orders and contracts include any clauses required by Federal Statutes, executive orders and implementing regulations.
Cause of Condition	The Municipality did not maintain appropriate monitoring procedures to detect the exclusion of certain contract clauses.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Part 570.489 (g).
Recommendation	We recommend management to update contract model according with the federal requirements.
Questioned Costs	None
Management Response	The Program Director requested information to the Municipality's Secretary Office Director of the clauses required to be included in the Federal fund contracts. New contracts for the following fiscal year will contain all clauses requested by Federal Law.

Responsible Person: Néstor Ramirez – Federal Program Director

Implementation Date: April, 2004

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-11
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Program Income
Statement of Condition	<p>During our audit of the program income requirements, we noted that the Municipality did not maintain internal controls to assure:</p> <ul style="list-style-type: none">a. That the program income was properly determined or calculated in accordance with stated criteria and that program income was only collected from allowable sources.b. That all program income was properly recorded in the accounting records.c. That program income was used in accordance with the program requirements and other regulations applicable.
Criteria	<p>Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Also, the CDBG-state program grant agreement states that the Municipality submit to the Office of the Commissioner of Municipal Affairs ("OCAM") an annual report about the program income.</p>
Cause of Condition	<p>Municipality did not maintain adequate internal controls in order to assure the proper determination, accounting, and use of program income.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-11 (continue)
Effect of Condition	Municipality is not in compliance with Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) and with the CDBG-state program grant agreement.
Recommendation	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.
Questioned Costs	None
Management Response	The Municipality's Management concurs with the finding. The Federal Program Director will discuss with the Finance Director the procedures to update the Federal Program Accounting Records for Program Income.

Responsible Person: Néstor Ramirez - Federal Program Director

Implementation Date: April, 2005.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-12
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico - Administration for Children and Families
Requirement	Allowable cost - Cost principles
Statement of Condition	During our disbursement test of the Child Care and Development Block Grant Program we verified electronic fund transfers from the program's account to the Municipality's General account, for a total of \$305,928.58 and \$69,809.60 to the Municipality's payroll account. Those electronic transfers were related to expenditures paid by the Municipality current account on behalf of the Child Care program. The Municipality did not prepare a disbursement or journal voucher to support the electronic transfers. The program maintains separately the support of those expenditures.
Criteria	Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (6) states that accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and sub grant award documents and others.
Cause of Condition	The Municipality's controls and procedures failed to assure that every cash outlays were supported by a disbursement or journal voucher.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (6).
Recommendation	We recommend that the Municipality should strengthen its procedures to assure that all disbursement transactions contain all supporting documents and approval signatures should be obtained before the related payments are made.
Questioned Cost	None
Management Response	The Municipality's Management concurs with the finding. The Finance Director will instruct the Finance Department Staff to prepare the disbursement voucher for the EFT reimbursements from the federal program bank account to the municipal current account.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-12 (continued)**

Responsible Person: Nestor Alicea Finance Director

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-13
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico - Administration for Children and Families
Requirement	Cash Management
Statement of Condition	During our Cash Management test we noted that for one (1) of the cash advances received during the fiscal year of \$136,972, \$91,560.55 were maintained in bank for two months approximately and \$45,413.07 for three months later. As result, the Municipality did not disburse the funds on a reasonable lapse of time.
Criteria	Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (7) state that the Municipality must maintain procedures in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by grantees and sub grantees whenever advance payment procedures are used.
Cause of Condition	The Municipality did not maintain appropriate cash management procedures in order to minimize the time elapsed between the transfer of funds from the federal entity and the disbursements made by the Municipality.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to continue strengthen it's procedures to minimize the time elapsed between the transfer of funds from the federal entity and the disbursements made by the Municipality.
Questioned Costs	None.
Management Response	The Municipality's Management concurs with the finding. The Finance Director will instruct the Program Staff of procedures to minimize the time elapsed between the transfer of funds from ACUDEN and the disbursements made by the Municipality.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-13 (continued)**

Responsible Person: Nestor Alicea

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-14
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico - Administration for Children and Families
Requirement	Equipment and Real Property Management
Statement of Condition	During our examination of equipment and real property management requirement we noted that the Municipality does not detail the serial number, location and use and condition of the property.
Criteria	Code of Federal Regulation 45, Subpart C, Part 92.32 (d) (1), states that the property records must be maintained to include a description of the property, serial number or other identification number, the source of property, title ownership, the acquisition date, cost of the property, percentage of Federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sales price of the property.
Cause of Condition	The Municipality's internal control and procedures failed to assure that equipment and real property records includes all necessary information as required by Code of Federal Regulation 45, Subpart C, Part 92.32 (d) (1).
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.32 (d) (1).
Recommendation	We recommend that the Municipality should implement procedures in order to assure that its property records include all required specifications suggested by federal agencies.
Questioned Costs	None
Management Response	The Municipality's Management concurs with the finding. The Program Coordinator will prepare its property records including all required specifications suggested by federal agencies.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-14 (continued)**

Responsible Person: Paulina De Jesús

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-15
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico - Administration for Children and Families
Requirement	Reporting and Financial Administration - Standard for Financial Management System
Statement of Condition	<p>During our reporting test we noted that the Annual Closing Report (CC-006) for the program fiscal year ended September 30, 2003 and, the Trial Balance as of September 30, 2003 were not submitted to the Pass through Agency during the fifteen (15) day period stated in the grant agreement. The Municipality submitted those reports on July 8, 2004 as detailed in the closing report.</p> <p>During our audit we noted that federal program books are maintained in Peachtree Accounting Software by an external consultant. Those books were not available for examination. As result we could not verify the accuracy of accounting record with the closing reports submitted to the pass through agency.</p>
Criteria	<p>Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1) states that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant. Also, the grant agreement states that the Annual Closing Report (CC-006) and the Trial Balance must be submitted to the Administration for Children and Families no later than fifteen (15) days after the grant agreement closing date.</p> <p>Code of Federal Regulations 45, Subpart C, Section 92.20 (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, un-obligated balances, assets, liabilities, outlays or expenditures, and income.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-15 (Continued)**

Cause of Condition The Municipality's controls and procedures failed to assure that the financial and programmatic reports were prepared and submitted to the pass-through agency according with federal regulations and the grant agreement.

The Municipality accounting records where not available for examination.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1), provisions regarding financial reporting.

The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (2).

Recommendation We recommend that the Municipality should strength its controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports. Also, we recommend that the financial and programmatic report must be submitted on time to the pass-through agency.

We recommend that the Municipality should implement controls and procedures in order to assure that an accurate set of accounting records are maintained in the program offices for all transactions realized during the period, in order to be available for the examination of auditors.

Questioned Cost None

Management Response The Municipality's Management concurs with the finding. The Finance Director notified the consultant in charge of the Program accounting that all accounting records have to be maintained in the Program Office in order to be available for the examination of auditors.

Responsible Person: Nestor Alicea - Finance Director

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
03-05	14.856	<p><u>In two (2) participant's files the PHA did not obtain, during the admission or re-examination process, complete third party evidence to support family annual income.</u></p> <p>Corrective action has been taken.</p>
03-06	14.856	<p><u>Two (2) participant's files did not indicate if Housing Quality Inspections were performed at the time of the initial occupancy and at least annually, to assure that units are decent, safe and sanitary. In nine (9) cases, the correction period has ended and the participant's files did not contain a unit inspection report or evidence of other verification documenting that any PHA required repairs were complete. Also, we did not find documents in the files that showed that the PHA property stopped HAP's or terminated the HAP contract.</u></p> <p>Partial corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-04.</p>
03-07	14.856	<p><u>We found that the PHA did not select the participants from the top of the waiting list according with the PHA's applicant selection policies.</u></p> <p>Corrective action has been taken.</p>
03-08	14.871	<p><u>Two (2) Housing Voucher Program disbursement vouchers did not include the invoice. Two (2) Housing Voucher Program disbursement vouchers were not available for examination. Three (3) Housing Voucher Program disbursement vouchers did not include the requisition form. Three (3) Housing Voucher Program disbursement vouchers did not include the purchases orders. One (1) Housing Voucher Program cancelled check was not available for our examination.</u></p> <p>Corrective action has been taken.</p>
03-09	14.871	<p><u>Five (5) participant's files did not include a release form to allow the PHA to obtain information from third parties. Five (5) participant's files did not include the annual release form to allow the PHA to obtain information about the employment. In five (5) participant's files there was no evidence that the PHA provided the assistance</u></p>

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

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
		<p><u>applicants and to the participants in the annual income recertification a "Privacy Act Notice". Three (3) participant's files did not include a federally prescribed general release form to allow the PHA to obtain information about the employment, signed by the head of household spouse or by any members of the family composition who is at least eighteen (18) years of age.</u></p> <p>Corrective action has been taken.</p>
03-10	14.871	<p><u>In one (1) new participant file the certification of reasonable rent included only one comparable unassisted unit. In two (2) new participant's files the certification of reasonable rent did not include the comparable rent with other similar units. In seven (7) participant's files the determination of reasonable rent included only one comparable unassisted unit in a change of unit during fiscal year 2002-2003. In one (1) participant file the determination of reasonable rent did not include the comparable rent with other similar unit in a change of unit during fiscal year 2002-2003.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-06.</p>
03-11	14.871	<p><u>In four (4) cases, the correction period had ended and the participant's files did not contain a unit inspection report or evidence of other verification documenting that any PHA required repairs were completed. Also, we did not find documents in the files that showed the PHA property stopped HAP's or terminated the HAP contract.</u></p> <p>Corrective action has been taken.</p>
03-12	14.871	<p><u>The PHA did not select the participant from the top of the waiting list according to the PHA's applicant selection policies.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-05.</p>
03-13	14.228	<p><u>Three (3) CDBG State Program disbursement vouchers did not have all supporting documents stamped as paid. Three (3) CDBG State Program disbursement vouchers did not include the invoice. One (1) CDBG State Program disbursement voucher was not available for</u></p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
		<p><u>examination. Nineteen (19) CDBG State Program disbursement vouchers did not include the requisition form. Fourteen (14) CDBG State Program disbursement vouchers did not include in the purchases orders.</u></p> <p>Partial corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-07.</p>
03-14	14.228	<p><u>Three (3) files did not include the pre-rehabilitation inspection which specified the participant housing unit deficiencies to be corrected. One (1) file did not include evidence of the residence deed. In three (3) cases the eligibility determination was not properly documented.</u></p> <p>Corrective action has been taken.</p>
03-15	14.228	<p><u>Five (5) files did not include the evidence regarding the identity verification for the family members. In five (5) files the participant did not complete the Approval Application Form OCAM-AH-004A. In five (5) files the participant did not complete a participation contract form OCAM-AH-005, establishing the service plan to be offered by the CDBG program. In five (5) cases the Service Coordinator visited only one time per month the participant house to ensure the quality of services.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-08.</p>
03-16	14.228	<p><u>The Municipality could not provide to the auditors the disbursement voucher related to the check # 245, issued on 10/24/02 by \$42,814.</u></p> <p>Full corrective action has been taken.</p>
03-17	14.228	<p><u>The Municipality did not apply adequately the monitoring system developed to ensure contractors compliance with payment of prevailing wages rates to employees. The contractor's and subcontractor's laborers interviews were not made. During the fiscal year 2002-2003, the contractor weekly payrolls were not requested to be reviewed by the municipal employee responsible of applying monitoring procedures.</u></p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
		No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-09.
03-18	14.228	<p><u>Two (2) contracts did not include a provision for compliance with Sections 103 and 107 of the Contract Work Hours & Safety Standards Act. Two (2) contracts did not include a provision for granting access to GAO or other federally agency, to books and other documents. One (1) contract did not include a provision for compliance with the Clean Air Act and Water Act. Two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act. Two (2) contracts did not include a provision for compliance with the Copeland "Anti-Kickback". Two (2) contracts did not include a provision for retention of all required records for three years.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-10.</p>
03-19	14.228	<p><u>The Municipality did not maintain internal controls to assure that the program income was properly determined or calculated in accordance with stated criteria and that program income was only collected from allowable sources; that all program income was properly recorded in the accounting records; that program income was used in accordance with the program requirements and other regulations applicable.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-11.</p>
03-20	14.228	<p><u>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.</u></p> <p>Corrective action has been taken.</p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
03-21	93.575	<p><u>The Municipality did not maintain, for the Child Care and Development Block Grant Program, a reliable set of accounting records that present the financial position of the program, the results of operations and changes in fund balance.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-15.</p>
03-22	93.575	<p><u>During our disbursement test of the Child Care and Development Block Grant Program we verified four (4) electronic fund transfers from the program's account to the Municipality's current account, for a total of \$365,343. Those electronic transfers were related to expenditures paid by the Municipality current account on behalf of the Child Care program. The Municipality did not prepare a disbursement or journal voucher to support the electronic transfers. The program maintains separately the support of those expenditures.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-12.</p>
03-23	93.575	<p><u>During our Cash Management test we noted that for two (2) of the cash advances received during the fiscal year the Municipality did not disburse the funds on a reasonable lapse of time.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-13.</p>
03-24	93.575	<p><u>On five (5) participant's files we noted that the eligibility determination and the parent's contribution were computed using incorrect income and deduction amounts. This situation did not affect the eligibility and the parent's contribution. On four (4) participant's files we noted that the eligibility determination and the parent's contribution were computed using incorrect income and deduction amounts. This situation did not affect the eligibility determination but affects the parent's contribution amount. On one (1) participant file we noted that the Municipality realized an eligibility reexamination during the fiscal year 2002-2003. That</u></p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
		<p><u>reexamination showed a reduction in the parents contribution from \$39 to \$37. The Municipality did not inform the family of the parent's contribution change.</u></p> <p>Corrective action has been taken.</p>
03-25	93.575	<p><u>During our examination of equipment and real property management requirement we noted that the Municipality does not have property records that include all required specifications required by federal agencies.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-14.</p>
03-26	93.575	<p><u>During our reporting test we noted that the Annual Closing Report (CC-006) for the program fiscal year ended September 30, 2002 and, the Trial Balance as of September 30, 2002 were not submitted to the Pass Through Agency during the fifteen (15) day period stated in the grant agreement. The Municipality submitted those reports on January 20, 2003.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-15.</p>
02-11	14.856	<p><u>The Municipality should 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.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-04.</p>
02-12	14.871	<p><u>The Municipality should establish monitoring procedures to assure that the participant's files include all documentation required by federal agencies.</u></p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
		Corrective action has been taken.
02-15	14.871	<p><u>The Municipality should establish controls to assure appropriate documentation of the determination of reasonable rent is maintained in participant's files.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 04-06.</p>
02-17	14.871	<p><u>The Municipality should 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.</u></p> <p>Corrective action has been taken.</p>
02-18	14.228	<p><u>The Municipality should 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-09.</p>
02-21	14.228	<p><u>The Municipality should update contract model according with the federal requirements, executive orders and regulations.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-10.</p>
02-22	14.228	<p><u>The Municipality should 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-11.</p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
02-24	14.228	<p><u>The Municipality should 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.</u></p> <p>Corrective action has been taken.</p>
01-07	14.228	<p><u>The Municipality did not apply monitoring procedures to assure contractors compliance with Davis-Bacon Act.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
01-09	14.228	<p><u>Failures with the procedures and controls over program income</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
01-10	83.544	<p><u>Activities Allowed or Unallowed - Allowable Cost/Cost Principles</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
01-11	83.544	<p><u>Failure to provide the quarterly progress reports</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
01-12	83.544	<p><u>Special Tests-Project Accounting</u></p> <p>The audit finding does not warrant further action because two years</p>

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SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
		have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.
99-III-04	14.228, 83.544	<u>Davis Bacon Act</u> The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.
00-III-01	83.544	<u>Activities Allowed or Unallowed – Allowed Cost</u> The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.
00-III-02	83.544	<u>Activities Allowed or Unallowed – Allowable Cost</u> The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.
00-III-05	14.228 83.544	<u>Davis Bacon Act</u> The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.